



To: Uniformity Committee

From: Don Jones, Chair, Partnership Work Group  
Helen Hecht, MTC

Re: Report to the Uniformity Committee on the Partnership Work Group

Date: December 14, 2016

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In late 2015, Congress passed the Bipartisan Budget Act, which codified new rules for how the IRS will conduct audits of partnerships and make adjustments with respect to taxes on partnership income. These changes are in response to one of the “worst-kept secrets” of tax enforcement—that the IRS does very few audits of partnership income reported and almost no audits of complex partnerships. The changes were designed to make it easier to audit partnership income.

Shortly after these changes were enacted, the MTC began having informational sessions for state members on what the new rules would require the IRS, partnerships, and partners to do and what states might do to conform. At its meeting in July in Kansas City, the Uniformity Committee agreed to form a work group to consider possible state conformity and other issues. This report summarizes the work group’s efforts to date and raises two questions for the committee.

#### Work Group Status

The work group has an informal structure with approximately 10 states that have expressed interest in having ongoing input through their representatives. (As always, all states and members of the public are encouraged to follow the work group activities and provide comments or other assistance.) The group has had several well-attended calls since July—typically including more than 50 participants. Members of the ABA/AICPA task force, which is working on state-federal conformity and on other issues, have also participated in the calls and have offered other assistance.

Due to uncertainty as to how some key provisions will be implemented and other recent events, MTC staff recently asked the work group whether it may want to suspend work until the IRS issues draft regulations. Staff also suggested that the work group or the committee might consider whether to provide comments to the IRS. Based on this input, the work group is now asking the committee how it wants to proceed. (See further discussion below.)

## Summary of Issues

The work group has prepared a detailed issue list—a working draft which will guide its efforts—which also contains an extensive explanation of the new federal audit and adjustment regime. The issue list, as well as other relevant documents, can be found on the group’s [project page](#) on the MTC website. But the essential elements of that new regime can be summarized here as follows:

- Certain small partnerships (less than 100 schedule K-1s) can elect out—in which case federal audits and adjustments will be made at the partner level
- For partnerships that cannot elect out:
  - The partnership must appoint a partnership representative who will make all decisions with respect to the audit
  - The audit will be conducted at the partnership level
  - The IRS will make its initial adjustment in the form of an “imputed underpayment” at the partnership level which will be:
    - Net adjustments in partnership items (netting tax-positive adjustments against tax-negative adjustments)
    - Plus tax-positive reallocations among partners (without netting tax-negative reallocations)
    - Times the highest applicable tax rate
  - The partnership will then have a period (at least 270 days) to take steps to lower the imputed underpayment which includes:
    - Partners filing amended returns
    - Showing the IRS that partners have a lower tax rate
  - After this period, the IRS will determine the final imputed underpayment and the partnership will have a choice to either:
    - Pay the (adjusted) imputed underpayment, or
    - “Push out” the adjustments to the partners on a new information return

Complicating state conformity are two state-specific issues:

- nexus over out-of-state partnerships and non-resident partners, and
- the need to apportion taxable income of nonresident partners and multistate partnerships.

Also complicating state conformity in general is the fact that, until the IRS issues formal guidance, there are significant questions about how the new rules will be implemented.

## Developments

As taxpayer groups, practitioners, and others, including IRS officials, have focused on the new provisions, uncertainties about how the provisions will work have been identified. In particular, there are inconsistencies with Subchapter K that could be disruptive. For example, unless the partnership pushes out offsetting adjustments related to reallocation of partnership items, partners that were over-allocated items of income or gain will have overpaid tax and will also

have inflated basis and capital accounts which could affect future taxes owed. As a result, there was a growing expectation that Congress might enact changes. On December 6, Congress introduced a technical corrections bill (HR 6439 and S 3506), as a discussion draft, making changes to certain provisions. The technical corrections appear to do the following:

- allow multi-tier partnerships to make the push-out election;
- require partnerships to push out adjustments so that both increases and decreases related to reallocation adjustments are reported to the affected partners; and
- provide for an alternative procedure for partners to concede adjustments in the course of the audit which may eliminate the need for filing amended returns.

The technical corrections bill and related report of the Joint Committee on Taxation are both available on the MTC website partnership page. While the bill did not pass, most expect that some version of it is likely to pass early in the new Congress.

In addition, practitioners have raised questions about how information will be shared by the IRS with the states and whether the IRS is able to collect information which it could provide to affected states (e.g. residency or place of business of partners and partnership). The states have two options. They could attempt to pursue this issue with the IRS, for example by submitting comments on the regulations being drafted (prior to or after the proposed regulations are issued), asking that certain information be obtained during audits or in reports required to be filed so that this information can be shared with the states. Alternatively, states could simply rely on state-level reporting requirements and on sharing state-reported tax information as necessary.

#### Questions for the Committee

The work group has raised two questions for this committee:

1. Should work be suspended on any drafting of state law conforming provisions until the Congress passes any technical corrections and/or the IRS issues proposed regulations—or should work proceed on specific issues where there is less uncertainty?
2. Does the committee wish to provide any input to the IRS regarding the regulations that it is currently drafting?