



TAX EXECUTIVES INSTITUTE, INC.

State and Local Tax Policy Statement Regarding State Implementation of the Federal Partnership Audit Rules

Tax Executives Institute maintains that consistency among state rules, as well as ease of reporting, is essential to the efficient implementation of the Bipartisan Budget Act of 2015's federal partnership audit rules at the state level.

Partnerships subject to partnership-level audits under the Bipartisan Budget Act of 2015 should have the right to appoint state partnership representative(s) that differ from the federal partnership representative and varies by State.

Imputed underpayments and overpayments arising from partnership level audits should be allocated among the partners as specified in the partnership agreement in effect for the reviewed year¹ and using the reviewed year's apportionment data, as adjusted.

Reporting partnership level audit adjustments to States shall be triggered by a final determination, which shall occur when all adjustments made by the IRS to the federal taxable income of the partnership have become final and all appeal rights under the IRC are exhausted or have been waived for the partnership's taxable year.

With the exception of composite return filers, the state partnership representative shall have the option to pay the tax at the partnership level or push out the state tax due, regardless of whether the partnership paid the tax or pushed out the tax at the federal level. Rights to overpaid taxes shall be claimed by the reviewed year's partners.

In 2015, Congress passed the Bipartisan Budget Act of 2015 (BBA), which adopted a new federal centralized partnership audit regime and is scheduled to become effective for taxable years beginning after December 31, 2017. Since its enactment, Congress has considered a technical corrections bill and Treasury released proposed regulations to provide taxpayers and the Internal Revenue Service (IRS) with guidance regarding the operation of the new federal partnership audit rules.

The new federal partnership rules, which allow the IRS to audit and assess partnerships at the partnership level, have important implications for the manner in which partnerships and their partners report federal adjustments and pay taxes to the States. The Multistate Tax Commission thus formed the Partnership Project to address whether new state statutes are needed, what States should be doing to audit

¹ Tax year of the partnership that is subject to audit.

and track partnership income, whether withholding statutes are effective for multiple-tiered entities, and how old statutes will intersect with entity-level liability.

Stakeholders such as TEI, the American Bar Association's SALT Committee, the Council on State Taxation, the American Institute of CPAs, and Institute for Professionals in Taxation have created a working group to participate in the MTC's Partnership Project, monitor proposed state legislation, and propose a model statute for reporting federal adjustments. The working group recognizes that consistency among state rules, as well as ease of reporting, is essential to the efficient implementation of the federal partnership audit rules at the state level.

This policy statement summarizes the federal partnership audit rules for context and outlines TEI's position with respect to such legislation at the state level.²

Summary of the BBA's Federal Partnership Audit Rules

Partnerships that do not elect out of the BBA's federal partnership audit rules will be audited at the partnership level. Partnerships that have an imputed underpayment arising from such audits have the option to pay assessment at the partnership level or push the assessment out their partners for payment.

Partnerships that pay imputed underpayments at the partnership level pay the tax on their current year return and will be subject to the highest federal tax rate. If the partnership pays the assessment, the adjustment year³ partners bear the liability. However, the partnership's imputed underpayment can be reduced if the reviewed year partners file amended returns and pay the tax or demonstrate that they are subject to a lower rate of tax or exempt from tax. Partnerships paying imputed underpayments recognize the change in the adjustment year. If the partnership pushes the imputed underpayments out to the partners, the reviewed year partners must increase their taxes in the adjustment year based on "as if amended" formula for the reviewed year through the current year.

The BBA also requires partnerships to designate a partnership representative who has sole authority to act on behalf the partnership with the IRS. The partnership and its partners are bound by the partnership representative's actions and decisions.

Proposed State Provisions

- The federal partnership representative shall serve as the state partnership representative unless the federal partnership representative delegates such

² This policy statement supplements TEI's policy statement regarding the Reporting of Federal Income Tax Adjustments, which TEI adopted in November 2015 and updated in January 2017. That policy statement outlines TEI's position regarding the timing, triggers, method for reporting federal adjustments to states generally, and identifies other provisions that would be useful to taxpayers and States.

³ Tax year in which the adjustments to the partnership's income become final.

authority to another person. The partnership may designate different persons as state partnership representatives for different States. Such delegation shall be made in writing and will be deemed accepted unless a state agency disapproves the designation for reasonable cause.

- Each partner's share of under or over-reported taxable income shall be determined as specified in the partnership agreement in effect for the taxable year subject to audit.
- The share of the partnership's income apportionable to the State shall be based upon the reviewed year's apportionment data, as adjusted by the federal audit.
- The partnership's final determination shall occur when all adjustments made by the IRS to the federal taxable income of the partnership have become final and all appeal rights under the IRC are exhausted or have been waived for the partnership's taxable year.
- The state partnership representative shall be provided at least 60 days from the date of the partnership's final determination to file a federal adjustments report with the State and make an election for all partners that are not composite return partners to pay the tax due at the partnership level, push out the state tax liability to the reviewed year partners, or a combination thereof, regardless of whether the partnership paid or pushed out the tax at the federal level.
 - Option 1: The state partnership representative opts to pay the state imputed underpayment on behalf of all partners. The state partnership representative shall be provided at least 180 days from the date of the partnership's final determination to file a schedule indicating each partner's apportioned share with the state. The tax shall be calculated at the highest rate of tax attributable to individuals for individuals, S-Corporations, trusts, estates, disregarded entities not owned by C-Corporations, and partnerships; the highest rate of tax attributable to corporations for C-corporations and entities owned by C-corporations; and a zero rate of tax for tax-exempt or nontaxable partners.
 - Option 2: The state partnership representative opts to push out the state tax liability to the reviewed year partners. The state partnership representative shall be provided at least 90 days from the partnership's final determination to mail amended K-1s to all partners and file a schedule with the state agency indicating each partners' apportioned share with the State. The partners shall be provided at least 180 days from the date of the partnership's final determination date to file a federal adjustments report and pay the tax to the State.
 - Option 3: The state partnership representative opts to pay the state imputed underpayment on behalf of all non-resident partners and push out the state tax liability to all resident partners. The state

partnership representative shall be provided at least 90 days from the partnership's final determination to mail amended K-1s to all resident partners. The state partnership representative shall be provided at least 120 days from the date of the partnership's final determination to file a schedule indicating each partners' apportioned share and pay the non-resident partners' tax. The tax attributable to non-resident partners shall be calculated in accordance with the method outlined in Option 1. The resident partners shall be provided at least 180 days from the date of the partnership's final determination to file a federal adjustments report and pay their tax to the State.

- The partnership shall pay the imputed underpayment of state tax on behalf of all composite return partners pursuant to Option 1, regardless of the election made.
- If the partnership does not have an imputed underpayment or the partnership has been dissolved or becomes insolvent, the state partnership representative shall follow the method prescribed in Option 2.
- Tiered partnership structures receiving amended K-1s shall file partnership adjustment tracking report with State and have the option to pay tax at the partnership level in accordance with the method outlined in Option 1 or furnish amended K-1s to its partners as outlined in Option 2. Such partnership shall be provided at least 60 days, but no later than the extended due date for the partnership's federal tax return that includes the audited partnership's final determination date, from receiving their amended K-1 to file such reports.

Approved: June 13, 2017