

Ohio Tax

27th Annual



Tuesday & Wednesday, January 23-24, 2018

Hyatt Regency Columbus, Columbus, Ohio

Workshop KK

**The Death of the Tax Matters
Partner: State Issues With
The New Federal Partnership
Audit Rules**

Wednesday, January 24, 2018
11 a.m. to 12:30 p.m.

Biographical Information

Fredrick J. Nicely, Senior Tax Counsel, Council On State Taxation (COST)
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Fred Nicely is Senior Tax Counsel for the Council On State Taxation. Fred's role as Senior Tax Counsel at COST extends to all aspects of the COST mission statement: "to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities."

Before joining COST, Fred served in the Ohio Department of Taxation for four years as Deputy Tax Commissioner over Legal and for the prior seven years as the Department's Chief Counsel. Fred's responsibilities at the Department included testifying before legislative committees, participating as an alternative delegate for Ohio at Streamlined Sales Tax Project meetings, and reviewing legal documents issued by the Department, including deciding the merits of filing an appeal.

He is a frequent speaker and author on Ohio's tax system and on multistate tax issues generally. Fred also has extensive experience in public utility tax law, having served as an administrator of the Department's public utility tax division.

Fred's undergraduate degree in psychology (with a concentration in accounting) is from the Ohio State University. He obtained his MBA and JD from Capital University in Columbus, Ohio.

Christine Locher, Director of Taxation
Rockbridge Capital, LLC, 4100 Regent St., Suite G, Columbus, OH 43219
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Christine started her career in public accounting with KPMG, LLP in Columbus, OH. As a manager at the firm, she served a variety of clients, with a focus on pass-through entities and tax-exempt organizations. Since her time at KPMG, Christine has held Tax Manager positions at Express, Inc. and The Scotts Miracle-Gro Company.

Christine joined Rockbridge in July 2016 as the Director of Taxation, where she currently oversees the tax function for the firm.

Christine holds both a B.S. in Business Administration and Masters of Accounting degree from The Ohio State University. She is a CPA in the state of Ohio.

Biographical Information

Michael Bryan, Director, Deloitte Tax LLP
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Mike is a Managing Director in the Multistate Tax Practice of Deloitte Tax LLP. For the 5 years before joining Deloitte Mike was the Director of the New Jersey Division of Taxation. Mike carries strong credentials with respect to state policy considerations and audit defense, and has deep relationships with other tax administrators. Prior to his leadership role with the state of New Jersey, Mike spent 16 years overseeing all federal, international and state controversy matters for a large publicly traded media company in Philadelphia.

Mike drives state controversy services for Multistate Tax's clients nationally, particularly controversies within New Jersey and is instrumental in working with the states on behalf of Deloitte clients. Mike serves as a resource to the entire Multistate Tax practice with respect to technical review of filing considerations and newly-developed technical positions, restructuring and other transactions and drafting formal opinions.

Mike is a graduate of Drexel University (B.S. Accounting) and Temple University, (MBA, Taxation)

Courtney L. Clark, Multistate Tax Services Senior Manager, Deloitte Tax LLP
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Courtney is a trusted business advisor to her clients on state and local tax matters. Courtney is a Certified Public Accountant, practicing in Columbus, Ohio, with over thirteen years of Big 4 experience. In her state and local practice, Courtney integrates her unique federal taxation background to assist clients in finding state taxation solutions. She focuses on the interplay of federal and state nuances, such as identifying organizational chart structural enhancements, state-only deductions and other planning opportunities.

Courtney assists firm-wide clients with Ohio taxation issues. She serves as a key member of our Jurisdictional Technical Lead program for Deloitte with a role of providing specialized assistance with Ohio tax controversy matters. She has deep experience with Ohio Commercial Activity Tax ("CAT") matters including audit representation.

Her article, "Real Estate Income as 'Business' Income for State Tax Purposes," was published in the fourth quarter 2016 edition of WG&L's Journal of Real Estate Taxation.

Courtney attended The Ohio State University for her BSBA in Accounting. She has received her Masters of Taxation degree from Capital University in Columbus, Ohio. She is a frequent presenter at Ohio Society of CPA seminars.

Biographical Information

David M. Kall, Managing Member, McDonald Hopkins
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Dave is managing member of the Cleveland office, vice chair of the Tax and Benefits Department, chair of the Multistate Tax Practice Group, and chair of the Capital Markets Practice Group within the firm's Business Department. As chair of the Capital Markets Practice Group, Dave spends a considerable amount of time counseling early and growth-stage companies, capital providers and entrepreneurs in a vast array of legal areas. Prior to joining the firm in 1996, Dave was a senior tax manager at Coopers & Lybrand LLP. While at Coopers & Lybrand LLP, Dave was responsible for providing advice to publicly traded and large privately held companies on a wide range of technical issues, including corporate, partnership, and REIT taxation.

Since joining the firm, Dave has developed extensive experience in working with our clients on all matters and challenges facing them as it relates to the Capital Markets Practice Group including fund formation and structuring, securities and regulatory compliance, fund administration and transfers of fund interests, investments in portfolio companies and related issues, sophisticated financing transactions involving commercial secured and unsecured loans and loan syndications, public and private issuances of debt and equity securities, and corporate governance matters.

Because of Dave's breadth of knowledge, he routinely represents our clients in connection with their general business needs. In particular, Dave has extensive experience structuring business transactions, negotiating and drafting corporate governance and transaction agreements, counseling directors and officers regarding the fiduciary duties owed to creditors and owners of the business, and structuring business succession plans.

Dave's approach to managing the Capital Markets Practice Group as an integrated, multidisciplinary practice is supplemented by Dave's broad-based federal and state tax practice involving corporate, partnership and venture capital transactions, tax controversy, and domestic tax planning. Dave's transactional tax practice includes assisting clients with structuring, negotiating, and documenting corporate, partnership, and limited liability company formation, merger, acquisition, disposition (including spin-off transactions, asset sales, stock sales, and Section 338(h)(10) transactions), joint venture, and financing transactions. Dave also provides independent advice to tax directors with respect to tax minimization strategies proposed by others or developed in-house. He has advised two publicly traded real estate investment trusts ("REITs") on an ongoing basis with respect to various issues, including going public, secondary offerings of debt and equity, tax compliance and private letter ruling requests, UPREIT structures, DownREIT transactions, and structuring and negotiating joint ventures and limited liability company agreements with developers, and other non-REITs.

Dave's tax practice also has included a significant amount of controversy work at both the federal and state levels involving domestic tax issues. He has represented clients under audit, at IRS Appeals, before the Ohio Department of Taxation and the Ohio Board of Tax Appeals. Because of Dave's extensive tax background, he provides a unique perspective to his clients seeking business counseling and advice.

Dave earned a J.D., with honors, from The Ohio State University Moritz College of Law in 1993. He received a B.A., summa cum laude, with Distinction in Political Science and Honors in the Liberal Arts, from The Ohio State University in 1989.

The Death of the Tax Matters Partner: State Issues with the New Federal Partnership Audit Rules

27th Annual Ohio Tax Conference

David Kall, McDonald Hopkins LLC

Fred Nicely, Council on State Taxation

Michael Bryan & Courtney Clark, Deloitte Tax LLP

Christine Locher, Rockbridge Capital

January 24, 2018

Presenters

- ▶ **McDonald Hopkins LLC**
 - ▶ David Kall, Managing Member
- ▶ **Council On State Taxation**
 - ▶ Fred Nicely, Senior Counsel
- ▶ **Deloitte Tax LLP**
 - ▶ Michael Bryan, Director
 - ▶ Courtney Clark, Tax Senior Manager
- ▶ **Rockbridge Capital**
 - ▶ Christine Locher, Director of Taxation

Overview

- ▶ Introduction: The Bipartisan Budget Act of 2015 and the New Federal Centralized Audit Regime
- ▶ Background: State Reporting For Federal Audit Adjustments
- ▶ State Issues Presented Under Federal Centralized Audit Regime
- ▶ Model Legislation and Recent Developments
- ▶ Questions

- Changes to Partnership Audit Rules:
The Centralized Audit Regime

Partnership Audit Rules Background

- ▶ The Bipartisan Budget Act of 2015 Adopted New IRS Audit Procedure for Partnerships and LLCs
 - ▶ HR 1314 (P.L. 114-74) enacted in 2015 separate from 2017 Tax Reform legislation
- ▶ The New Audit Rules For Taxable Years Beginning After December 31, 2017
 - ▶ Option to elect into the new rules for earlier years
- ▶ Expected to raise additional tax revenue by enabling the IRS to more efficiently audit partnership and LLCs
 - ▶ According to Government Accountability Office (GAO), less than one percent of large partnerships were audited during 2012, compared to a 27 percent audit rate of corporations with assets exceeding \$100 million.



Centralized Audit Regime Overview

- ▶ **Centralized Audit Regime Applies To All Partnerships and LLCs**
 - ▶ All Partnership and Operating Agreements for entities taxed as a partnership should be reviewed and amended.
- ▶ **By Default, Audit Adjustments Assessed and Collected at the Entity Level**
 - ▶ The partnership pays the tax, interest, and penalties on any “imputed underpayments” in the adjustment year (partner allocation adjustments also flow-through in adjustment year).
 - ▶ The tax due is calculated at the highest corporate or individual rate (37% in 2018).
 - ▶ Liability Mismatch: current partner group liability for former partner group underpayment
- ▶ **Replaces Tax Matters Partner With “Partnership Representative”**
 - ▶ The Partnership Representative has the sole, exclusive authority to make decisions on behalf of the p’ship in IRS audit proceedings.
 - ▶ Important decisions: audit rules elections, reporting decisions, appeal rights and decisions settlement authority, statute of limitations waivers, etc.
- ▶ ~~The Tax Matters Partner concept eliminated beginning with 2018 taxable year.~~

Centralized Audit Regime Overview

- ▶ **Important Elections:** There are at least three ways that partnerships may opt-out or otherwise adjust their liability under the new audit rules:
 - ▶ **The True Opt-Out Election: Section 6221 Election**
 - ▶ Applies only to small partnerships
 - ▶ **Voluntary Reporting During 270-Day Period: Section 6225 Reporting**
 - ▶ Partners affected by a reallocation must agree to file individual amended returns; OR
 - ▶ Partnership demonstrates that a portion of the imputed underpayment is allocable to a tax-exempt entity or a C corporation or individual with a tax rate lower than the highest marginal rate (37% in 2018).
 - ▶ **The Push-Out Election: Section 6226 Election**
 - ▶ The Partnership Representative elects on behalf of the Partnership to push-out the audit adjustment to the former partner group from the year under review.



Opting Out of Centralized Audit Regime

- ▶ Small Partnerships May Opt Out of Centralized Audit Regime (Section 6221)
 - ▶ P'ships that opt-out are subject to pre-TEFRA rules for p'ship audits
- ▶ Criteria
 - ▶ 100 or Fewer K-1s: P'ship must have fewer than 100 partners;
 - ▶ Eligible Partners: Partners must be individuals, corporations, and/or estates of deceased partners
 - ▶ Disclose Partners: The names and taxpayer identification numbers (TINs) of each partner must be provided to the IRS (particularly applicable with S corporation partners)
- ▶ Annual Election
 - ▶ P'Ship Makes Annual Election: the partnership must make a "Section 6221 election" on its tax return for the opt-out year
 - ▶ Notice to All Partners: P'ship must notify all partners of the election to opt-out

Centralized Audit Regime Timeline

If P'ship fails to opt-out, is ineligible, or chooses not to opt-out, then any IRS audit proceeds as follows:

1. IRS sends Notice of Administrative Proceeding to Partnership Representative and the Partnership itself.
2. After conducting audit, IRS will send a Notice of Proposed Partnership Adjustments (NOPPA)
3. Within 270 days of receiving the NOPPA, the partnership can request to modify the imputed underpayment under certain circumstances (see the earlier slide discussing voluntary reporting under Section 6225)

Centralized Audit Regime Timeline (cont.)

4. After 270 days, the IRS sends its Final Proposed Adjustment (FPA)
5. Within 45 days of receiving the FPA, the partnership may elect to push out the imputed underpayment to reviewed year partners OR pay at entity level
 - ▶ Operating Agreement should address P'ship Rep authority to make Push Out Election
 - ▶ Push Out Election increases interest rate by 2 percent on imputed underpayment
6. OR, within 90 days of receiving the Final Proposed Adjustment, the partnership may file a petition for readjustment with the U.S. Tax Court, U.S. district courts, or the Court of Federal Claims

Statute of Limitations

- ▶ The statute of limitations structure for auditing partnership also significantly changed in light of the new centralized audit regime.
- ▶ Code Section 6235 provides a single partnership statute of limitations of 3 years after the later of:
 - ▶ (i) the date of filing the partnership return (IRS Form 1065);
 - ▶ (ii) the due date of the partnership return; or
 - ▶ (iii) the date the partnership files an “administrative adjustment request”

► Background: State Reporting of Federal Audit Adjustments

Reporting Federal Audit Adjustments: Background

- ▶ States use federal taxable income, and other federally determined amounts, for computing state taxable income—so if a taxpayer underreports federal income, the taxpayer will also owe state tax
- ▶ This allows states to benefit from federal audit efforts
- ▶ Federal (IRS) audits can take years – audits generally extend beyond normal federal and state statute of limitations
- ▶ IRS audit issues are often resolved at different times, with some issues creating refunds and others creating liabilities
- ▶ Some IRS audit adjustments have no impact at the state level (e.g., some federal credit adjustments)

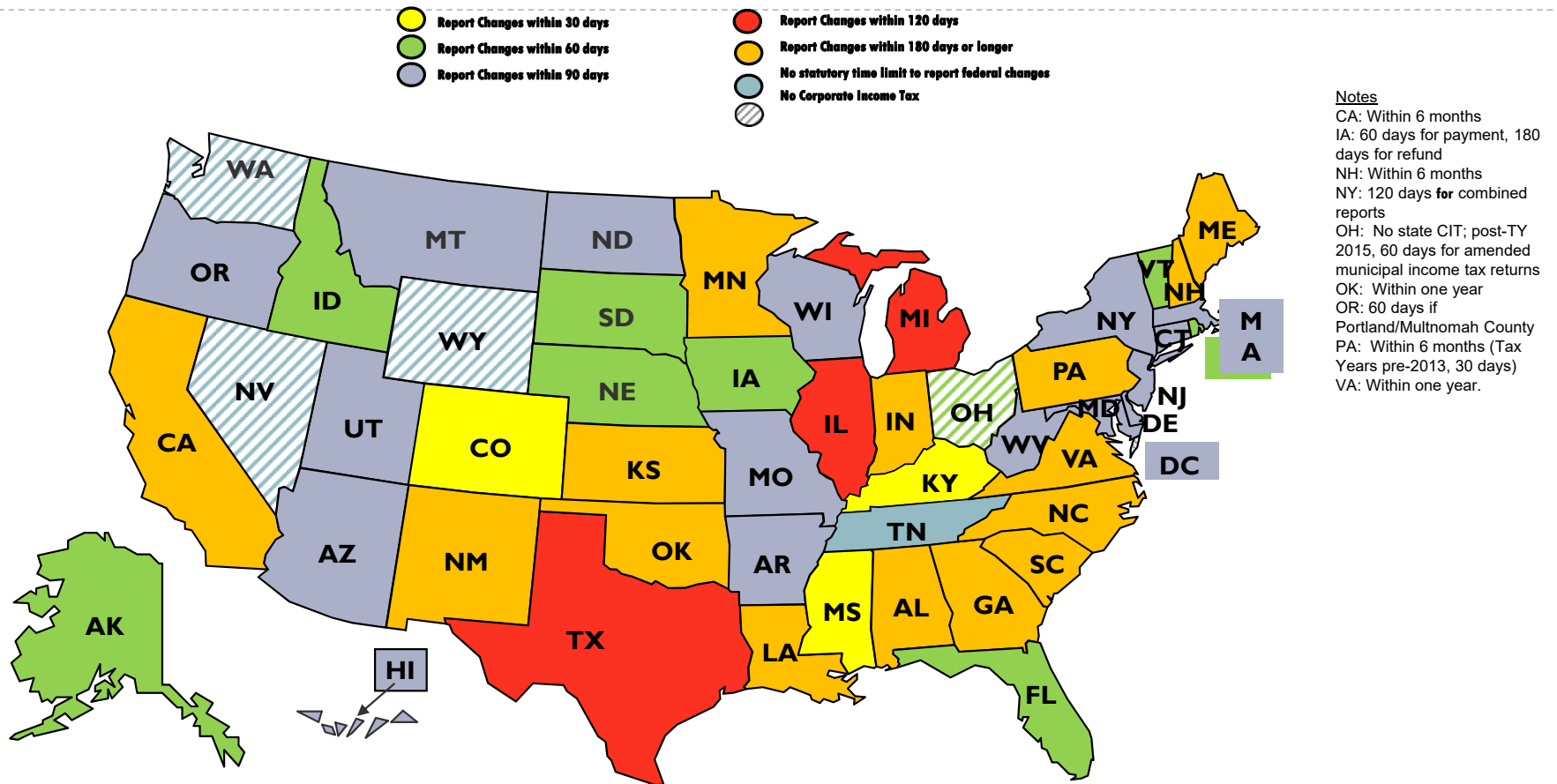
Reporting Federal Audit Adjustments: Background

- ▶ Multistate Tax Commission currently has a Model Statute for states on how to report federal audit adjustments
- ▶ Model Statute Details
 - ▶ Model Statute adopted in 2003 when all states already had some type of reporting requirement in place
 - ▶ No state has adopted the Model Statute
 - ▶ Model Statute needs updating to:
 - ▶ Address changes in IRC and IRS audit procedures
 - ▶ Add provisions that create efficiency for taxpayers and state tax administrators

Reporting Federal Audit Adjustments: Background

- ▶ Taxpayer groups working to inform state legislators of the need for uniformity:
- ▶ The time to report federal audit adjustments to states varies widely
 - ▶ Some states have not set a date
 - ▶ Other states range from 30 days to one year

When Do Taxpayers Have to File



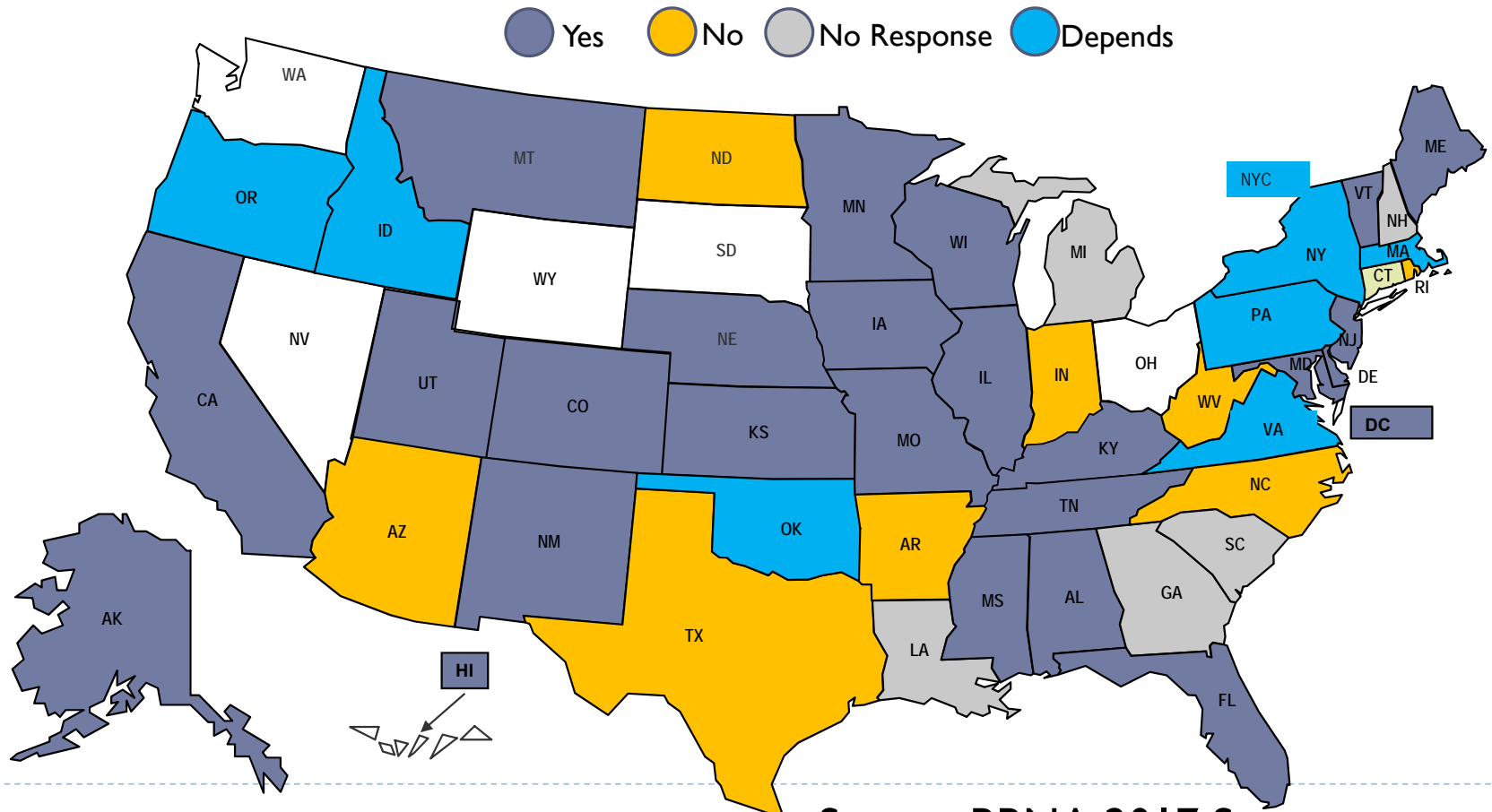
Reporting Federal Audit Adjustments: Background

- ▶ Taxpayer groups working to inform state legislators of the need for uniformity
- ▶ The events triggering the reporting of federal audit adjustments vary widely
 - ▶ Definition of final determination varies significantly
 - ▶ Some states require adjustments to be reported as settled – serial reporting; other states only require reporting after all adjustments are final
 - ▶ Some states require filing based on other state and local tax adjustments

Map of the United States showing the availability of the 'Age' variable by state. States are colored red for 'No definition', purple for 'Defined', and grey for 'Not applicable'. A legend at the bottom right explains the color coding. A separate legend on the right side of the map shows the color coding for the 'Age' variable: red for 'No definition' and purple for 'Defined'.

State	Age Availability
WA	Not applicable
OR	No definition
ID	Defined
MT	No definition
ND	Defined
WY	Not applicable
SD	No definition
MN	No definition
WI	Defined
MI	No definition
NY	Defined
ME	Defined
VT	No definition
NH	Defined
MA	Defined
CT	No definition
RI	No definition
NJ	No definition
MD	No definition
DE	No definition
DC	No definition
PA	No definition
OH	No definition
IN	Defined
IL	Defined
IA	No definition
MO	Defined
NE	Defined
KS	No definition
OK	No definition
TX	Defined
NM	Defined
AZ	Defined
UT	No definition
NV	Not applicable
CA	Defined
AK	Defined
HI	No definition
LA	No definition
MS	No definition
AL	Defined
GA	Defined
FL	No definition
SC	No definition
NC	No definition
VA	Defined
WV	No definition

States That Require Filing/Payment Based on Partial Settlement



Source: BBNA 2017 Survey

Legend:

- No Response (Blue)
- States that require filing based on other state AND local tax agency adjustment (Green)
- States that require filing based on other state tax agency adjustment (Orange)

Map Data:

Category	States
No Response	MT, ND, SD, MN, WY, CO, NM, TX, OK, AR, MS, AL, GA, FL, SC, NC, TN, KY, IN, OH, PA, NY, NJ, DE, MD, WV, IL, IA, MO, MI, WI, HI
States that require filing based on other state AND local tax agency adjustment	CA, OR, ID, AZ, NE, KS, ME
States that require filing based on other state tax agency adjustment	WA, ID, WI, VA, NYC

MA: Depends for local tax changes

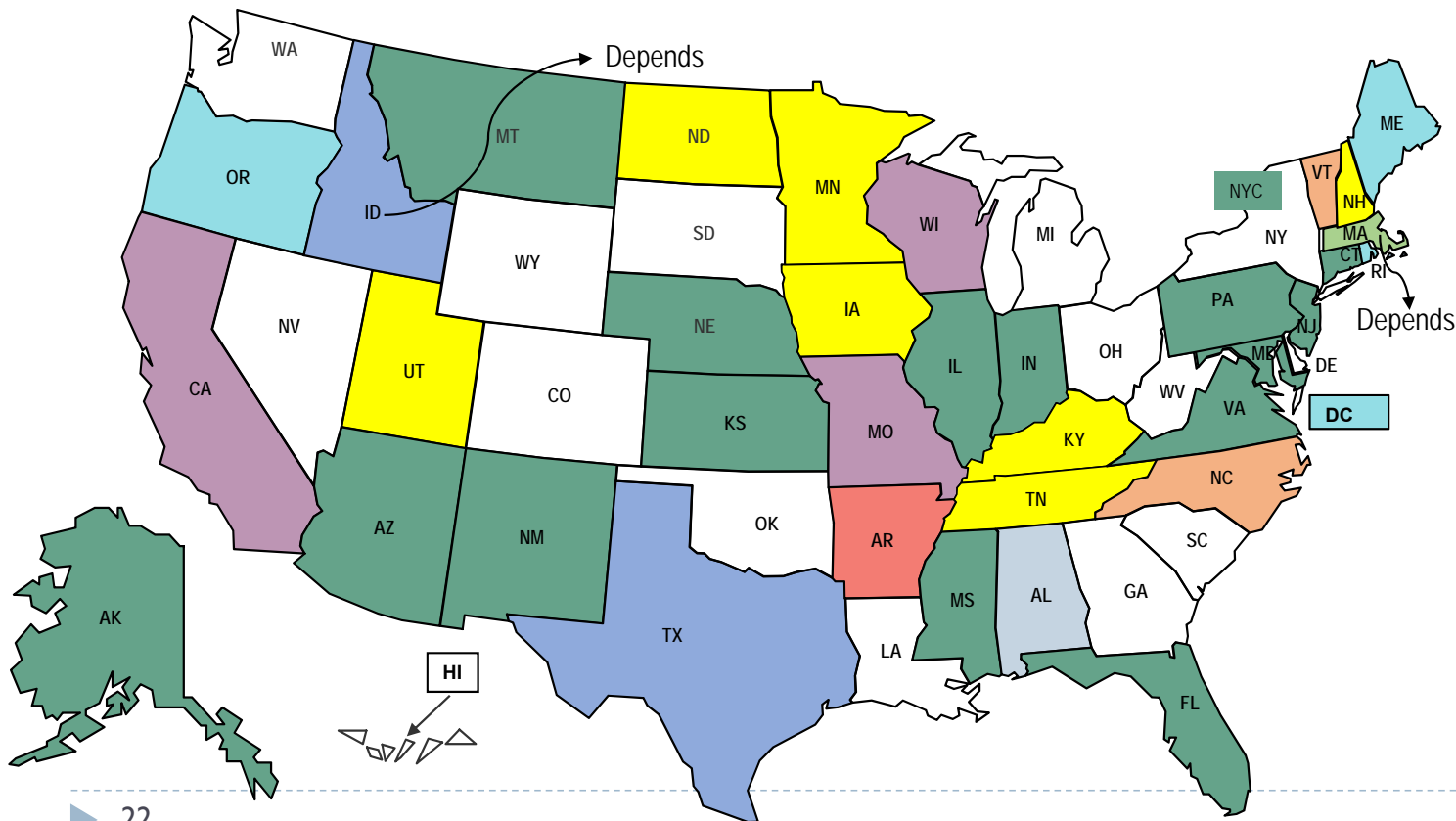
Source: BBNA 2017 Survey

Source: BBNA 2017 Survey

Reporting Federal Audit Adjustments: Background

- ▶ Taxpayer groups working to inform state legislators of the need for uniformity:
- ▶ The method to report federal audit adjustments varies widely
 - ▶ Full amended return
 - ▶ Other state specific notice requirements (e.g., simplified amended return or other written notification)
 - ▶ State specific spreadsheet or template

States That Require Return & Those That Allow Writing or Imputed Filing



Source: BNA 2017 Survey

Adequate notice of a reportable adjustment is only made when a taxpayer **actually files** an amended return

Adequate notice of a reportable adjustment may be made when a taxpayer files some type of **notice in writing** to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer **files notice in writing** to the agency

Adequate notice of a reportable adjustment is **imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment may be made when a **taxpayer files notice in writing** and is **imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a **taxpayer actually files an amended return** and is **imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer **files notice in writing** to the agency and is **imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Reporting Federal Audit Adjustments: Opportunities for Enhancements

- ▶ Uniformity alone would aid taxpayers and improve compliance
 - ▶ 180 days allows for more accurate reporting
 - ▶ Clear final determination date that requires reporting federal tax changes once is more efficient for tax agencies and taxpayers
 - ▶ Streamlined reporting would enable taxpayers to report adjustments more quickly and accurately
- ▶ Other recommendations to improve efficiency
 - ▶ Many federal audit adjustments are *de minimis*; however, most states still require full reporting
 - ▶ Difficult for taxpayers to make “estimated payments”
 - ▶ States unnecessarily wait for tax payments from taxpayers
 - ▶ Taxpayers are subject to interest on under-remitted amounts

- ▶ State Issues Presented Under Federal Centralized Audit Regime

State Effects - Generally

- ▶ Issues the states need to address:
 - ▶ State procedural rules need to be amended to match the new federal audit and adjustment process
 - ▶ Whether to allow different treatment at the state level
 - ▶ How to treat amended federal returns taxpayers may file during the modification period
 - ▶ Are partnerships that pay the tax subject to state reporting requirements
 - ▶ Can partnerships simply file amended returns (entity returns along with any composite or withholding returns) and K-1s for partners and have partners file amended returns for the reviewed year?
 - ▶ Proper allocation and apportionment of federal adjustments
 - ▶ How to collect tax owed when the liability will have occurred years earlier and the partnership may be defunct or partners may have moved from the state

New Federal Partnership Audit Rules: State Implications

- ▶ MTC has an ongoing “Partnership Project” to study -
 - ▶ Do the states need to amend their tax laws to address new partnership audit procedures?
 - ▶ If so, how should those laws be revised?
 - ▶ How should the states deal with multiple-tiered entities?
 - ▶ Website: <http://www.mtc.gov/Uniformity/Project-Teams/Partnership-Informational-Project>
- ▶ Only Arizona has enacted legislation conforming to new federal legislation
 - ▶ Arizona’s legislation does not comprehensively address federal changes (e.g., fails to address tiered partnerships)
- ▶ Five states (CA, GA, MN, MO and MT) proposed but did not pass legislation in 2017
 - ▶ None of the proposals took the same approach nor were as comprehensive as the Draft Model Statute

► Draft Model Legislation

How It's Accomplished: Interested Parties

- ▶ The Interested Parties that prepared the Draft Model Statute are:
 - ▶ ABA Section of Taxation SALT Committee Task Force (ABA)
 - ▶ American Institute of CPAs (AICPA)
 - ▶ Council On State Taxation (COST)
 - ▶ Institute for Professionals in Taxation (IPT)
 - ▶ Master Limited Partnership Association (MLPA)
 - ▶ Tax Executives Institute (TEI)
- ▶ The Interested Parties have been working with the Multistate Tax Commission (MTC), this presentation based on revisions to the Draft Model Statute as of January 3, 2018
- ▶ Note: The Draft Model Statute has not yet been formally endorsed by the Interested Parties - it is a draft *for discussion purposes only*

How It's Accomplished: Draft Model Statute – Overview of MTC's October 25th Version

Section A—Definitions

Section B—Reporting Adjustments to Federal Taxable Income – General Rule

**Section C—Reporting Adjustments to Federal Taxable Income – Partnership
Level Audit and Administrative Adjustment Request**

Section D—Assessments of Additional [State] Tax, Interest, and Penalties Arising from
Adjustments to Federal Taxable Income – Statute of Limitations

Section E—Estimated [State] Tax Payments During the Course of a Federal Audit

Section F—Claims for Refund or Credits of [State] Tax Arising from Federal Adjustments
Made by the IRS

Section G—Scope of Adjustments and Extensions of Time

Section H—Effective Date

Optional Regulations

How It's Accomplished: Key General Definitions

▶ **Federal Adjustments**

- ▶ Change to item or amount used by the taxpayer to compute state tax owed, whether resulting from an IRS audit, amended federal return, or administrative adjustment request by the taxpayer

▶ **Federal Adjustments Report (FAR)**

- ▶ Method or form required to report Federal Adjustments to state
- ▶ Includes an amended state tax return or uniform multistate report

▶ **Final Determination Date**

- ▶ For IRS audits, date on which no Federal Adjustments arising from an audit remain to be finally determined
- ▶ For combined/consolidated returns, applies to entire group
- ▶ For amended federal returns, refund claims, and administrative adjustment requests, the date on which the requests were filed

How It's Accomplished:

Optional Final Determination Date Regulation

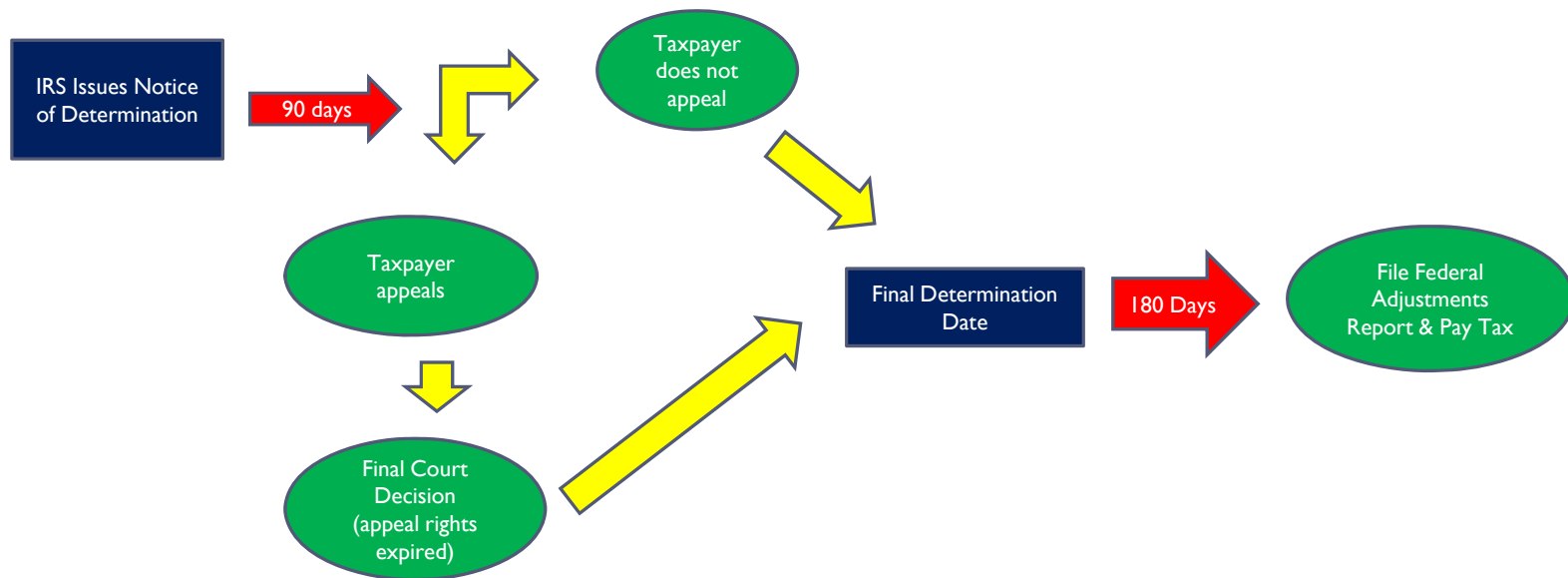
- ▶ States have the option to have a more expansive definition of Final Determination Date that can be put in the state's statute or a regulation
 - ▶ More detailed description of what constitutes a Final Determination Date along with cites to IRC provisions
 - ▶ Examples of when a Final Determination Date occurs

How It's Accomplished: General Reporting Process

- ▶ **Reporting Adjustments to Federal Taxable Income – General Rule** (this does not apply to a partnership (and their partners) subject to a partnership level audit)
 - ▶ Taxpayers shall file a Federal Adjustments Report within **180 days** after the Final Determination Date for Reviewed Year and Subsequently Affected Years
 - ▶ Includes an optional provision to notify state agency of *de minimis* (\$250) changes without filing Federal Adjustments Report
 - ▶ Note: De minimis provisions will not apply to partnerships subject to a partnership level audit or their partners

Flow Chart Following Reporting Federal Audit Adjustment

(This is not for Partnerships subject to Partnership Level Audit)



How It's Accomplished: Key Partnership Definitions

- ▶ **Direct Partner**

- ▶ Partner holding an interest directly in Partnership or Pass-Through Entity

- ▶ **Indirect Partner**

- ▶ Partner in a Partnership or Pass-Through Entity that also holds an interest in another Partnership or Pass-Through Entity

- ▶ **Resident Partner**

- ▶ Individual, trust or estate Partner domiciled in the state

- ▶ **Tiered Partner**

- ▶ Partner that itself is a Partnership or Pass-Through Entity

How It's Accomplished: Key Partnership Definitions

- ▶ **Audited Partnership**

- ▶ Partnership directly subject to Partnership Level Audit

- ▶ **Partnership Level Audit**

- ▶ BBA audit (IRC Section 6221(b))

- ▶ **Reallocation Adjustment**

- ▶ Federal Adjustment that changes the shares of partnership income, gain, loss, expense, or credit allocated to partners
 - ▶ Positive reallocation adjustment increases income owed by Partner
 - ▶ Negative reallocation adjustment decreased income owed by Partner

How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Default Rule

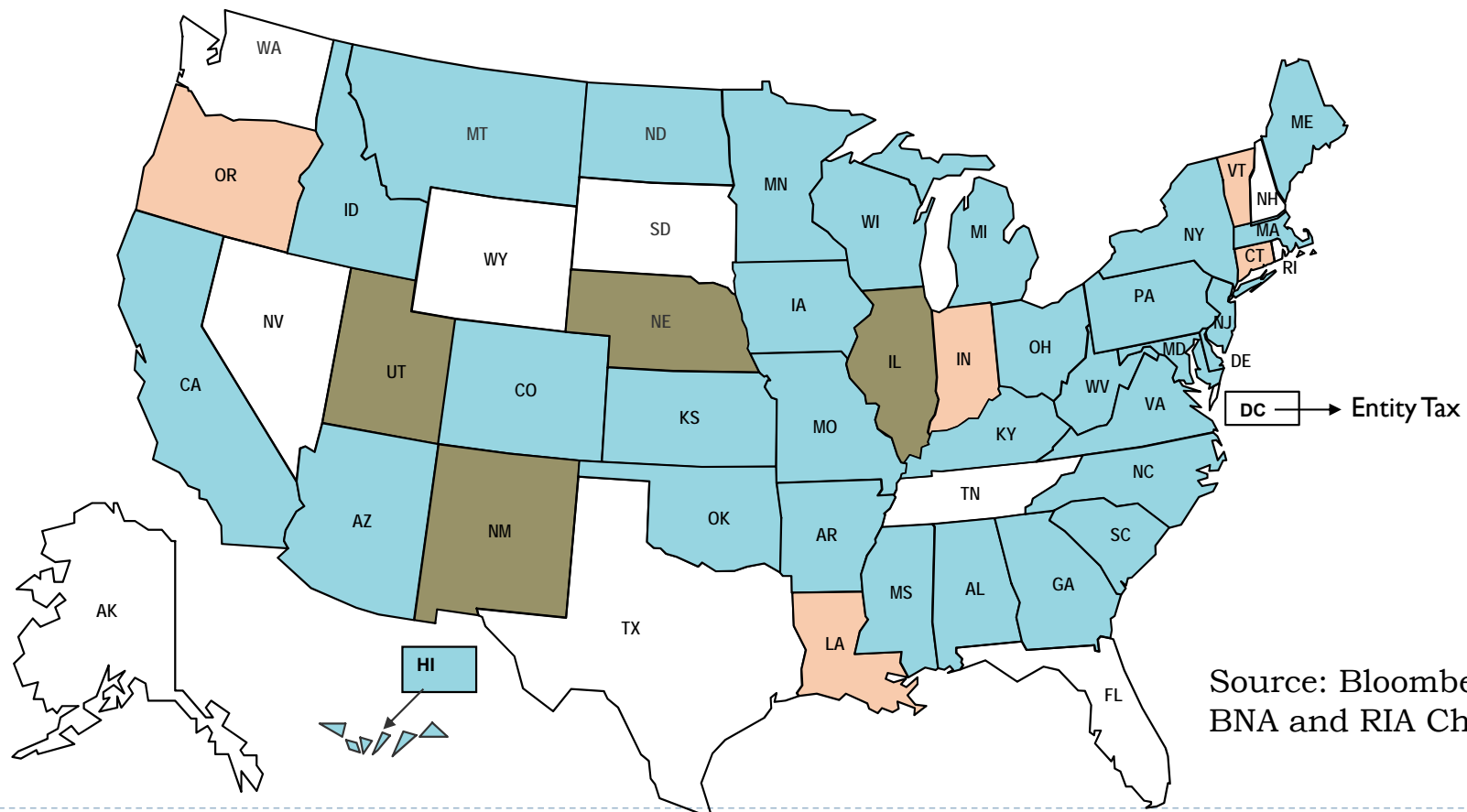
- ▶ For Reviewed Years, Audited Partnership shall:
 - ▶ Within 90 days of the Final Determination Date
 - ▶ File a Federal Adjustments Report;
 - ▶ Notify Direct Partners of their distributive share adjustments; and
 - ▶ File amended composite/withholding returns and pay the related tax liability on behalf of such partners
 - ▶ Within 180 days of the Final Determination Date, excluding Tiered Partners, each Direct Partner
 - ▶ File an Federal Adjustment Report to the state; and
 - ▶ Pay the additional tax, including penalty and interest, to the state (less any applicable credits)

How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Default Rule

- ▶ For Tiered Partners
 - ▶ Within 90 days after the date of federal deadline for Tiered Partners the Tiered Partners shall:
 - ▶ Complete all the above reporting requirements; and
 - ▶ Make all payments
 - ▶ Upon request, Audited Partnership or Tiered Partner with over 10,000 Direct Partners can request an additional 60-day extension

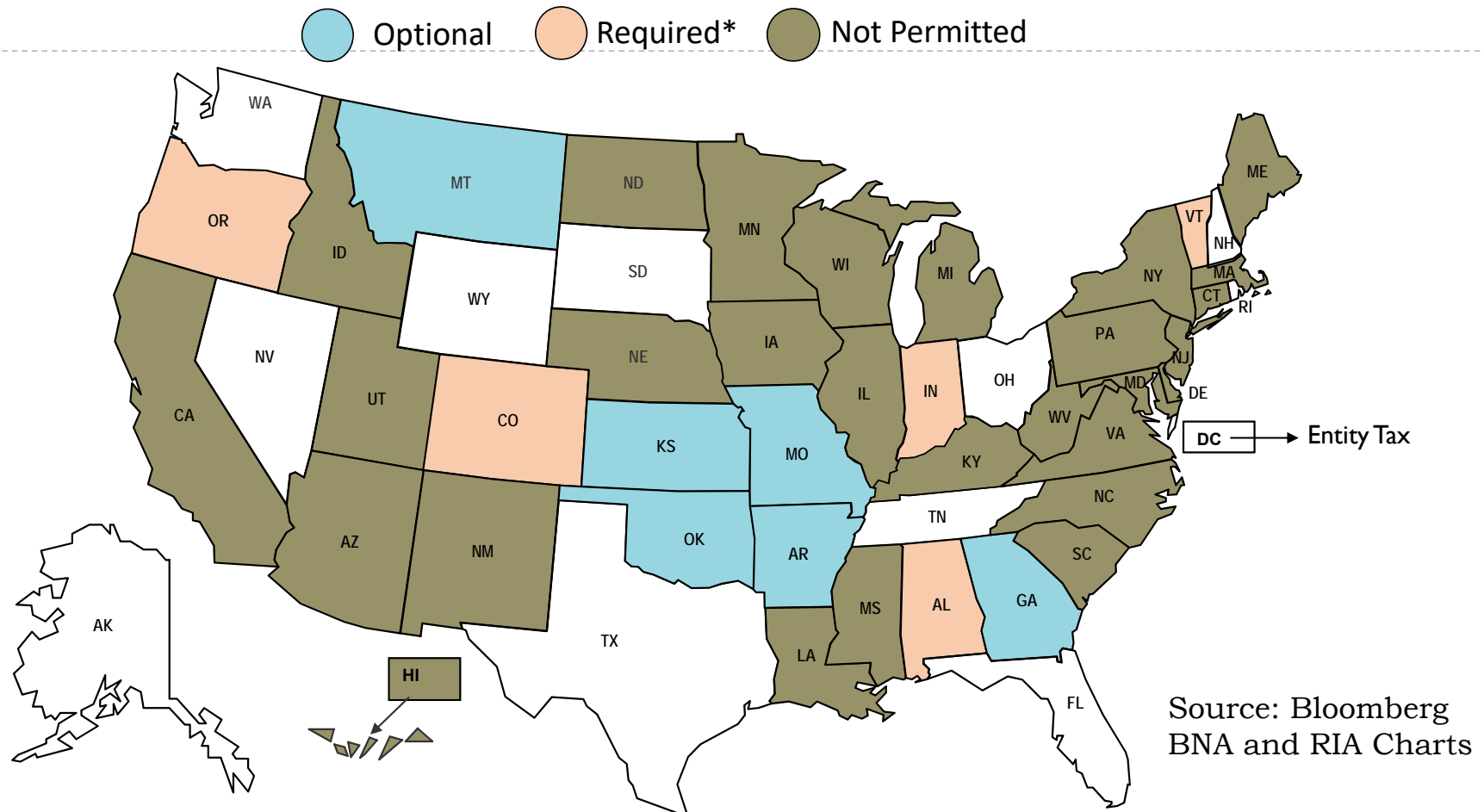
Composite Returns for Individuals

Optional Required Under Certain Circumstances Not Permitted



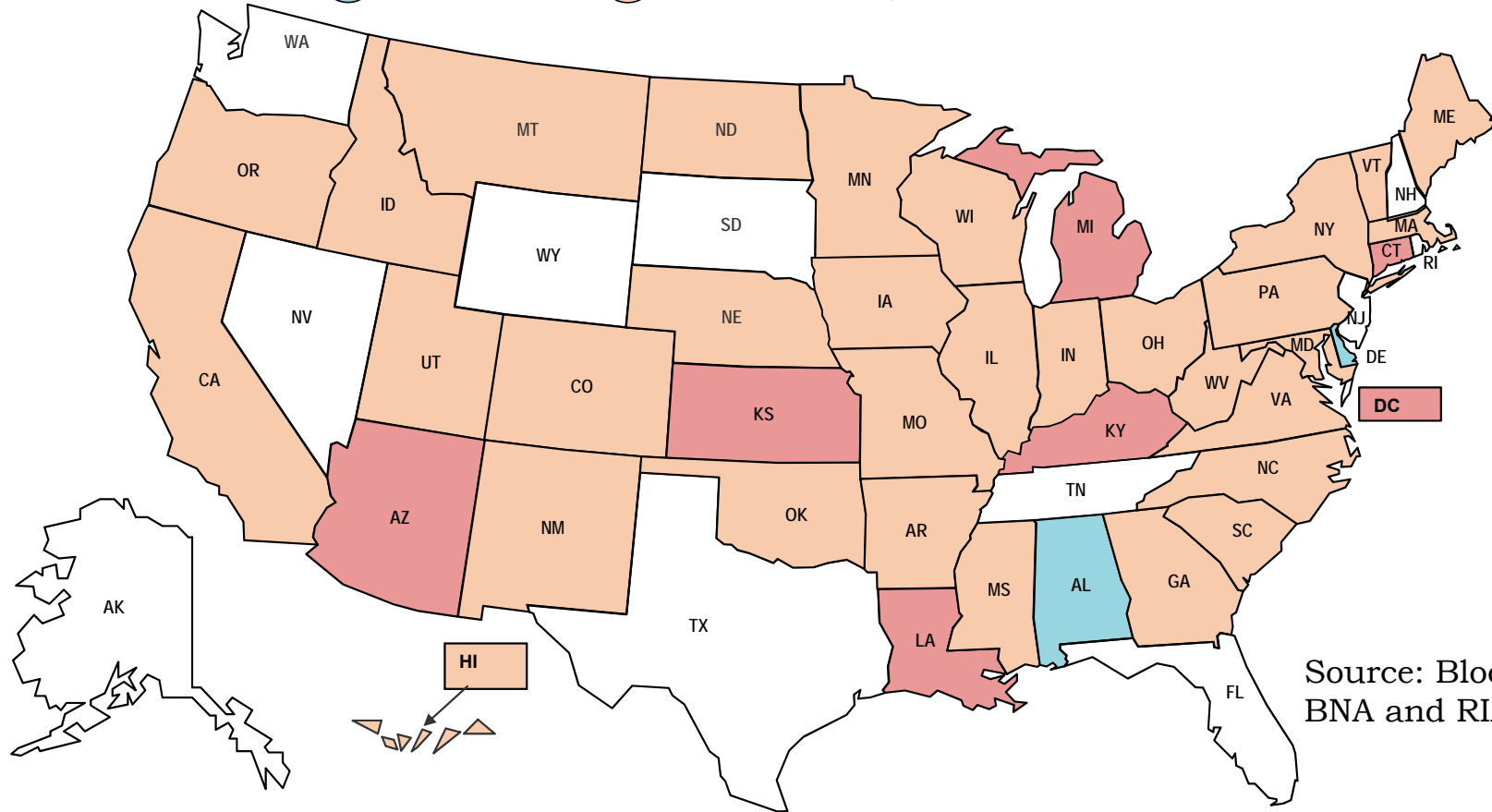
Source: Bloomberg
BNA and RIA Charts

Composite Returns for Corporations



Withholding for Individuals

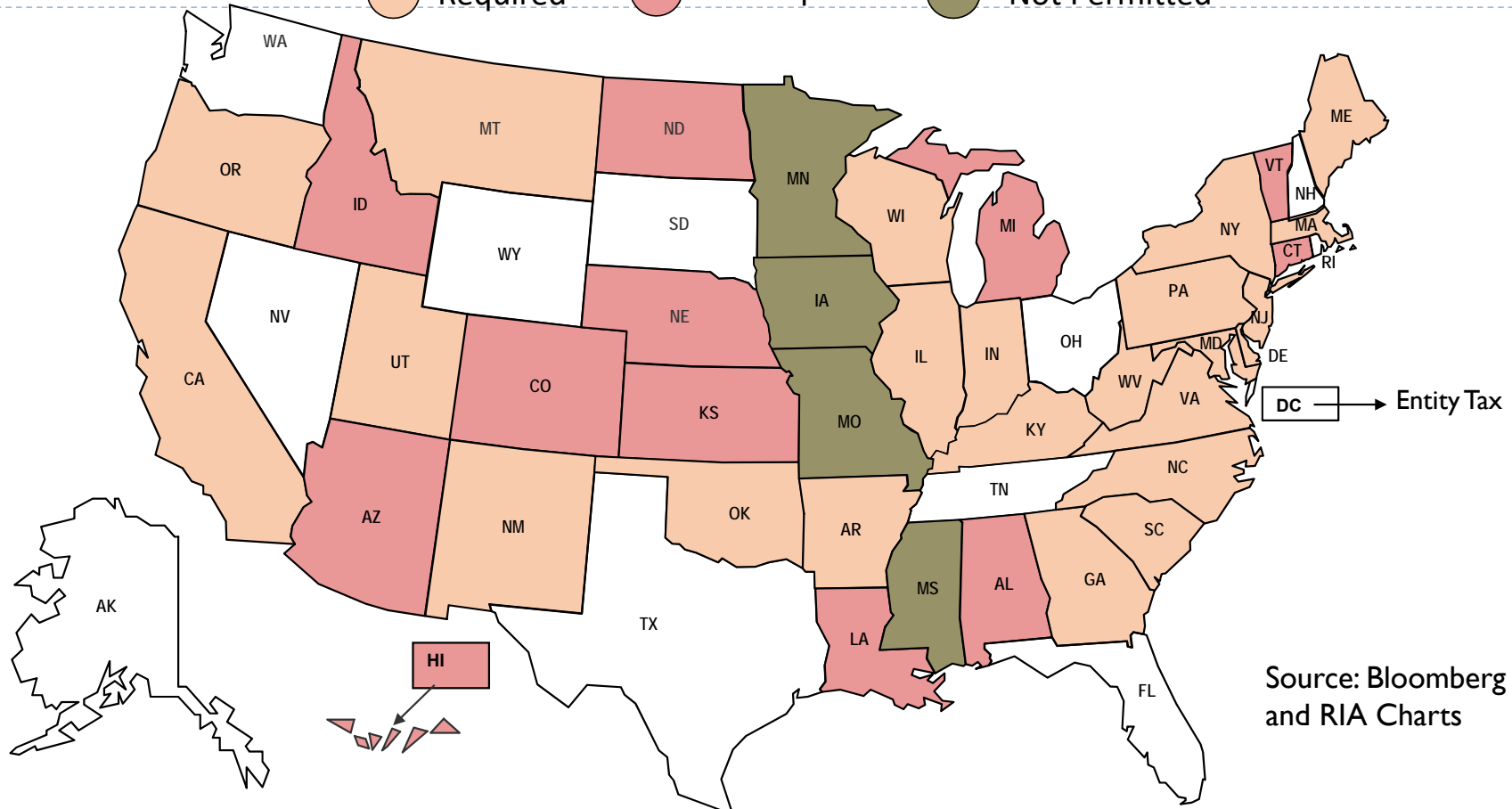
Optional Required* Not Required



Source: Bloomberg
BNA and RIA Charts

Withholding for Corporations

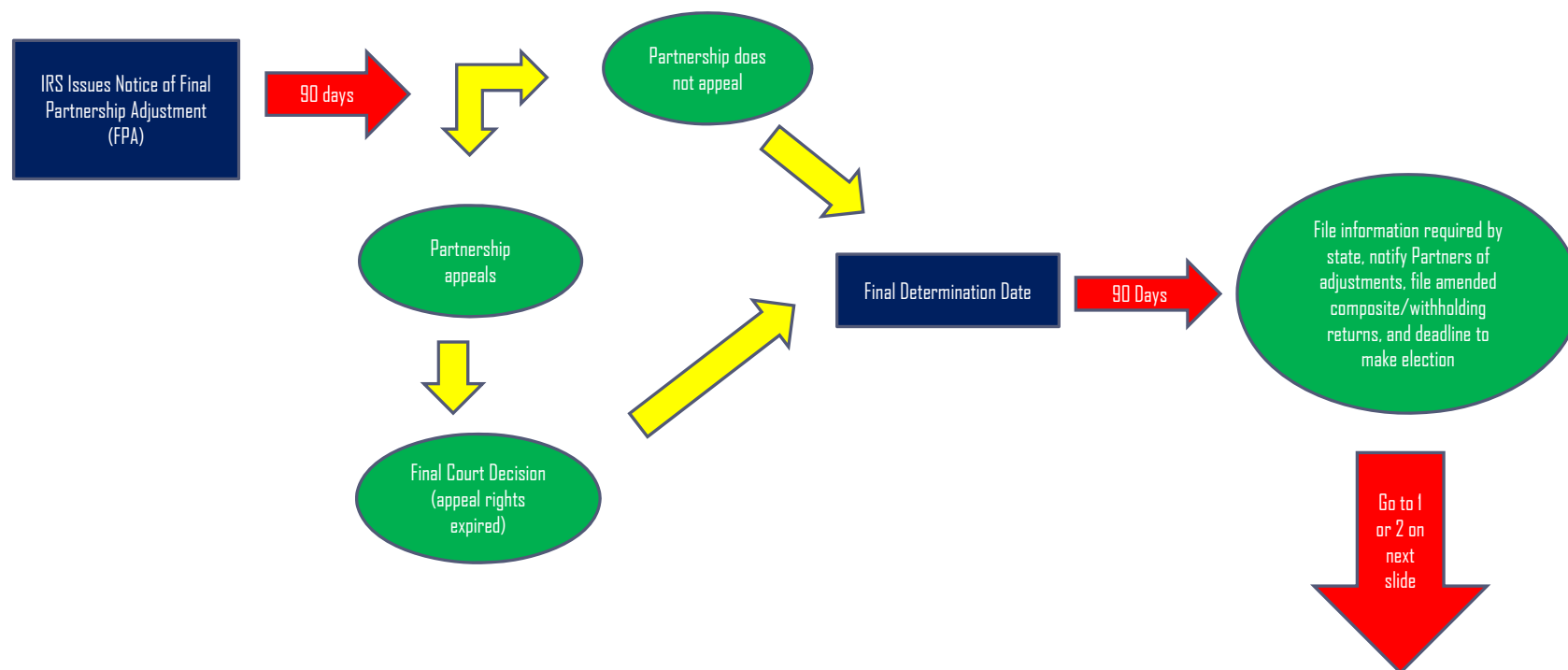
Required* Not Required Not Permitted



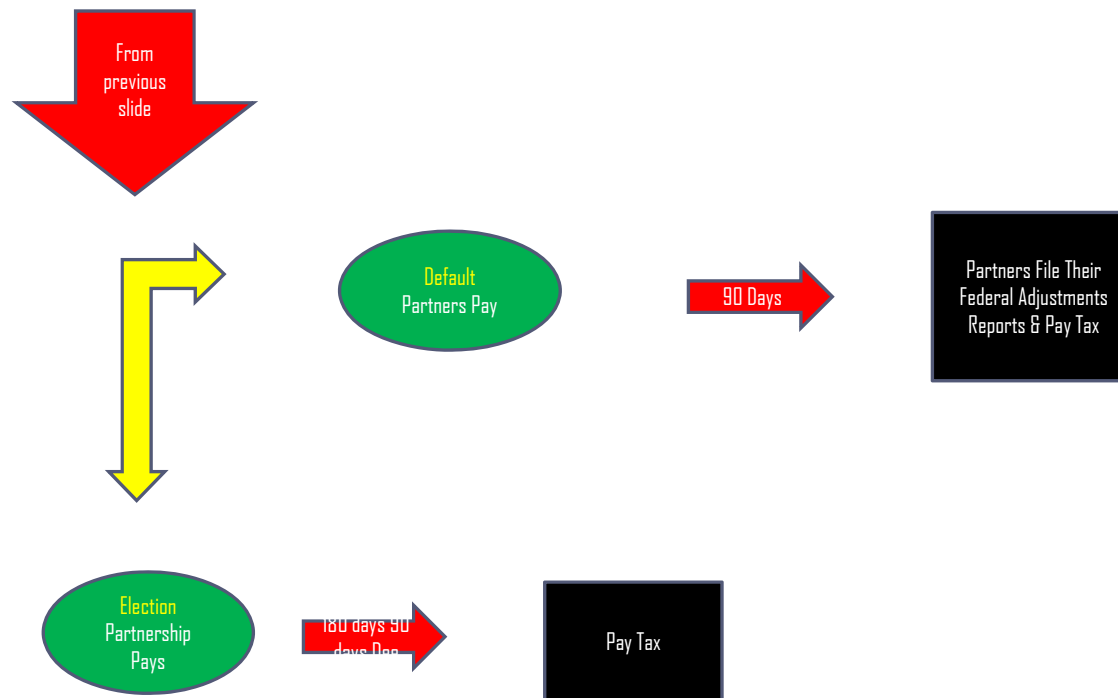
How It's Accomplished: Reporting Federal Adjustments for Partnership Level Audits – Election

- ▶ Alternatively, Audited Partnership can make an election to pay the tax for Reviewed Years
- ▶ Within 90 days of Final Determination Date the Audited Partnership shall:
 - ▶ File a Federal Adjustments Report; and
 - ▶ Notify the state of the election
- ▶ Within 180 days of Final Determination Date, the Audited Partnership shall:
 - ▶ Pay tax for its Direct Partners based on calculation prescribed in Draft Model Statute
- ▶ Tiered Partners – Also eligible to make the election but are not subject to the interim time restrictions – must finalize all elections, reporting, and payment of the tax within 90 days after the date of federal deadline for Tiered Partners
 - ▶ Federal deadline is extended due date of the Audited Partnership's return for the adjustment year

Flow Chart following Federal Partnership Audit Adjustment — Slide 1



Flow Chart following Federal Partnership Audit Adjustment – Slide 2



* For Composite Return Partners, Option I is used

Alternative Election by Mutual Agreement

- ▶ To address unique situations, the Model allows the Audited Partnership or Tiered Partners to enter into a mutual agreement with the [State Agency]
 - ▶ Can agree to use:
 - ▶ A different reporting method
 - ▶ A different payment method
 - ▶ Audited Partnership & Tiered Partners required to demonstrate requested method is reasonable

Comparison of Federal Process to Draft State Model

Federal Audit Reporting Process	Draft MTC State Model Process
Default – Partnership pays the tax using highest individual/corporate income tax rates	Default – Partnership notifies partners and partners pay the tax (composite/withholding filers still subject to partnership paying the tax)
Has option for partners to file amended returns to remit tax	Partnership can remit tax using partnership's apportionment/allocation rules with tax paid using highest individual/corporate income tax rates
Has option for partnership to “push-out” tax to review year partners to remit the tax when they file their tax return for the year IRS completes the audit (adjustment year)	No “push-out” option
Tiered Partners – must complete all filings by the extended due date of the Audited Partnership's return for the adjustment year	Subject to extension, Tiered Partners must complete all reporting and payments 90 days after the extended due date of the Audited Partnership's return for the adjustment year

Interested Parties' Major Changes from MTC's October 25, 2017 Draft

- ▶ **Significant reduction in the number of defined terms**
- ▶ **Streamlining of the process for Audited Partnership and Tiered Partners to make elections and pay the tax**
- ▶ **Add additional 60-day extension upon request of Audited Partnership or Tiered Partner that has over 10,000 Direct Partners (i.e., K-1 reports)**

Other Misc. Model Provisions: Assessments

Assessments of Additional State Tax, Interest, and Penalties Arising from an Adjustments to Federal Taxable Income

- ▶ An assessment must be issued within the later of one year or the expiration of the general limitations period where a taxpayer timely files a Federal Adjustments Report
- ▶ Otherwise the following statutes apply:
 - ▶ The expiration of the general limitations period
 - ▶ One year following the date the Federal Adjustments Report was filed
 - ▶ Six years following the Final Determination Date, absent fraud

Other Misc. Model Provisions: Estimated Payments

- ▶ **Estimated Payments** - Taxpayers should be allowed to make an estimated payments to a state during a pending IRS audit
 - ▶ State obtains tax faster
 - ▶ Stops the running of interest to the taxpayer
 - ▶ Does not require filing of any type of pro-forma amended return for a taxpayer to make an estimated payment
 - ▶ Some work may be needed with some of the Integrated Tax System Providers used by the states
 - ▶ Any overpaid tax would be subject to a refund (or credit)

Other Misc. Model Provisions

Model Statute:

- Clarifies the period in which a taxpayer may file a claim for refund and that a taxpayer's Federal Adjustment Report will serve as a claim for refund
- Provides that state adjustments shall be limited to the adjustments made by the IRS, unless a taxpayer and state taxing agency otherwise agree in writing
- Allows taxpayers and the state agency to agree in writing to extend the statute beyond periods otherwise provided
- Specifies that the states should provide a clear effective date when the changes apply

► Questions?

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INTERESTED PARTIES' VERSION – January 3, 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

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 Income¹].
- (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, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit remain to be finally determined, 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.

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

- (b) 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 for the entire group.
 - (c) If the Federal Adjustment results from filing an amended federal return, a federal refund claim, or an Administrative Adjustment Request, the Final Determination Date means the day on which the amended return, refund claim, or Administrative Adjustment Request was filed.
- (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.²
 - (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 that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Reallocation Adjustment means a Reallocation Adjustment that would increase state taxable income for Direct Partners, and a negative Reallocation Adjustment means a Reallocation Adjustment that would decrease state taxable income for Direct Partners.
 - (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

² 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.”

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 512.³

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 Final Federal Adjustments arising from an audit 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:

(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.

(b) **Option to Request a Federal Adjustments Report.** In the event the Taxpayer provides the [State Agency] with notice that the 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 Taxpayer no later than 90 days after the date on which the Taxpayer filed the notice with the [State Agency].

(c) **Filing of Requested Federal Adjustments Report.** In the event the [State Agency] requests a Federal Adjustments Report within the time prescribed in subsection 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.

(d) **State Tax Liability.** [Option 1] If the Taxpayer reported that it would have owed the State a de minimis [State] tax liability or was entitled to a de minimis [State] tax refund, and the [State Agency] does not request that the Taxpayer file a Federal Adjustments Report within

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

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 or refunded.

[Option 2] If the Taxpayer reported that it would have owed the State a de minimis [State] tax liability 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.

- (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

(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, 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 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:

- (a) The Audited Partnership shall, no later than 90 days after the Final Determination Date,
 - (i) file a completed Federal Adjustment Report, including partner level information as required under [reference to State law] with [State Agency]; and
 - (ii) notify each of its Direct Partners of their distributive share of the adjustments; and
 - (iii) 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] shall:
 - (i) file a Federal Adjustment Report reporting their distributive share of the adjustments reported to them under subparagraph (a)(ii) of subsection (2) as required under [reference to State Laws]; and
 - (ii) 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 subsection (2).
- (3) **Election – Partnership Pays.** If an Audited Partnership makes an election under this subsection, it shall:
 - (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;
 - (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:
 - (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 under Section B reporting such distributive share and paid any additional [State] tax liability due;
 - (iii) Allocate and apportion at the Partnership level 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;
 - (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, 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).

(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)⁴].

(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.

(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, will be treated as paid in lieu of taxes owed by its Direct Partners 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 to another state or local tax jurisdiction.

(7) **Failure of Audited Partnership or Tiered Partner to Report or Pay.** Nothing in this Section C is intended to prevent the [State Agency] from assessing Direct Partners or Indirect Partners for taxes they owe 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.

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

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

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] of the [State] tax that it determines may ultimately be owed to [State] as a result of 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 (1) 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:

- (1) 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 (1) 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, 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 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 [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.*