Uniformity Developments
-
Federal Conformity Issues



November 10, 2026
Report of MTC Staff

Commission Purposes

To support –

- **Multistate apportionment**
- **Uniformity or compatibility in tax systems**
- **Taxpayer convenience and compliance**
- **Rules to avoid duplicative taxation**

MTC
MULTISTATE TAX COMMISSION

Challenges of Federal Conformity

- **Enforcement –**
  - States come to rely on the IRS, even when it's not reliable
- **Ties to the international system –**
  - Make change hard and slows necessary adaptation
- **General (sometimes ambiguous) statutes –**
  - Require extensive rule-making that is slow and subject to challenge
  - Subject to litigation with split courts and circuits
- **Revenue effects –**
  - Federal policies can be at odds with creating a stable revenue source

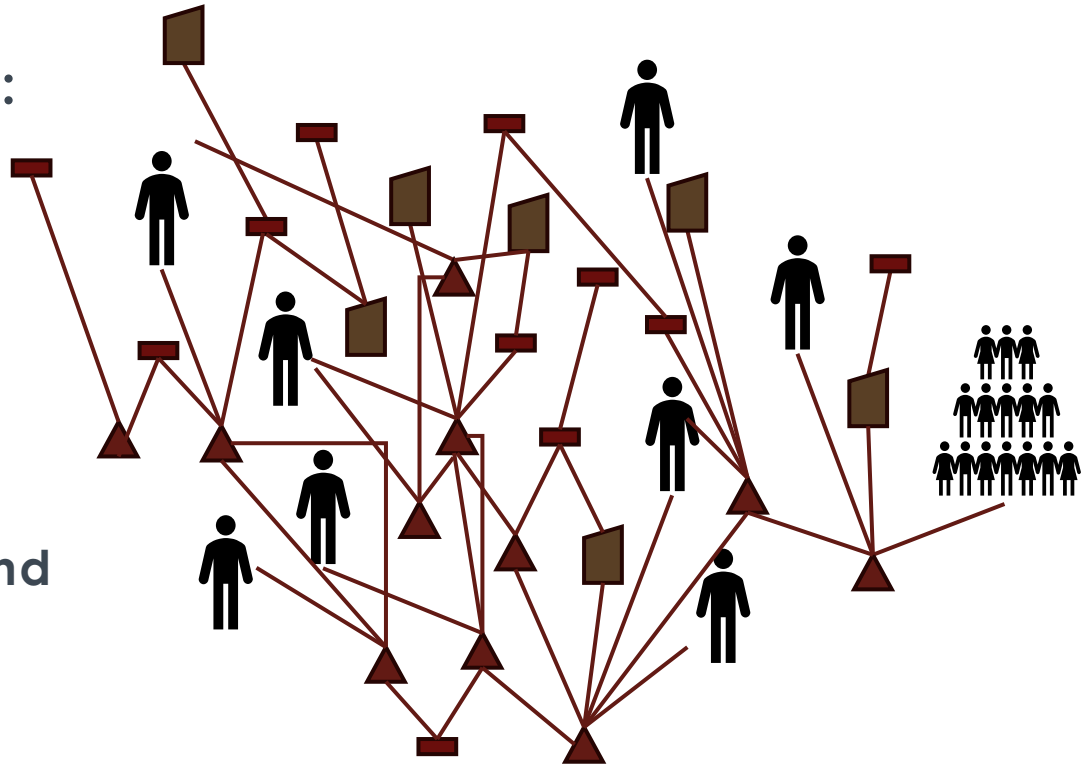
But de-conforming can also be a challenge

Reliance on Federal Enforcement

Complex business structures

These structures are costly:

- Ongoing maintenance and administration
- Friction which inhibits growth and change
- Difficulty assessing risks and making investments



Complex structures may be driven by different factors including investor demands and changes in finance – including derivatives, hedging, private equity, private debt, etc.

Reliance on Federal Enforcement

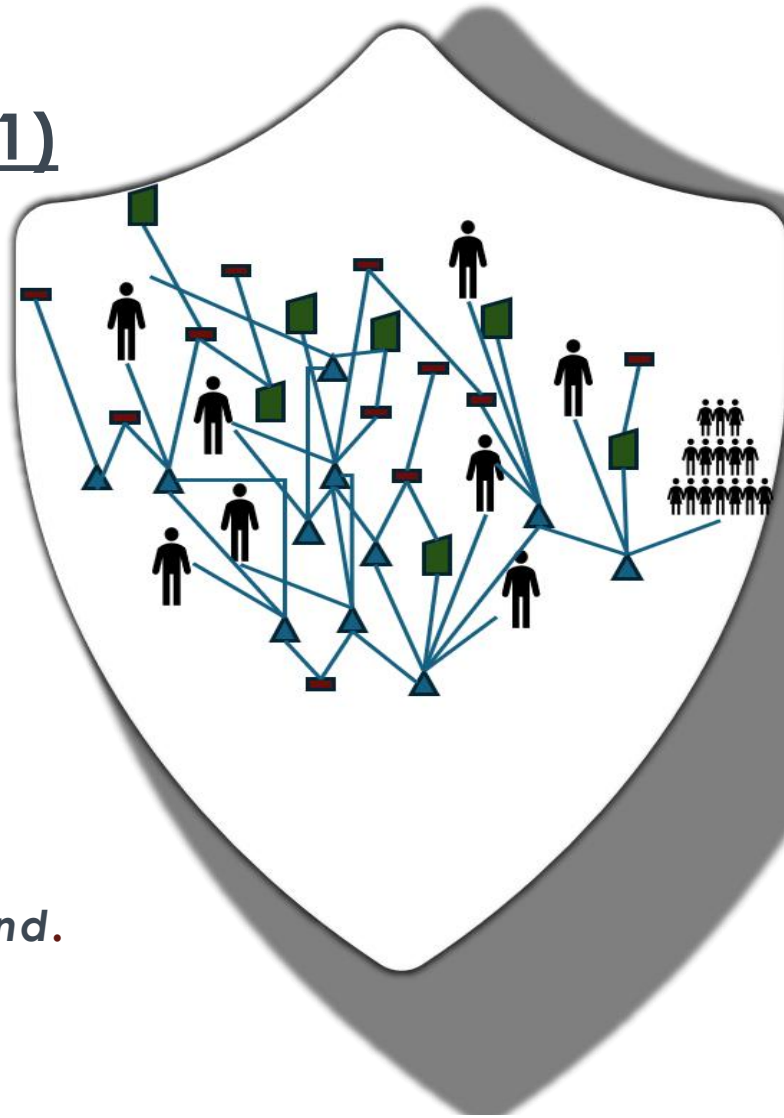
Can act as a legal shield

One federal solution -

Corporate Transparency Act (2021)

- Required reporting of beneficial ownership information
- Intended to keep complex structures from being used to evade the law
- Met opposition and split the federal courts with some holding that only states have the power to require such information reporting

See *Texas Top Cop Shop, Inc., et al. v. Garland*.



Example - Circular Structures

Moody's provides the following for corporate structures:

> "Circular ownership refers to a corporate structuring method where companies own stakes in each other, forming a loop of control. . . . These structures often involve more than two entities, which can make it difficult to identify the ultimate beneficial owners (UBOs)."

https://www.moodys.com/web/en/us/kyc/resources/insights/circular-ownership-and-complex-corporate-structuring.html

Example - Circular Structures

Moody's goes on to list "5 key takeaways" –

- "Circular ownership . . . can obscure control."
- ". . . can be used by bad actors to evade regulation, conceal beneficial ownership, or facilitate financial crime."
- "Access to beneficial ownership data can support identification and verification of UBOs."
- Using shell company indicator can flag potential instances of circular ownership.
- Integrating this intelligence into compliance workflows can support enhanced due diligence, risk assessment, and decision-making."

Example - Circular Structures

Article by David Klasing in CPA Practice Advisor - *How IRS BBA Assessments Can Affect Individual Partners: IRS Audits of High-Income Taxpayers and Partnerships*, Oct. 13, 2026.

> "High-income individuals and partnerships present some of the most complicated federal tax returns the IRS examines. They often involve multiple businesses, pass-through entities, investments, related-party transactions, complex basis calculations, and tax positions . . .. Government data initially showed a substantial increase in IRS examination activity . . .. A 2025 Treasury Inspector General for Tax Administration report found that partnership examination starts increased 63%, from 4,106 in FY 2020 to 6,709 in FY 2023."

https://www.cpapracticeadvisor.com/2026/10/13/how-irs-bba-assessments-can-affect-individual-partners-irs-audits-of-high-income-taxpayers-and-partnerships/191607/

Example - Circular Structures

Article by David Klasing in CPA Practice Advisor - *How IRS BBA Assessments Can Affect Individual Partners: IRS Audits of High-Income Taxpayers and Partnerships* (cont'd)

"The enforcement picture has changed materially since then. Treasury's latest performance data show that partnership examination starts fell to 2,285 in FY 2024 and 1,589 in FY 2025, a roughly 76% decline from FY 2023.. . . The decline reflects an important reality for taxpayers in 2026: the IRS is operating with substantially reduced enforcement resources. TIGTA reported that the IRS Pass-Through Entities program lost more than 20% of its staff during 2025 and concluded that the agency would need to reassess its large-partnership examination coverage goals."

Example - Circular Structures

Chris William Sanchirico and Reed Shuldiner, "Circular Partnerships: Pinpointing the Problems, Proposing Solutions," Tax Notes State Oct. 26, 2026

Article references the problems in circular partnership structures –

- Recursive allocations – tracing allocations through circular structures
- Tax-year-phasing – shifting recognition between years

Notes that there are short-cut solutions that have been proposed—

> "But as a practical matter, this shortcut is likely only implementable — at least without further policy intervention — when the circular structure has centralized control and self-awareness."

Example - Circular Structures

Chris William Sanchirico and Reed Shuldiner, "Circular Partnerships: Pinpointing the Problems, Proposing Solutions," (cont'd)

Finds there may be no better solution to the recursive allocation problem than to:

> ". . . to establish, or aid in the establishment of, institutions that produce and facilitate the kind of coordination that is otherwise lacking in decentralized structures — the kind of coordination that would render up-front calculation feasible — per our second theoretical guidepost. Here we draw on the sorts of clearinghouse systems that are successfully used to clear decentralized financial trading. Could an analogous clearinghouse be developed for decentralized circular partnership structures?

Recent development

Reliance on Federal Enforcement

October 27, 2026 – 20 states and D.C. filed suit in federal court against the Treasury Dep't arguing FinCEN cannot simply decide not to enforce the CTA, and saying:

> "Congress enacted the Corporate Transparency Act in response to a problem that has long plagued law enforcement and tax administration in the United States: the existence of secretive shell corporations, arranged in complex, layered structures designed to hide information about the individuals who own or control them, a category of information referred to as beneficial ownership information (BOI)."

Effect on the States

The states must take up the task of requiring additional reporting information on business structures, especially in the partnership tax area, to ensure taxpayers can properly compute their taxes.

States may also have to look at increased audit enforcement—but clarifying rules is also critical.

Ties to the International System

Transfer pricing rather than aggregation

GAAP & SEC rules require consolidation

Why?

- **Related entities generally share values created by coordination, integration, and economies of scale that do not translate into identifiable transactions and are impossible to accurately value.**
- **Or as the Supreme Court said in *Container Corp.*:**

> ***"One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise."***

Ties to the International System

Transfer pricing rather than aggregation

Federal system does not require aggregation

Why?

- **Ties to the international system have dictated that domicile determines when entities' activities can be consolidated (aggregated) and the "location" of intangible property for sourcing purposes.**
- **It's NOT about sourcing. A consolidated group can source income using apportionment OR the traditional internation sourcing rules.**

Ties to the International System

Transfer pricing problems have only grown

- Timing – typically looking at years long past
- Requires detailed information, much of which only the taxpayer possesses
- Differences in approaches – can lead to results that diverge by billions of dollars IN TAX
- The tax cost means that it's worth it for taxpayers to incur other costs related to litigation over many years
- Cases are subject to appeal and courts come to different conclusions

Some Recent U.S. Transfer Pricing Cases

Company	Year Started	Years at Issue	Tax Dollars at Issue	Issues	Status
Microsoft	2023	2004 – 2013	$28.9 Billion	Cost-sharing and IP	Still going
Meta / Facebook	2016	2010	$5 Billion	Platform contribution and periodic adjustment rules	Still going
Meta / Facebook	2025	2017 - 2019	$16 Billion	Various	Still going
Coca-Cola	2015	2007 - 2009	$18 Billion	Profit-splitting	Still going
Amgen (two cases)	2021	2010 – 2015	$8.65 Billion	Use of the comparable profits method	Still going
Medtronic (I & II)	2011	2005 - 2006	$1.35 Billion	Comparable uncontrolled transaction vs. profits method	Still going
3M vs. IRS	2013	2006	$23.7 Million	Preemption of method by jurisdiction's currency laws	Still going
Eaton II (two cases)	2023	2011 – 2013	$800 Million+ for both cases	Interest, royalties, guarantee fees and penalties.	Still going

Ties to the International System

It's only taken 40 years to recognize this

- 1980's – the federal government pressured states to use water's edge filing rather than worldwide combined filing—promising that they would enforce transfer pricing.
- The OECD has acknowledged that the system does not work and shifted to a "pick-up" or minimum tax.
- The federal government has shifted to attribution which, like aggregation (consolidation or combination), offsets intercompany transactions.

Effect on the States

- Take-aways
  - It may be time to rethink water's-edge filing given the federal and international shift—which may mean taxing NCTI or shifting to WWCR.
  - NOTE – including NCTI means that intercompany transactions between parent and sub, giving rise to intercompany income and expense, are effectively offset.

Effect on the States

- See the MTC Briefing Book on Changes in Federal Taxation of Multinational Corporate Groups
  - NCTI is not a dividend or a deemed dividend in any sense – just as partnership distributive share is not a distribution. It is attributed income. (See *Moore v. United States*--which found that under Subpart F Congress treated CFCs as "pass-throughs".)
  - States should consider factor representation and may face challenges otherwise.

General (Sometimes Ambiguous) Statutes

Loper Bright comes at the worst time

- Federal government is entirely reliant on income taxes.
- Business income is now generated globally through complex structures.
- The income tax system is also becoming more complex over time.
- Federal statutes are not significantly more detailed but are written using general terms and concepts.
- The parts of the system have to work together or the whole system will break down.
- Litigation can take years, puts all the expense of resolving issues on particular taxpayers, and the courts do not always agree.

REVENUE EFFECTS - STATE BUDGET PRESSURES

Expensing and Decoupling

Revenue volatility and federal policy changes (TCJA, OB3) frequently drive states to decouple from federal deductions.

The Decoupling Dilemma:

Immediate Budget Protection

Vs.

Long-term Administrative & Technical Challenges Across Multiple Tax Years

Expensing and Decoupling

POSSIBLE SOLUTION

Leverage timing modifications of loss carryovers to …

- Reduce Volatility
- Keep Underlying Tax Accounting Conformity

The Federal Income Tax Accounting Framework

Broad Starting Base: IRC §61(a) defines gross income broadly.

Clear Reflection of Income: IRC §446(b) mandates accounting methods that clearly reflect income (Cash vs. Accrual).

The Matching Principle: Core requirement matching expenses to the character and timing of the income they generate (e.g., IRC §163 interest limitations).

Five Classes of Federal Deductions

Ordinary Business Expenses

IRC § 162 (trade or business expenses) and IRC § 212 (expenses for production of income).

Cost of Goods Sold (COGS)

Direct costs of producing goods under IRC § 471 inventory rules.

Capital Cost Recovery

Systematic recovery of capital expenditures through depreciation, amortization, and depletion.

States can decouple from these without affecting tax accounting

Allowable Personal Deductions

Specific personal and itemized deductions (e.g., charitable contributions, qualified mortgage interest).

Standard Deductions & Policy Rate Reducers

Statutory allowances (e.g., IRC § 199A Qualified Business Income deduction, § 250 FDII/GILTI deductions).

Capital Cost Recovery Fundamentals

Cost-Basis Fundamentals

IRC § 1001 ties gain/loss realization to adjusted cost basis upon disposition.

Capital Recovery

Taxpayers are allowed to take deductions for the cost of acquiring capital assets.

Basis Adjustment

Basis is reduced by the capital recovery deduction taken.

Recapture Rules

IRC §§ 1245 & 1250 gain recapture as ordinary income upon sale.

Capital Cost Recovery & Accelerated Expensing

Capital Recovery: Acceleration vs. Matching

- **Straight-line:** Spreads deductions evenly over useful life.
- **MACRS:** Front-loads deductions.
- **Bonus Depreciation (IRC §168(k)):** Immediate 100% (or phased) expensing—injects cash-basis mechanics into accrual taxpayers.
- **Section 179 Expensing:** Direct expensing capped by taxable income (cannot create an NOL).

Mismatch with Matching: Front-loading deductions breaks traditional matching principles by creating artificial "paper losses" in early years followed by inflated gains upon asset sale.

State Conformity Models

Rolling Conformity: Automatically adopts IRC changes in real time; simplifies compliance and leverages federal reporting but exposes state budgets to sudden federal shifts.

Static (Fixed-Date) Conformity: Conforms to the IRC as of a specific date (e.g., Jan 1, 2016); offers predictability but requires maintaining legacy rules when federal laws change.

State Modifications & Decoupling:

- ***Decoupling:*** Explicit rejection of specific federal provisions (e.g., §168(k) bonus depreciation, §199A QBI).
- ***Modifications:*** State-specific adjustments, additions, subtractions, and standard deductions.

The Ripple Effects of Decoupling from Capital Recovery

Divergent Asset Bases: Decoupling from federal depreciation forces taxpayers to maintain separate depreciation schedules and adjusted bases across states.

Gain/Loss Mismatch on Sale:

- Lower state depreciation in Year 1 = higher adjusted basis.
- Asset sale in Year 2 produces smaller state gain than federal gain.

The Ripple Effects of Decoupling from Capital Recovery

Multi-State Example (Anything Goes Inc. - $1M Machine):

- ***Federal Deduction (Bonus)*** = $1.0M | Basis = $0 |
  - Sale at $1.1M in Year 2 -> **Gain = $1.1M**
- ***State A Deduction (Straight-Line)*** = $100k | Basis = $900k |
  - Sale at $1.1M in Year 2 -> **Gain = $200k**
- ***State B Deduction (MACRS)*** = $150k | Basis = $850k |
  - Sale at $1.1M in Year 2 -> **Gain = $250k**

Interstate Tax Credits & Administrative Burden

Resident Credit Distortions: Differences in capital recovery schedules alter annual tax liabilities unevenly across states, creating double taxation risks.

Administrative Overload:

- ***For State Tax Authorities:*** Developing specialized reporting forms, tracking historical basis differentials, and training audit staff.
- ***For Taxpayers & Practitioners:*** Maintaining parallel accounting systems across multiple states, increasing compliance costs and dispute volume.

The Mechanics of Losses & Carryovers

Definition of Tax Loss

An arbitrary annual snapshot representing excess deductions over receipts—not necessarily economic or cash loss.

Role of Carryovers

Carryovers bridge artificial tax years, restoring multi-year matching without requiring retroactive asset basis adjustments.

Key Loss Regimes

- ***Pass-Through Losses:*** Outside basis limits, IRC §465 (At-Risk), and IRC §469 (Passive Activity Loss) suspensions.
- ***NOLs & Excess Business Losses*** *(IRC §461(l)):* Federal NOLs carry forward indefinitely, capped at 80% of taxable income.

Crucial Takeaway

Once an excess deduction is categorized as an NOL/carryover, it ceases to affect underlying asset accounting.

Proposed Solution: State Excess Deduction Carryover to Regulate Timing

Core Concept: Conform fully to federal asset accounting and basis calculations but manage state revenue timing at the modified taxable income level.

Mechanics (Excess Business Loss Approach):

a. Add back targeted accelerated deductions (e.g., bonus depreciation) to determine Modified State Taxable Income.

b. Cap current-year deduction of the targeted item (e.g., allow up to 50% of modified income).

c. Convert the disallowed portion into a State Carryover/NOL to offset future taxable income.

Proposed Solution: State Modification to Regulate Timing

Benefits:

- Eliminates separate state asset basis tracking.
- Eliminates gain/loss recalculations on sale.
- Resolves partnership capital account tracking complexities.
- Smooths state tax collections over economic cycles.

Case Study: State Deductions Smoothing Mechanism

- **Fact Pattern:** Corp has $200M revenue, $150M ordinary expenses, and $100M bonus depreciation (Federal Loss = -$50M). State adopts a 50% cap.
- **Year 1:**
  - Modified Taxable Income = $200M - $150M = $50M (adding back $100M bonus).
  - Allowed Current Deduction (50% cap) = $25M.
  - Current State Taxable Income = $25M; Carried Forward State Deduction = $75M.
- **Year 2 Application ($20M net federal income):**
  - Modified Taxable Income = $20M.
  - Carryover Allowed (50% cap) = $10M.
  - Taxable Income = $10M; Remaining Carryover rolled forward = $65M

Design Considerations

Customizable Percentage Caps: States can set limitation caps (50%, 80%, etc.) based on specific fiscal needs.

Carryover Architecture:

- ***Unified Pool:*** Merge state timing carryovers with traditional NOLs for simplicity.
- ***Separate Buckets:*** Establish distinct carryover buckets with defined ordering rules.

Pass-Through Application: Apply limitation rules at the partner/shareholder level without disturbing partnership accounting books.

The Partnership Conundrum

Multi-Tiered Tracking: Decoupling alters inside asset bases, outside partnership bases, and partner capital accounts across different state jurisdictions.

Suspended Loss Disconnect: Federal passive loss or basis suspensions may neutralize state decoupling efforts, resulting in immense paperwork with zero net tax effect.

Capital Account Distortions: Divergent state capital accounts allow tax-free cash distributions in states with higher tax bases.

Substantial Economic Effect (IRC §704(b)): Federal allocation rules continue to control; without state-level §704(b) decoupling, special allocations can undermine state policy goals.

Conclusion

Conformity with Flexibility: States do not need to choose between severe revenue swings and overwhelming accounting complexity.

Strategic Policy Alignment: Treating timing changes through modification and carryover limitations protects state budgets, preserves federal base alignment, and removes administrative deadweight.

Recommendation: State legislatures and tax commissions should consider adopting carryover-based timing modifications in lieu of direct capital recovery decoupling.