

**INTERESTED PARTIES' VERSION – January 3, 2018**

**With MTC Staff Notations on Suggested Revisions and Edits as of 1/23/2018**

**Model Uniform Statute and Regulation for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments**

*Revised Draft (Version #5.1) Submitted for Consideration on January 3, 2018 (Redline as of 1/23/18)*

**SECTION A. Definitions**

The following definitions apply for the purposes of [this subdivision of the State Code]:

- (1) “**Administrative Adjustment Request**” means an administrative adjustment request filed by a Partnership under IRC section 6227.
- (2) “**Audited Partnership**” means a Partnership subject to a Federal Adjustment resulting from a Partnership Level Audit.
- (3) “**Corporate Partner**” means a Partner that is subject to tax under [reference to State Law].
- (4) “**Direct Partner**” means a Partner that holds an interest directly in a Partnership or Pass-Through Entity.
- (5) “**Exempt Partner**” means a Partner that is exempt from taxation under [reference to state law] [except on Unrelated Business Taxable Income<sup>1</sup>].
- (6) “**Federal Adjustment**” means a change to an item or amount determined under the Internal Revenue Code that is used by a Taxpayer to compute state tax owed for the Reviewed Year whether that change results from action by the IRS, including a Partnership Level Audit, or the filing of an amended federal return, federal refund claim, or an Administrative Adjustment Request by the Taxpayer. A Federal Adjustment is positive to the extent that it increases state taxable income as determined under [reference to State Law] and is negative to the extent that it decreases state taxable income as determined under [reference to State Law].
- (7) “**Federal Adjustments Report**” includes a method or form required by [State Agency] for use by a Taxpayer to report Final Federal Adjustments, including an amended [State] tax return or a uniform multistate report.
- (8) “**Federal Partnership Representative**” means the person the Partnership designates for the taxable year as the Partnership’s representative, or the person the IRS has appointed to act as the Federal Partnership Representative, pursuant to IRC Section 6223(a).
- (9) “**Final Determination Date**” means the following:
  - (a) Except as provided in paragraph (b), if the related Federal Adjustment arises from an IRS audit or other action by the IRS, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit or other action remain to be finally determined,

**Comment [HH1]:** We can't use the term "Reviewed Year" here because it applies only to changes that result from a federal partnership audit and a "federal adjustment" is much broader than that.

**Comment [HH2]:** Needed so that we know what the final determination date is for non-audit actions (e.g. math/clerical error notices, etc.).

<sup>1</sup> Drafting note: This portion of definition should only be used by the [State] if it taxes unrelated business income.

whether by agreement, or, if appealed or contested, by a final decision with respect to which all rights of appeal have been waived or exhausted. For agreements required to be signed by the IRS and the Taxpayer, the Final Determination Date is the date on which the last party signed the agreement.

(b) For Federal Adjustments arising from an IRS audit, if the Taxpayer filed as a member of a [combined/consolidated return/report under State law], the Final Determination Date means the first day on which no related Federal Adjustments arising from that audit remain to be finally determined, as described in paragraph (a) of this subsection, for the entire group.

Comment [HH3]: Just for clarity.

Comment [HH4]: Just for clarity.

(c) If the Federal Adjustment results from filing an amended federal return, a federal refund claim, or an Administrative Adjustment Request, or if it is a Federal Adjustment reported on an amended federal return or other similar report filed pursuant to IRC section 6225 (c), the Final Determination Date means the day on which the amended return, refund claim, or Administrative Adjustment Request was filed.

Comment [HH5]: Needed to resolve a conflict, as discussed, because the adjustment is both one that "results" from a federal audit (and so could be included in (a)) but is also reported on an amended federal return.

(10) "**Final Federal Adjustment**" means a Federal Adjustment after the Final Determination Date for that Federal Adjustment has passed.

(11) "**Indirect Partner**" means a Partner in a Partnership or Pass-Through Entity that itself holds an interest directly, or through another Indirect Partner, in a Partnership or Pass-Through Entity.

(12) "**IRC**" means the Internal Revenue Code of 1986, as codified at 26 United States Code (U.S.C.) Section 1, et seq., [insert State's current practice to incorporate IRC] and applicable regulations as promulgated by the U.S. Department of the Treasury.<sup>2</sup>

(13) "**IRS**" means the Internal Revenue Service of the U.S. Department of the Treasury.

(14) "**Partner**" means a person that holds an interest directly or indirectly in a Partnership or other Pass-Through Entity.

(15) "**Partnership**" means an entity subject to taxation under Subchapter K of the IRC.

(16) "**Partnership Level Audit**" means an examination by the IRS at the partnership level pursuant to Subchapter C of Title 26, Subtitle F, Chapter 63 of the IRC, as enacted by the Bipartisan Budget Act of 2015, Public Law 114-74, which results in Federal Adjustments.

(17) "**Pass-Through Entity**" means an entity, other than a Partnership, that is not subject to tax under [reference to State Law imposing tax on C corporations or other taxable entities].

(18) "**Reallocation Adjustment**" means a Final Federal Adjustment resulting from a Partnership Level Audit or an Administrative Adjustment Request that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Reallocation Adjustment means a portion of a Reallocation Adjustment that would increase state taxable income for one or more Direct Partners, and a negative Reallocation Adjustment means a portion of a Reallocation Adjustment that would decrease state taxable income for one or more Direct Partners, assuming the Direct

Comment [HH6]: These changes are meant to clarify and not change the substance.

<sup>2</sup> Drafting note: A State may need to address undefined terms. Suggested language – "To the extent terms used in this [article] are not defined in this Section or elsewhere in [citation to chapter in which this article is contained], it is the intent of the Legislature to conform as closely as possible to the terminology used in the amendments to the IRC pertaining to the comprehensive partnership audit regime as contained in the Bipartisan Budget Act of 2015, Public Law 114-74, as amended, and this [article] shall be so interpreted."

~~Partners were required to report and pay tax under [reference to State Law].~~

**Comment [HH7]:** This is necessary because you could have an audited partnership with all pass-through partners and they would not have “taxable” income.

- (19) “**Resident Partner**” means an individual, trust, or estate Partner that has his or her domicile in or is a resident for tax purposes in [State].
- (20) “**Reviewed Year**” means the taxable year of a Partnership that is subject to a Partnership Level Audit from which Federal Adjustments arise.
- (21) “**Taxpayer**” means [insert reference to State definition] and, unless the context clearly indicates otherwise, includes a Partnership subject to a Partnership Level Audit or a Partnership that has made an Administrative Adjustment Request, as well as a Tiered Partner of that Partnership.
- (22) “**Tiered Partner**” means any Partner that is a Partnership or Pass-Through Entity.
- (23) “**Unrelated Business Taxable Income**” has the same meaning as defined in IRC Section 512.<sup>3</sup>

#### SECTION B. Reporting Adjustments to Federal Taxable Income – General Rule

Except in the case of Final Federal Adjustments ~~arising from a Partnership Level Audit or an Administrative Adjustment Request filed by a Partnership under IRC section 6227,~~ which are required to be reported by a Partnership and its Partners and Indirect Partners using the procedures in Section C, a Taxpayer shall ~~notify the [State Agency] of report and pay any state tax due with respect to~~ Final Federal Adjustments arising from an audit ~~or other action~~ by the IRS or reported by the Taxpayer on a timely filed amended federal income tax return, including a return filed pursuant to IRC section 6225, or federal claim for refund as follows:

**Comment [HH8]:** This is unnecessary here and may create ambiguity about how adjustments reported on an amended federal return during the modification period are treated. (See introductory language inserted into C instead.)

**Comment [HH9]:** E.g. math/clerical notices.

- (1) **Reporting of Final Federal Adjustments.** Except as provided in subsection B(2), a Taxpayer shall file a Federal Adjustments Report with the [State Agency] for the Reviewed Year and, if applicable, pay the additional [State] tax owed by the Taxpayer no later than 180 days after the Final Determination Date.

#### (2) De Minimis Exception.

- (a) **Notice of De Minimis Adjustments.** In the event the adjustments to the Taxpayer’s federal taxable income result in a [State] tax liability of less than \$250 (excluding penalties and interest) or a refund, the Taxpayer may, in lieu of filing a Federal Adjustments Report, notify the [State Agency] in writing or on a form prescribed by the [State Agency] that the Final Federal Adjustments are de minimis. The Taxpayer shall file that notice with the [State Agency] no later than 180 days following ~~the earlier of the Final Determination Date or the date on which the Taxpayer filed an amended federal income tax return or claim for refund with the IRS.~~ The Taxpayer’s notice shall contain information reasonably necessary to provide the [State Agency] with an understanding of the Final Federal Adjustments and their impact on the Taxpayer’s [State] tax liability.

**Comment [HH10]:** This is the same thing as the final determination date.

- (b) **Option to Request a Federal Adjustments Report.** In the event the Taxpayer provides the [State Agency] with notice that the ~~adjustments~~ Final Federal Adjustments are de minimis pursuant to subsection B(2), the [State Agency] may nevertheless request, in writing, that the Taxpayer file a Federal Adjustments Report. The [State Agency] shall mail that request to the

<sup>3</sup> Drafting note: This term should only be used by the [State] if it taxes unrelated business income.

Taxpayer no later than ~~90~~ 180 days after the date on which the Taxpayer filed the notice with the [State Agency].

**Comment [HH11]:** At least one state has a concern that the time period is too short.

- (c) **Filing of Requested Federal Adjustments Report.** In the event the [State Agency] requests a Federal Adjustments Report within the time prescribed in ~~subsection paragraph~~ B(2)(b), the Taxpayer has 60 days from the date the [State Agency's] request is mailed to the Taxpayer to file a Federal Adjustments Report with the [State Agency] and, if applicable, pay the additional ~~[State]~~ tax owed by the Taxpayer.

**Comment [HH12]:** We use this "[State]" modifier throughout and it appears to be unnecessary and is likely to be omitted any particular state's statute.

- (d) **State Tax Liability.** *[Option 1]* If the Taxpayer ~~reported~~ notifies the [State Agency] that it ~~would have owed~~ owes the State a de minimis ~~[State]~~ tax liability or ~~was~~ is entitled to a de minimis [State] tax refund, as required in paragraph (a) of this subsection B(2), and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report within the time prescribed in subsection B(2)(b), the Taxpayer's notice that the adjustments are de minimis will be accepted by the [State Agency], and no ~~[State]~~ tax shall be ~~due assessed~~ or refunded. *[Option 2]* If the Taxpayer ~~reported~~ notifies the [State Agency] that it would ~~have owed~~ owes the State a de minimis ~~[State]~~ tax liability, as required by paragraph (a) of this subsection B(2), and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report within the time prescribed in subsection B(2)(b), the Taxpayer's notice that the adjustments are de minimis will be accepted by the [State Agency] and the [State Agency] may assess and bill the Taxpayer the fixed sum of \$250, which will include statutory interest and penalties.

**Comment [HH13]:** The changes below are not meant to change the substance.

- (e) **Finality of De Minimis Adjustments.** Absent fraud, the Taxpayer will not be subject to additional assessment, nor is the Taxpayer permitted to file a claim for refund or credit of [State] taxes pursuant to [citation to State statute setting forth claim for refund requirements], based on de minimis adjustments to the Taxpayer's federal taxable income for the tax year reported pursuant to subsection B(2)(a).

### Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Adjustment Request

Final Federal Adjustments arising from a Partnership Level Audit not reported on an amended federal return under IRC section 6225(c) and adjustments arising from an Administrative Adjustment Request filed by a Partnership under IRC section 6227 shall be reported as required under this section C.

#### (1) State Partnership Representative.

- (a) With respect to an action required or permitted to be taken by a Partnership under this Section C and a proceeding under [reference to provisions for State administrative appeal or judicial review] with respect to ~~Federal Adjustments arising from a Partnership Level Audit or an Administrative Adjustment Request~~ that action, the State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership, and its Partners and Indirect Partners shall be bound by those actions.
- (b) The State Partnership Representative for the Reviewed Year is the Partnership's Federal Partnership Representative unless the Partnership designates in writing another person as its State Partnership Representative.
- (c) The [State Agency] may establish reasonable qualifications for and procedures for designating a person, other than the Federal Partnership Representative, to be the State Partnership

**Comment [HH14]:** This language is unnecessary (and may have been included in lieu of the introductory language) and simply referencing the action (required or permitted to be taken by the partnership) is sufficient. The language may also set up a potential conflict vis-à-vis adjustments reported by a partner under Sec. B.

Representative.

(2) **Reporting and Payment Requirements for Partnerships Subject to a Final Federal Adjustment and their Direct Partners.** ~~Unless an Audited Partnership makes the election in subsection (3), then, for all Final Federal Adjustments~~ Except for Final Federal Adjustments subject to a properly made election under subsection (3), Final Federal Adjustments resulting from a Partnership Level Audit or an Administrative Adjustment Request filed by a Partnership under IRC section 6227 shall be reported as follows:

**Comment [HH15]:** The proposed changes to subsection (3) now limit the adjustments subject to that election. (See subsection (3)(c).) Therefore, the exclusion here has to be worded in terms of the adjustments, rather than in terms of the audited partnership.

(a) The Audited Partnership shall, no later than 90 days after the Final Determination Date,

**Comment [HH16]:** Can't use audited here or we would be excluding AARs.

(i) ~~file-File~~ a completed Federal Adjustment Report, including partner level information as required under [reference to State law] with [State Agency]; and

(ii) ~~notify-Notify~~ each of its Direct Partners of their distributive share of the adjustments; and

(iii) ~~file-File~~ an amended composite return for Direct Partners as required under [reference to State Law] and/or an amended withholding return for Direct Partners as required under [reference to State Law] and pay the additional amount due under [reference to State Law(s)] that would have been due had the Federal Adjustments been reported properly as required.

(b) [Except as provided under {State law} for minimal tax liabilities], no later than 180 days after the Final Determination Date, each Direct Partner, ~~other than a Tiered Partner,~~ that is taxed under [reference to State Law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:

**Comment [HH17]:** This reference to Tiered Partners seems unnecessary, assuming they are not taxed under the referenced section.

(i) ~~file-File~~ a Federal Adjustment Report reporting their distributive share of the adjustments reported to them under subparagraph (a)(ii) of ~~this~~ subsection (2) as required under [reference to State Laws]; and

(ii) ~~pay-Pay~~ any additional amount of tax due as if the Final Federal Adjustment had been properly reported, plus any penalty and interest due under [reference to State Law] and less any credit for related amounts paid or withheld and remitted on behalf of the Direct Partner ~~by the Partnership or Pass-Through Entity~~ under subparagraph (a)(iii) of ~~this~~ subsection (2).

**Comment [HH18]:** I believe this is unnecessary since we're talking about Direct Partners – all that's necessary is a reference to (a)(iii).

**Comment [HH19]:** This is how I handled the suggestions for limiting the application of this election.

(3) **Election – Partnership Pays.** ~~Subject to the limitations in paragraph (c) of this subsection, if an Audited Partnership~~ ~~mak~~~~ing~~~~e~~s an election under this subsection, ~~it~~ shall:

**Comment [HH20]:** This appears to limit this election to Audited Partnerships – so that it would not include AARs – and based on our discussion, this is one of the limitations on the election that the states are considering. See also new paragraph (3)(c).

(a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustment Report, including partner level information, and notify the [State Agency] that it is making the election under this subsection;

**Comment [HH21]:**

(b) No later than 180 days after the Final Determination Date, pay an amount, determined as follows, in lieu of taxes owed by its Direct Partners and Indirect Partners:

**Comment [HH22]:** The partnership will pay tax on the share of adjustments allocated to “pass-through partners” (see vi below) so that, presumably, the tax paid at the partnership level needs to be in lieu of the tax for both the Direct and Indirect Partners.

(i) Exclude from Final Federal Adjustments and any positive Reallocation Adjustments the

distributive share of these adjustments made to an Exempt Partner that is not Unrelated Business Taxable Income:

- (ii) Exclude from Final Federal Adjustments and any positive Reallocation Adjustments the distributive share of these adjustments made to a Partner that has ~~previously~~ filed a valid Federal Adjustment Report and paid the [State] tax due, as required under Section B, reporting such distributive share, for the distributive share of adjustments reported on a federal amended return under IRC section 6225 and paid any additional [State] tax liability due;
- (iii) Allocate and apportion ~~at the Partnership level, all remaining Final Federal Adjustments and positive Reallocation Adjustments to [State]~~ using [reference to existing multi-state business activity allocation/apportion law or regulation], ~~all remaining Final Federal Adjustments and positive Reallocation Adjustments to [State];~~
- (iv) Determine the total distributive share of the allocated and apportioned Final Federal Adjustments and positive Reallocation Adjustments determined in subparagraph (iii) that are allocated to Corporate Partners or Exempt Partners subject to tax under [reference to State Law], the total distributive share allocated to Partners subject to tax under [reference to State Law applying to individuals and/or trusts] and the total distributive share allocated to any remaining Partners, including ~~Pass-Through Entities~~ Tiered Partners;
- (v) For the total distributive shares of net Final Federal Adjustments plus positive Reallocation Adjustments allocated to Corporate Partners or Exempt Partners subject to tax under [reference to State Law] as determined in subparagraph (iv), multiply the total by the highest tax rate under [reference to State Law];
- (vi) For the total distributive shares of net Final Federal Adjustments plus positive Reallocation Adjustments allocated to Partners subject to tax under [reference to State Law applying to individuals and /or trusts] plus the total distributive shares allocated to any remaining Partners, including ~~Pass-Through Entities~~ Tiered Partners, as determined in subparagraph (iv), multiply the total by the highest tax rate under [reference to State Law applying to individuals and/or trusts];
- (vii) Add to the amount determined in subparagraph (v) to the amount determined in subparagraph (vi).

(c) Final Federal Adjustments subject to this election exclude:

- (i) The share of Final Audit Adjustments, including positive Reallocation Adjustments, that must be included in the unitary business income of Corporate Partner required to file a return separately or as a member of a group as provided in [reference to state law];
- (ii) The share of Final Federal Adjustments, including positive Reallocation Adjustments, that are income or other items required to be attributed to [this State] on the basis of the residency or domicile of the Partner rather than apportioned under [reference to state law]; and
- (iii) Any Final Federal Adjustments resulting from a Administrative Adjustment Request.

**Comment [HH23]:** Clarifying what I think is meant by valid – that is – that the FAR is require under Section B because the adjustments were reported on an amended federal return under 6225.

**Comment [HH24]:** NOTE – This is a critical piece that we have agreed to leave to the states to determine under their respective laws. One issue, in particular, that will need to be addressed is the potential for income shifting (similar to what may be done were related corporate entities file separately) when a partnership apportions at the separate entity level. States may need to come up with anti-abuse provisions to prevent income shifting or factor stripping using related entities.

**Comment [HH25]:** This is the way issues raised with the partnership pays election have been addressed. But see subsection (5) below.

(4) **Tiered Partners.** Each Tiered Partner and each Indirect Partner of an Audited Partnership that reported Final Federal Adjustments pursuant to subsection C(2)(a)(ii) shall be subject to the applicable election, reporting and payment requirements for Audited Partnerships and their Direct Partners under this Section, notwithstanding the interim time requirements in subsections (2) and (3), and all reports and payments required to be made by such Partners under this Section shall be completed within 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established by the IRS under IRC section 6226 and regulation section [301.6226.3(e)(3)(ii)<sup>4</sup>].

[OPTIONAL Subsection (4)]

(a) Each Tiered Partner of an Audited Partnership that was required to provide a notice pursuant to C(2)(a)(ii) must, no later than 90 days after the date the notice was required to be provided, comply with the requirements for reporting its share of Final Federal Adjustments subject to subsection C(2) or, if it makes a proper election, subsection C(3), as if it were the Audited Partnership. [If the Tiered Partner is not a Partnership, then the [State Agency], by regulation or instruction, may provide for the reporting of information to the Partners consistent with otherwise applicable state law.]

**Comment [HH26]:** This is the optional subsection (4) discussed. States may prefer this or the version above.

(b) Each Direct Partner in a Tiered Partner making a report under paragraph (a) of this subsection (4) must within 180 days comply with the filing, reporting, and payment requirements of section C(2)(b).

**Comment [HH27]:** This is required, presumably, because some tiered partners may not be partnerships (e.g. S corporations) and therefore may not be subject to composite return reporting requirements.

(c) Notwithstanding the interim time requirements in paragraphs (a) and (b) of this subsection (4), all reports and payments required to be made by Tiered Partners and their taxpayer Partners under this section are required to be made within 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established by the IRS under IRC section 6226 and regulation section [301.6226.3(e)(3)(ii)<sup>5</sup>].

(5) **Modified Reporting and Payment Method.** Subject to the approval of the [State Agency], an Audited Partnership or Tiered Partner may use a different reporting and payment method if the Audited Partnership or Tiered Partner demonstrates that the requested method will reasonably provide for the reporting and payment of taxes, penalties, and interest owed on Final Federal Adjustments, including adjustments excluded from the election in subsection (3) of this section C.

**Comment [HH28]:** This leaves open the possibility that adjustments not subject to the election in (3) could still be reported by the partnership under some other method, depending on the circumstances, including AAR adjustments.

(6) **Effect of Election by Audited Partnership or Tiered Partner and Payment of Amount Due.**

(a) The election made pursuant to subsection (3) or (5) is irrevocable, unless [State Agency], in its discretion, determines otherwise.

(b) If properly reported and paid by the Audited Partnership or Tiered Partner, the amount determined in paragraph (b) of subsection C(3), or similarly under an optional election under subsection (5), will be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the extent applicable, on the same Final Federal Adjustments. – The Direct Partners or Indirect Partners may not take any deduction or credit for this amount or claim a refund of the amount in this State. Nothing in this subsection shall preclude Resident Partners from claiming a credit against taxes paid to this State pursuant to [reference to State Law], any amounts paid by the Audited Partnership or Tiered Partners on the Resident Partner’s behalf

**Comment [HH29]:** See similar comment above – it seems this would be necessary.

**Comment [HH30]:** NOTE – some states that allow a deduction for state taxes claimed on the federal return may wish to change this.

<sup>4</sup> This is the current regulation citation, as proposed by the IRS on December 19, 2017

<sup>5</sup> This is the current regulation citation, as proposed by the IRS on December 19, 2017

to another state or local tax jurisdiction, provided the amount of the credit claimed is determined in accordance with the general requirements of Subchapter K and the agreement of the Partners.

~~(b)~~(c) A Partnership or Tiered Partner making an election under subsection (3) or (5) shall maintain and provide to Partners the information necessary for them to properly report tax related to the Final Federal Adjustments to this State for the Reviewed Year and any Subsequent Year, and shall provide that information to the [State Agency] if requested.

- (7) **Failure of Audited Partnership or Tiered Partner to Report or Pay.** Partnerships and Tiered Partners are subject to the reporting requirements of this Section C if they have a Direct Partner that filed a return for the year affected by the Final Federal Adjustment in [this State] as a resident, regardless of whether the Partnership or Tiered Partner is doing business in this state. Nothing in this Section C is intended to prevents the [State Agency] from assessing Direct Partners or Indirect Partners for taxes they owe, using the best information available, in the event that an Audited Partnership or Tiered Partner fails to timely make any report or payment required by this Section for any reason. Nothing in this Section

**Comment [HH31]:** This was a suggestion that may need some refinement. The idea is that the partnership should be required to provide necessary information to partners, even if it is paying tax on their behalf—but there may be no penalties for not doing so.

**Comment [HH32]:** One state specifically asked that this be set out.

**Comment [HH33]:** This would exclude partnerships filing an AAR.

#### **SECTION D. Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income – Statute of Limitations**

The [State Agency] will assess additional [State] tax, interest, and penalties arising from Final Federal Adjustments arising from an audit by the IRS, including a Partnership Level Audit, or reported by the Taxpayer on an amended federal income tax return or as part of an Administrative Adjustment Request by the following dates:

- (1) **Timely Reported Federal Adjustments.** If a Taxpayer files with the [State Agency] a Federal Adjustments Report or an amended [State] tax return as required within the period specified in Section B or Section C, as appropriate, reporting all Final Federal Adjustments, the [State Agency] may assess any [State] amounts, including in-lieu-of amounts, taxes, interest, and penalties arising from those Federal Adjustments if [State Agency] issues a notice of the assessment to the Taxpayer no later than:
- (a) The expiration of the limitations period specified in [citation to State statute setting forth normal limitations period]; or
  - (b) The expiration of the one (1) year period following the date of filing with the [State Agency] of the Federal Adjustments Report.
- (2) **Untimely Reported Federal Adjustments.** If the Taxpayer fails to file the Federal Adjustments Report within the period specified in Section B or Section C, as appropriate, or the Federal Adjustments Report filed by the Taxpayer omits Federal Adjustments or understates the correct amount of [State] tax owed, the [State Agency] may assess amounts or additional amounts including in-lieu-of amounts, taxes, interest, and penalties arising from the Final Federal Adjustments, if it mails a notice of the assessment to the Taxpayer by a date which is the latest of the following:
- (a) The expiration of the limitations period specified in [citation to State statute setting forth normal limitations period]; or
  - (b) The expiration of the one (1) year period following the date the Federal Adjustments Report was filed with [State Agency]; or

(c) Absent fraud, the expiration of the six (6) year period following the Final Determination Date.

#### SECTION E. Estimated [State] Tax Payments During the Course of a Federal Audit

A Taxpayer may make estimated payments to the [State Agency], following the process prescribed by the [State Agency], of the [State] tax ~~that it determines may ultimately be owed to [State] as a expected to result of from~~ a pending IRS audit, prior to the due date of the Federal Adjustments Report, without having to file the report with the [State Agency].- The estimated [State]-tax payments shall be credited against any tax liability ultimately found to be due to [State] (“Final [State] Tax Liability”) and will limit the accrual of further statutory interest on that amount.- If the estimated [State]-tax payments exceed the final [State]-tax liability and statutory interest ultimately determined to be due ~~on that amount, or the IRS ultimately does not make any adverse adjustments to the Taxpayer’s federal taxable income~~, the Taxpayer is entitled to a refund or credit for the excess, provided the Taxpayer files with [State Agency]-a Federal Adjustments Report or claim for refund or credit of [State] tax pursuant to [citation to State statute setting forth claim for refund requirements] no later than one (+) year following the Final Determination Date.

#### SECTION F. Claims for Refund or Credits of [State]-Tax Arising from Final Federal Adjustments Made by the IRS

Notwithstanding the reporting requirement contained in Sections B or C, a Taxpayer may file a claim for refund or credit of [State]-tax arising directly or indirectly from Federal Adjustments made by the IRS on or before the later of:

**Comment [HH34]:** As discussed, it’s not clear what “directly or indirectly” means in this context.

- (1) ~~the~~The expiration of the last day for filing a claim for refund or credit of [State] tax pursuant to [citation to State statute setting forth claim for refund requirements], including any extensions; or
- (2) ~~one (+)One~~ year from the date a Federal Adjustments Report prescribed in Sections B or C, as applicable, was due to the [State Agency], including any extensions pursuant to Section G.

The Federal Adjustments Report shall serve as the means for the Taxpayer to report additional [State] tax due, report a claim for refund or credit of [State]-tax, and make other adjustments (including to its net operating losses) resulting from adjustments to the Taxpayer’s federal taxable income.

#### SECTION G. Scope of Adjustments and Extensions of Time.

- (1) Unless otherwise agreed in writing by the Taxpayer and the [State Agency], any adjustments by the [State Agency] or by the Taxpayer made after the expiration of the [State’s normal statute of limitations for assessment and refund] is limited to changes to the Taxpayer’s [State] tax liability arising directly from Federal Adjustments.
- (2) The time periods provided for in [this subdivision of the State Code] may be extended:
  - (a) ~~automatically~~Automatically, upon written notice to [State agency], by 60 days for an Audited Partnership or Tiered Partner which has [10,000] or more Direct Partners; or
  - (b) ~~by~~By written agreement between the Taxpayer and the [State Agency] [pursuant to any regulation issued under this section].
- (3) Any extension granted under this Section G for filing the Federal Adjustments Report extends the last day prescribed by law for assessing any additional [State]-tax arising from the adjustments to federal taxable income and the period for filing a claim for refund or credit of [State]-taxes pursuant to

**Comment [HH35]:** See similar comment above.

[citation to State statute setting forth claim for refund requirements].

**SECTION H. Effective Date**

The amendments to this [section/chapter] applies to any adjustments to a Taxpayer's federal taxable income with a Final Determination Date occurring on and after [date].

\* \* \* \* \*

*\*Prepared by a working group consisting of representatives of the Council On State Taxation (COST), Tax Executives Institute (TEI), the ABA Section of Taxation's SALT Committee, the American Institute of CPAs (AICPA), the Institute for Professionals in Taxation (IPT) and the Master Limited Partnership Association (MLPA). As of this date, this draft has not been officially endorsed by these organizations.*

\* \* \* \* \*

### Optional Model Regulation or Inclusion in Model Statute

- (1)
  - (a) The “Final Determination Date” that arises from an IRS audit is the first day on which all adjustments to the Taxpayer’s federal taxable income are final, and all appeal rights under the IRC are exhausted, for the Taxpayer’s federal taxable year.
  - (b) In the case of a Taxpayer that is a member of a [State combined reporting group and/or a State consolidated group], the Final Determination Date is the date on which the federal taxable income for all members of the Taxpayer’s group have become final and all appeal rights under the IRC are exhausted for any member of the group’s federal taxable year.
- (2) The “Final Determination Date” that arises from the filing of an amended final return, a federal refund claim, or the filing by a Partnership of an Administrative Adjustment Request, is the day on which the amended return, refund claim or Administrative Adjustment Request was filed to the IRS.
- (3) The Final Determination Date shall be the date on which one of the following occurs:
  - (a) The Taxpayer: (i) has final adjustments to its federal taxable income resulting from an examination by the IRS pursuant to Section 7601 of the IRC, including any requisite review by the Joint Committee on Taxation pursuant to Section 6405 of the IRC; and (ii) has not filed a petition for redetermination with the United States Tax Court pursuant to Sections 6213 or 6234 of the IRC or a claim for refund with a district court or the United States Court of Federal Claims pursuant to Sections 6234 or 7422 of the IRC, and the time for the Taxpayer to timely file the petition for redetermination or a claim for refund has lapsed under the applicable statute.

*Example 1: The Taxpayer is audited on a depreciation issue and an issue with the accrual of some gross income, both of which will require the Taxpayer’s state tax returns to be adjusted. The depreciation issue resulting in a \$500,000 federal income tax refund is resolved May 20, 2019 with a signed Form 870-AD; however, the accrual of gross income issue, resulting in a \$2.5 million tax deficiency, is not finalized by the IRS until June 30, 2020. The Taxpayer is not sure if it will file an appeal to the Tax Court; however, it ultimately does not file. The Final Determination Date is 90 days from June 30, 2020, when the Taxpayer was last able to timely file an appeal. The Taxpayer only has to report the \$2 million net tax deficiency for both issues.*

- (b) The Taxpayer and the IRS have executed the forms necessary for the relevant tax period so as to establish finality under Section 7121(b) of the IRC.

*Example 2: The Taxpayer and the IRS have multiple audit issues for taxable year 2018 and they decide to resolve their issues by entering into a bilateral settlement agreement using a Form 870-AD on November 10, 2020. The Taxpayer signs the settlement on November 11, 2020, and the IRS signs it on November 15, 2020. The Final Determination Date is November 15, 2020.*

- (c) The time for the IRS to make an assessment for the relevant tax period has expired pursuant to Section 6501 of the IRC.

*Example 3: The Taxpayer files an amended return with the IRS for taxable year 2018 that was timely filed with the IRS on March 15, 2019. The amended return, reporting \$1 million in additional income, was received by the IRS on February 28, 2022. The IRS has 60 days to assess the Taxpayer for additional tax because the return was filed no later than 60 days after the*

*expiration of the three-year statute of limitations. The IRS takes no additional action; therefore, the Final Determination Date is 60 days from the date IRS received the amended return on February 28, 2022.*

or

- (d) A judgment from a United States court, or any other court of original jurisdiction to which the United States has submitted to personal jurisdiction regarding a Taxpayer's tax issues, has become final under Section 2412(d)(2)(G) of Title 28 of the United States Code.

**Example 4:** *Same facts as example 1, except the Taxpayer timely pays the \$2 million in tax and files for a refund and sues in federal district court. On July 10, 2021, the Taxpayer receives a ruling from the court denying the refund in full. The Taxpayer timely files an appeal with a federal circuit court of appeals and on August 15, 2022 the Taxpayer receives a final order which allows it to deduct \$1 million more of the IRS assessed tax on the accrual of income. Neither the Taxpayer nor the IRS appeals to the U.S. Supreme Court. The Final Determination Date is 90 days from August 15, 2022, the last day a writ of certiorari, without an extension, could timely be filed.*

- (e) With respect to Partnerships that have undergone a Partnership Level Audit, the latter of (i) the close of the 90th day after the day on which a notice of a final partnership adjustment was mailed, and (ii) if a petition is filed under IRC Section 6234 with respect to the notice, the decision of the court has become final.

**Example 5:** *Partnership's Federal Partnership Representative agrees with IRS changes after the audit is concluded. The Final Determination Date for the Partnership is 90 days from the date the IRS mailed the final partnership adjustment.*

- (f) The Taxpayer files an amended return with the IRS.

**Example 6:** *A Taxpayer files an amended return (could be additional tax due or a refund) with the IRS for taxable year 2015 on June 15, 2018. The Final Determination Date for the Taxpayer is June 15, 2018.*