
SEATA 2018

Recent Developments for Partnerships & Pass-Through Entities

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Overview

▶ Part I

- ▶ Connecticut Unincorporated Business Tax
- ▶ New York State Unincorporated Business Tax Draft
- ▶ Additional Updates

▶ Part II

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

▶ Part III

- ▶ Proposed Model Legislation and Recent Developments

▶ Questions

▶ Connecticut Unincorporated Business Tax

Connecticut Unincorporated Business Tax

Applicable to tax years beginning on or after January 1, 2018, CT requires an 'affected business entity' to pay an entity level tax at the rate of 6.99%.

▶ Tax Base

- ▶ Federal income derived from or connected to in-state sources, as increased or decreased by certain modifications that relate to an item of the entity's income, gain, loss, or deduction, to the extent derived from or connected to in-state sources.
- ▶ If the amount calculated results in a net loss, such net loss may be carried forward to succeeding taxable years until fully used.
- ▶ An affected business entity may elect an alternative basis to compute the tax, under which the 6.99% rate is applied to the 'resident portion of unsourced income' plus 'modified Connecticut source income.'

▶ Combined election

- ▶ An affected business entity may elect to file a combined return with one or more commonly owned (based on an 80% ownership threshold) affected business entities subject to the new tax.
- ▶ The election must be made in writing by the extended due date of the return, and must include a consent for all included entities.

Connecticut Unincorporated Business Tax

▶ Offsetting Credit

▶ Individual Members -

- ▶ Allowed a Connecticut personal income tax credit equal to 93.01% of the pro rata share of tax paid by the entity
- ▶ If the credit exceeds the member's Connecticut tax, the excess generally is refundable for individual taxpayers.

▶ Corporate Members -

- ▶ A credit is available to those subject to tax under Chapter 208 of an affected business entity.
- ▶ Such credit is applied after all other credits are applied, and is not limited to 50.01% of the Corporation Business Tax liability as are other credits under Conn. Gen. Stat. Sec. 12-217zz.
- ▶ If the credit exceeds the tax, the credit shall be carried forward to each of the succeeding income years until such credit is fully taken.
- ▶ There appears to be no modifications for entities that file under Chapter 207 of the Connecticut Code (insurance companies and health care centers).

Connecticut Unincorporated Business Tax

▶ Nonresident filing obligations

- ▶ Nonresident members of an affected business entity generally are not required if
 - ▶ The pass-through business is the only source of Connecticut income for the member or the member's spouse *and*
 - ▶ The pass-through business has paid the entity tax.
- ▶ However, nonresidents must file a return
 - ▶ if the entity files on a combined basis and the individual's personal income tax liability would not be fully satisfied by the credit
 - ▶ Prior to the Act, a pass-through business generally was required to file an income tax return and pay the tax on behalf of any nonresident member for whom the business is the only source of Connecticut income. For taxable years beginning on or after January 1, 2018, the Act eliminates these requirements.

- ▶ New York State Unincorporated Business Tax Draft

NYS Unincorporated Business Tax Draft

May 2018 - proposed discussion draft of a new unincorporated business tax on partnerships with an offset credit at the partner level beginning 1/1/19.

- ▶ Unincorporated business net income would be the sum of:
 - ▶ Federal ordinary business income (under IRC Section 702(a)(8)) as applied to the partnership under IRC Section 702;
 - ▶ Taxes paid or incurred during the taxable year under this new UBT by the affected partnership to the extent deducted in computing federal ordinary income; and
 - ▶ Guaranteed payments paid by the affected partnership to its partners under IRC Section 707(c).

- ▶ Unincorporated business taxable income would be the sum of:
 - ▶ Unincorporated business net income or loss (excluding the affected partnerships' distributive share of any such amounts from a lower-tier partnership), allocated to New York; and
 - ▶ Any unincorporated business net income of a lower-tier partnership to the extent it was sourced to New York by such lower-tier partnership.

- ▶ Apportionment Factor - average of a property, payroll and gross income percentage.

NYS Unincorporated Business Tax Draft

▶ *Offsetting credit*

- ▶ Corporate and individual partners of an affected partnership paying the tax would be allowed a credit against their liabilities.
- ▶ The credit would equal the product of (1) the taxpayer's ownership percentage of the affected partnership; (2) 93%; and (3) the greater of: the UBT of the affected partnership; or the unincorporated business credit of the affected partnership
- ▶ Additionally, an affected partnership that is a partner in a lower-tier partnership would be allowed a credit the greater of:
 - ▶ (1) the UBT of the lower-tier partnership; or
 - ▶ (2) the unincorporated business credit calculated by the lower-tier partnership.
- ▶ If an affected partnership has a direct ownership interest in more than one lower-tier partnership, the unincorporated business credit would be the sum of the credits as calculated above with regard to each lower-tier partnership in which the affected partnership has a direct ownership interest.

NYS Unincorporated Business Tax Draft

- ▶ *Other provisions*
 - ▶ Four estimated tax payments annually, on the 15th of March, June, September and December
 - ▶ Annual UBT returns on the 15th day of the 3rd month following the close of the tax year
 - ▶ The affected partnership to provide its partners with a report detailing
 - ▶ the unincorporated business net income of the affected partnership;
 - ▶ the unincorporated business taxable income of the affected partnership;
 - ▶ the UBT imposed on the affected partnership; and
 - ▶ the total unincorporated business credit calculated by the affected partnership

The Department released the draft of the UBT to provide “interested parties with the opportunity to provide feedback on both the general concept of a statewide UBT and the specific design and implementation details of such a tax.” Comments are due July 16, 2018

NYS Unincorporated Business Tax Draft

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▶ Additional Legislative Updates

Additional Legislative Updates

- ▶ **TN Single Sales Factor For Asset Managers**
 - ▶ On April 9, Tennessee Governor Bill Haslam (R) signed into law Senate Bill 2256 (the legislation), which provides a single sales factor apportionment election for 'Financial Asset Management Companies' doing business in Tennessee for both excise and franchise tax purposes.
 - ▶ The election must be made with an originally filed return and will remain in effect for a minimum of five years. Upon revoking an election, a new election may not be made for the next five years beginning with the tax year in which the election was revoked.
 - ▶ According to a report issued by the Tennessee General Assembly Fiscal Review Committee, there currently are no financial asset management companies located in Tennessee and the legislation is intended to promote such companies to move to the state.

Additional Legislative Updates

- ▶ **California - proposes to amend entity classification rules**
 - ▶ Pursuant to California Revenue and Taxation Code (CRTC) section 23038, classification of a business entity is determined under regulations issued by the Franchise Tax Board (FTB) and conforms to the federal regulations as of January 1, 1997.
 - ▶ However, the IRS has amended the federal regulations multiple times since 1997.
 - ▶ On September 14, 2014, California enacted AB 1143, which amended CRTC section 23038 by requiring the business entity classification regulations issued by the FTB to be consistent with the federal regulations as in effect May 1, 2014.
 - ▶ California's proposed regulations are intended to comply with this regulation and make California regulations consistent with the federal regulations as of May 1, 2014.
 - ▶ Proposed CCR section 23038(b)-4 would be a reserved section to mirror the federal regulation numbering, and proposed CCR section 23038(b)-5 would clarify the definitions of a corporation and a domestic entity in circumstances where the business entity is considered to be created or organized in more than one jurisdiction.
 - ▶ Note that since the May 1, 2014 conformity date in AB 1143 is a static date, there is still a conformity lag as California does not conform to federal amendments made subsequent to 2014.
 - ▶ Effective dates for specific amendments are stated in the regulation and are intended to be consistent with the federal effective dates.

Additional Legislative Updates

▶ Illinois – Personal Property Replacement Tax Rate Increase

- ▶ HB 4798 (Welch), introduced in February, would amend the Illinois Personal Property Replacement Tax to increase rates from 1.5% to 7.5% for partnerships and trusts. The corporate rate remains unchanged. This Bill will also remove the exemption for investment partnerships from the tax and subjects limited liability companies to the tax which presumably is targeting DREs owned by individuals.
- ▶ The Bill is currently still in the House and didn't move forward before the House session end on May 31.

▶ Texas - Single Member LLCs

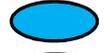
- ▶ PLR 1/8/2018 – guidance on “affiliated entities for purposes of the intercorporate services exemption

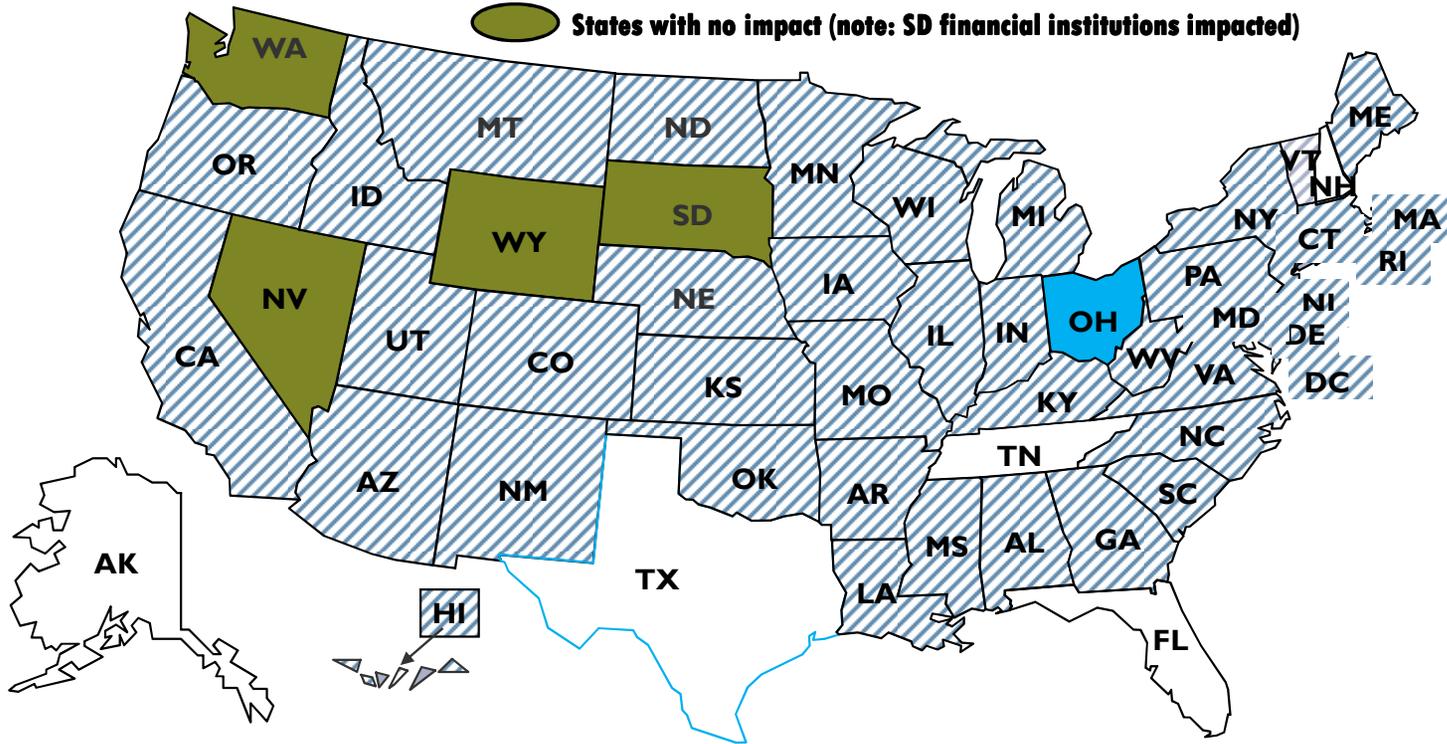
Additional Legislative Updates

- ▶ Sale of Partnership/LLC Interest by nonresident
 - ▶ New York State
 - ▶ A nonresident is a partner in a partnership where a sale or transfer of the membership interest of the partner is subject to IRC §1060, any gain recognized federally from the transaction is treated as New York source income allocated as otherwise provided for by state law in the year of the sale or transfer. This amendment takes immediate effect.
 - ▶ Colorado
 - ▶ Gain from the sale of an interest in an LLC is not sourced to Colorado (the state of the taxpayer's commercial domicile) because such sourcing would not fairly represent the taxpayer's activity in Colorado.
 - ▶ Ohio
 - ▶ Updated its guidance on partnership's apportionment of a gain from the sale of a closely-held business (R.C. 5747.212) after the Court found the special rules for apportioning such gain was unconstitutional, *Corrigan v. Testa*
 - ▶ Idaho
 - ▶ Tax Commission finds gain on the sale of partnership interest to be business income and subject to the standard apportionment. However, the Commission did allow for the use of an alternative apportionment method based on the facts presented.

- ▶ Changes to Partnership Audit Rules: The Centralized Partnership Audit Regime

States Impacted by the Change

-  States imposing both a corp. income & personal income taxes
-  States only imposing a corp. tax or other impacted tax (note: NH imposes the BPT; TX imposes the Margin Tax; NH & TN tax interest and dividends for individuals)
-  States with impact limited to personal income tax
-  States with no impact (note: SD financial institutions impacted)



Partnership Audit Rules Background

- ▶ The Bipartisan Budget Act of 2015 Adopted New IRS Audit Procedures for Partnerships and Multi-Member LLCs
 - ▶ HR 1314 (P.L. 114-74) enacted in 2015
 - ▶ Projected \$9.3 Billion revenue-raiser (federal alone)
- ▶ Consolidated Appropriations Act of 2018, HR 1625 (P.L. 115-141), enacted in March 2018, made several useful technical corrections and added a unique new “pull-in procedure” described later in these slides.
- ▶ The New Audit Rules For Taxable Years Beginning After December 31, 2017
 - ▶ Option to elect into the new rules for earlier years (few did so)
- ▶ Expected to raise additional tax revenue by enabling the IRS to more efficiently audit “large” 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 Partnership Audit Regime Overview

- ▶ **Centralized Partnership Audit Regime (CPAR) Applies to All Subchapter K Entities**
 - ▶ All Partnership and Operating Agreements for entities taxed as a partnership (including most JV's) 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: opt-out and 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 Partnership 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 (more later)
 - ▶ 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 LTCG or qualified dividends, i.e., with a lower max. tax rate than the highest marginal rate (37% in 2018); or
 - ▶ Partnership makes new “pull-in” election and enlists the help of its accounting firm.
 - ▶ 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 Partnership Audit Regime

- ▶ “Small” Partnerships May Opt-Out of Centralized Partnership Audit Regime (Section 6221)
 - ▶ P’ships and their partners that opt-out are subject to pre-TEFRA rules for p’ship audits
- ▶ Criteria
 - ▶ 100 or Fewer K-Is: P’ship must have fewer than 100 partners all of whom must be “eligible”;
 - ▶ Eligible Partners: Partners must be individuals, C or S corporations, and/or estates of deceased partners; and
 - ▶ 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
 - ▶ Partnership Makes Annual Election: the partnership must make a “Section 6221 election” on its timely-filed federal tax return for the opt-out year
 - ▶ Notice to All Partners: P’ship must timely notify all partners of the election to opt-out

Centralized Partnership Audit Regime Timeline

If Partnership fails to timely 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 Partnership Audit Regime Timeline (cont.)

4. After 270 days, the IRS sends its Notice of Final Proposed Adjustments (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 brings with it increased interest rate (by 2 percent) on imputed underpayment
6. OR, within 90 days of receiving the FPA, the partnership may file a petition for readjustment with the U.S. Tax Court, appropriate U.S. district court, 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” (e.g., an amended return)

- ▶ Background: State Reporting of Federal Audit Adjustments

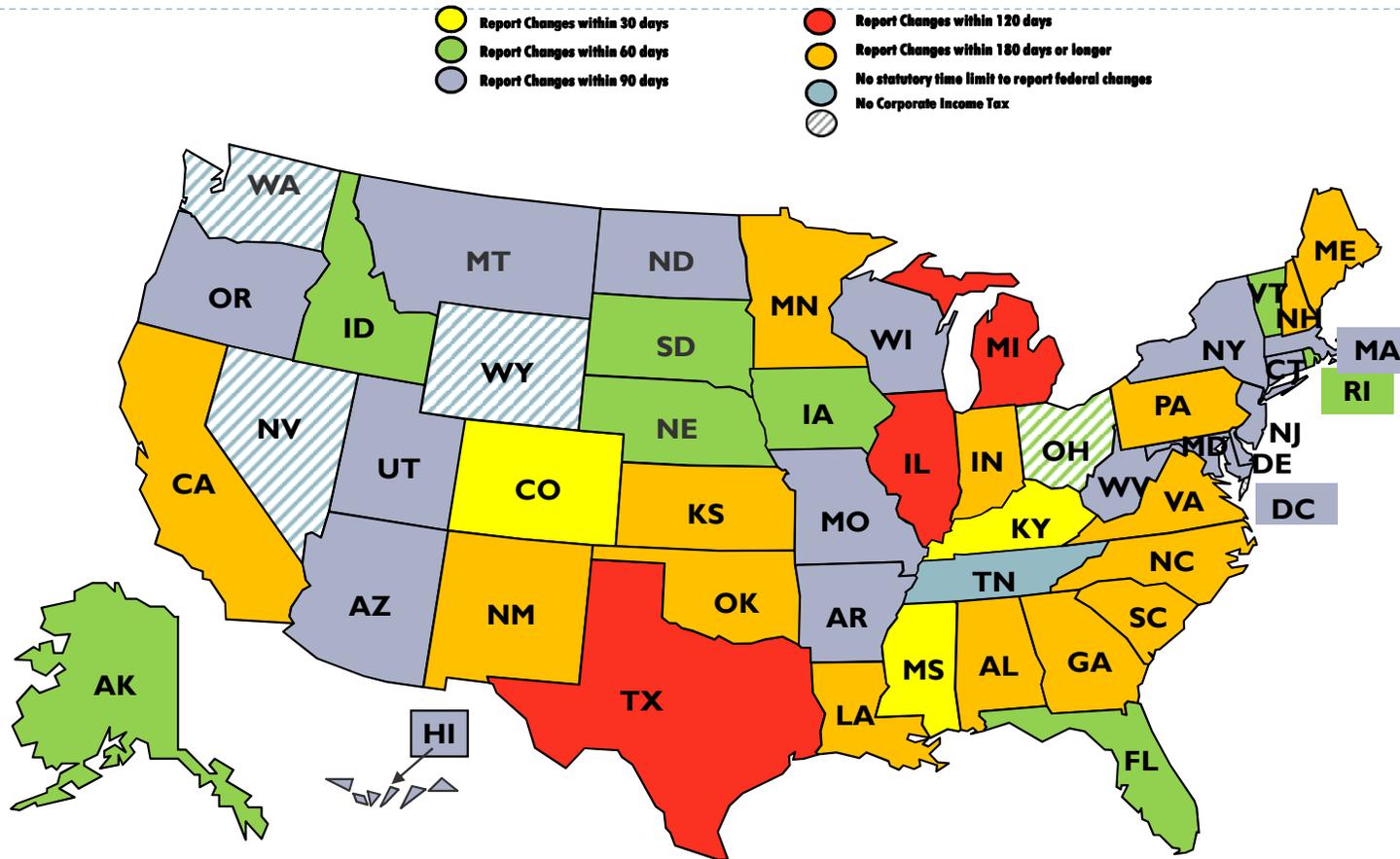
Reporting Federal Audit Adjustments: Background

- ▶ States typically use federal taxable income, and other federally determined amounts, for computing state taxable income—so if a taxpayer underreports federal taxable income, the taxpayer will likely also owe additional state tax
- ▶ This allows states to benefit from federal audit efforts
- ▶ 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 tax credit adjustments)

Reporting Federal Audit Adjustments: Background

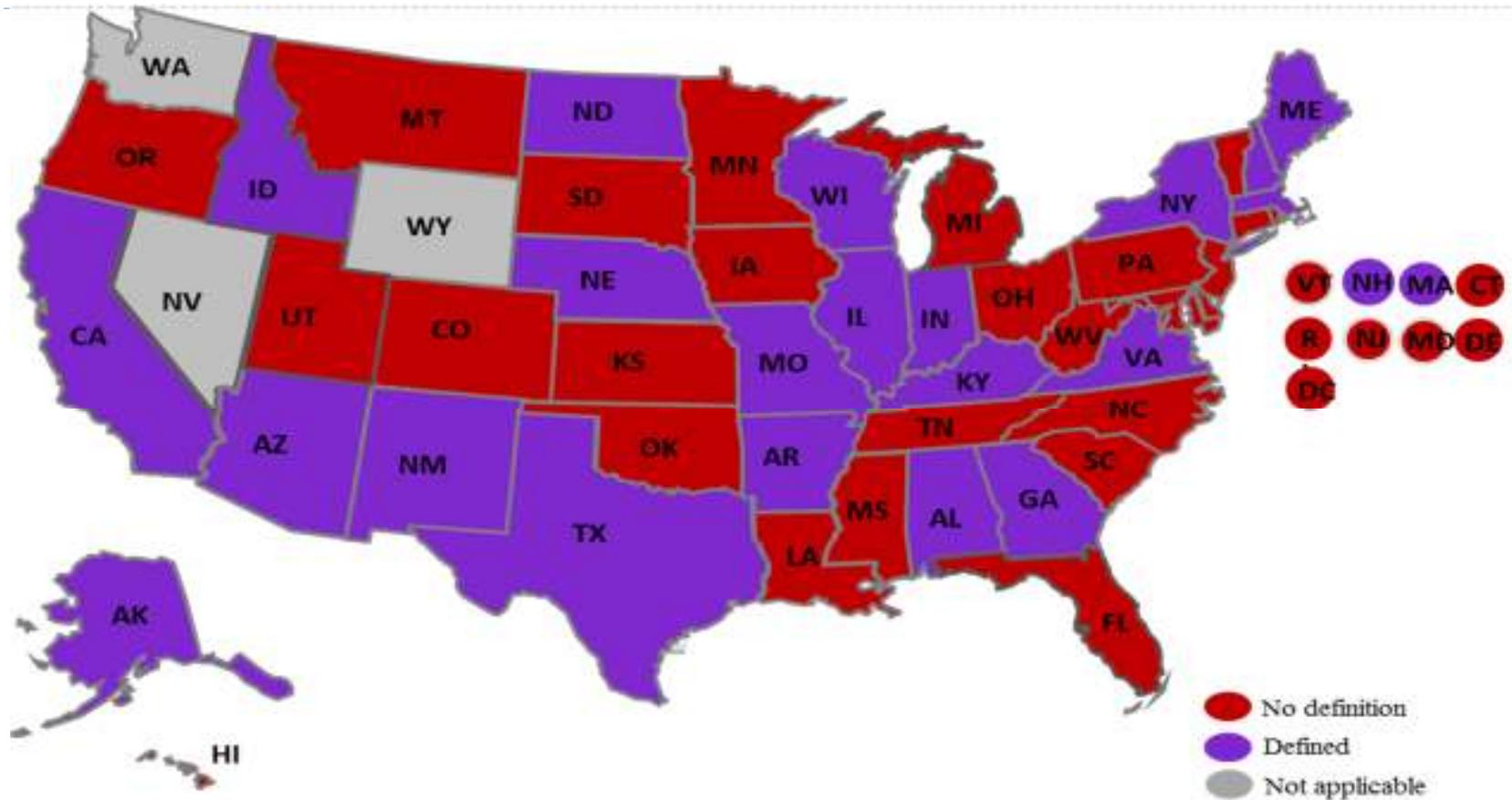
- ▶ Multistate Tax Commission currently has a Model Statute for states on how to report federal audit adjustments
- ▶ Model Statute Details
 - ▶ Model Statute adopted in 2003 when all states already had some type of reporting requirement in place
 - ▶ No state has fully adopted the Model Statute
 - ▶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

When Do Taxpayers Have to File

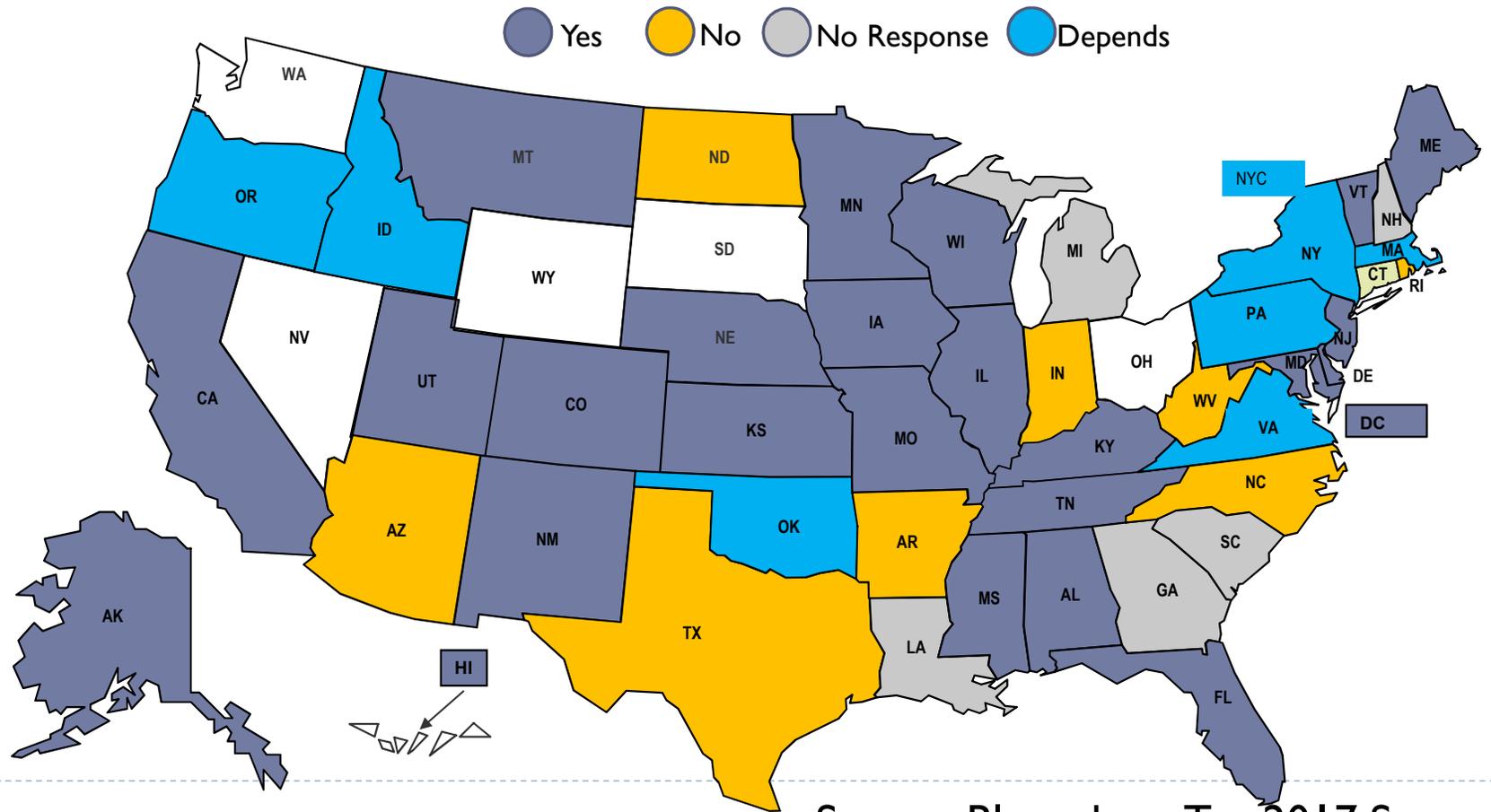


Notes
 CA: Within 6 months
 IA: 60 days for payment, 180 days for refund
 NH: Within 6 months
 NY: 120 days for combined reports
 OH: No state CIT; post-TY 2015, 60 days for amended municipal income tax returns
 OK: Within one year
 OR: 60 days if Portland/Multnomah County
 PA: Within 6 months (Tax Years pre-2013, 30 days)
 VA: Within one year.

States with Definition of a “Final Determination”



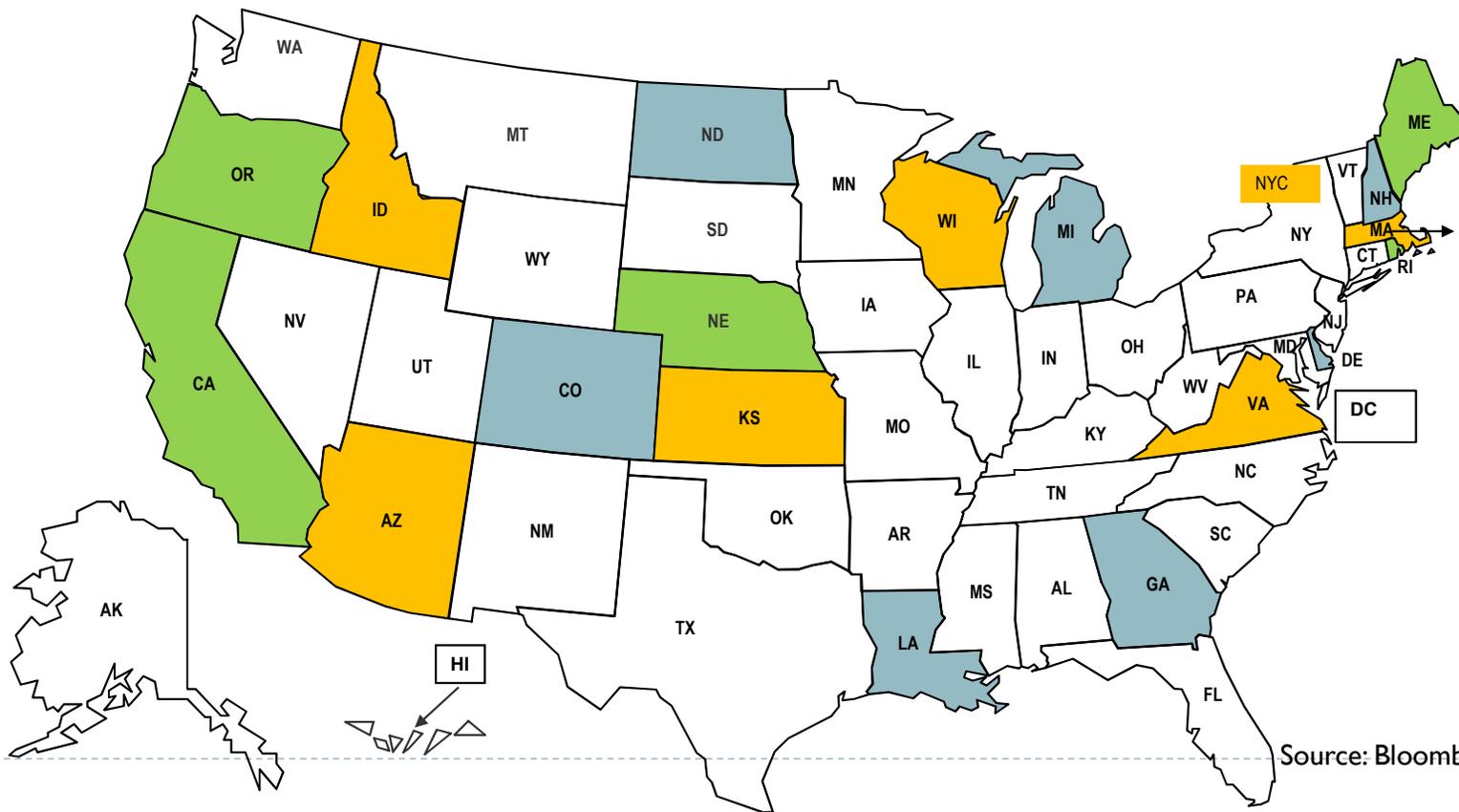
States That Require Filing/Payment Based on Partial Settlement



Source: Bloomberg Tax 2017 Survey

States That Require Filing Based on Other State and Local Tax Agency Adjustment

- No Response
- States that require filing based on other state AND local tax agency adjustment
- States that require filing based on other state tax agency adjustment



Source: Bloomberg Tax 2017 Survey

Reporting Federal Audit Adjustments: Background

- ▶ Taxpayer groups (a/k/a “Interested Parties”) 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

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” during IRS audit
 - ▶ 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 partnership 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

State Effects – Apportionment

- ▶ At the federal level, the IRS can impose tax on 100 percent of any adjustment. For state purposes, that adjustment needs to be apportioned and/or allocated if the partnership is operating or doing business in multiple states.
 - ▶ Many states use different apportionment rules for partnerships that are part of a unitary business
- ▶ If the partnership pays, the payment is being made on behalf of its partners.
 - ▶ Can the partnership's apportionment factor be used as a general rule?
 - ▶ How do resident individual partners calculate their credits for taxes paid to other states?
 - ▶ Does that credit apply if the partnership paid the tax in another state?
 - ▶ Can a partnership seeking to pay the tax on behalf of its direct and indirect partners be forced to know (and certify ?) the residency status of its indirect partners?

State Effects – Nexus Considerations

- ▶ At the federal level, the IRS has jurisdiction to collect tax from all partnerships and partners. States, however, may only impose and collect tax on taxpayers with nexus (pesky Constitution!).
 - ▶ Should/can the new audit rules expand the state's ability to impose and collect tax from out-of-state partners?
 - ▶ Nexus can vary year by year – partnership activity in state can change along with partners' residency status in a state
- ▶ Example: Nevada partnership with five partners—four are California individual residents and one is a Nevada individual.
 - ▶ Original Return Filing: The partnership does not file a California return because it does not do business in the State. California partners report 100 percent of their partnership income on their California individual returns.

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>
- ▶ In 2017, only AZ enacted legislation conforming to 2015 federal legislation
 - ▶ AZ’s legislation does not comprehensively address federal changes (e.g., fails to address tiered partnerships)
 - ▶ Five other states proposed but did not pass legislation in 2017
- ▶ In 2018, thus far, only GA has enacted conformity legislation
 - ▶ Follows the Interested Parties’ model fairly closely – lacks “mutual agreement” provision
- ▶ **There’s plenty of time – first returns not due until March, 2019**

▶ 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 May 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 May 2018 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**

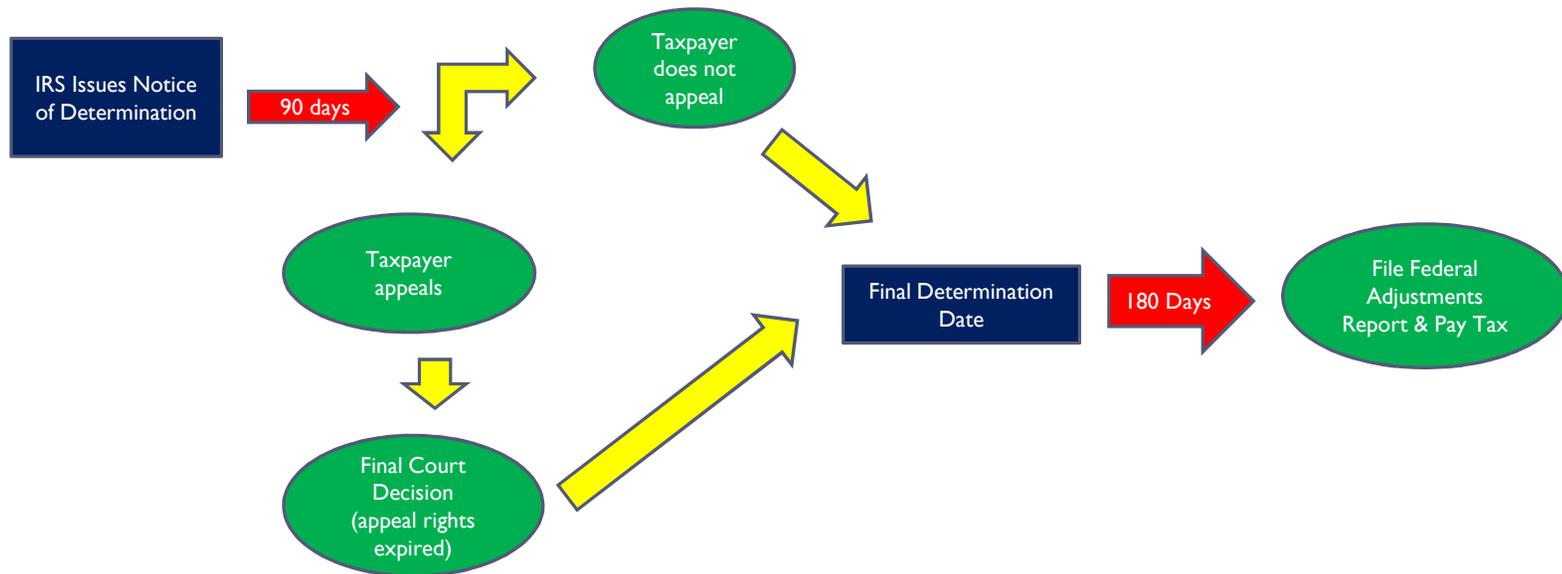
- ▶ For IRS audits, date on which no Federal Adjustments arising from an audit remain to be finally determined
- ▶ For combined/consolidated returns, applies to entire group
- ▶ For amended federal returns, refund claims, and administrative adjustment requests, the date on which the requests were filed

How It's Accomplished: General Reporting Process

- ▶ **Reporting Adjustments to Federal Taxable Income – General Rule** (this does not apply to a partnership or their partners (unless the partner filed an amended return during the modification period) 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 allow states to use a *de minimis* threshold before a Federal Adjustments Report (is required)
 - ▶ Note: a state would also have the option to apply a *de minimis* threshold to partnerships subject to a partnership level audit (change from original model)

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 distributive 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

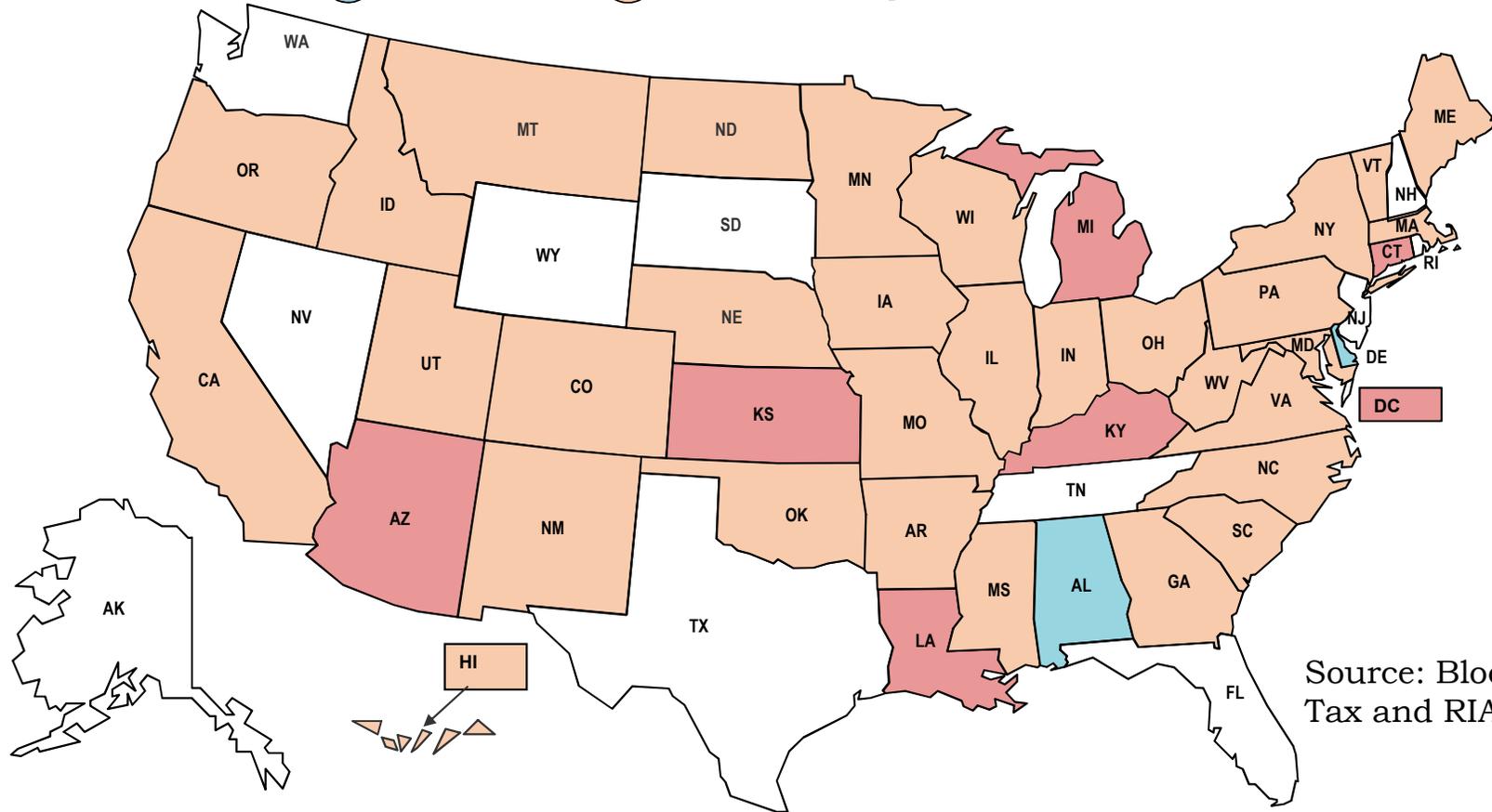
- ▶ For Reviewed Years, Audited Partnership shall:
 - ▶ Within 90 days of the Final Determination Date
 - ▶ File a Federal Adjustments Report;
 - ▶ Notify Direct Partners of their distributive share adjustments; and
 - ▶ File amended composite/withholding returns and pay the related tax liability on 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

Withholding for Individuals

Optional Required* Not Required

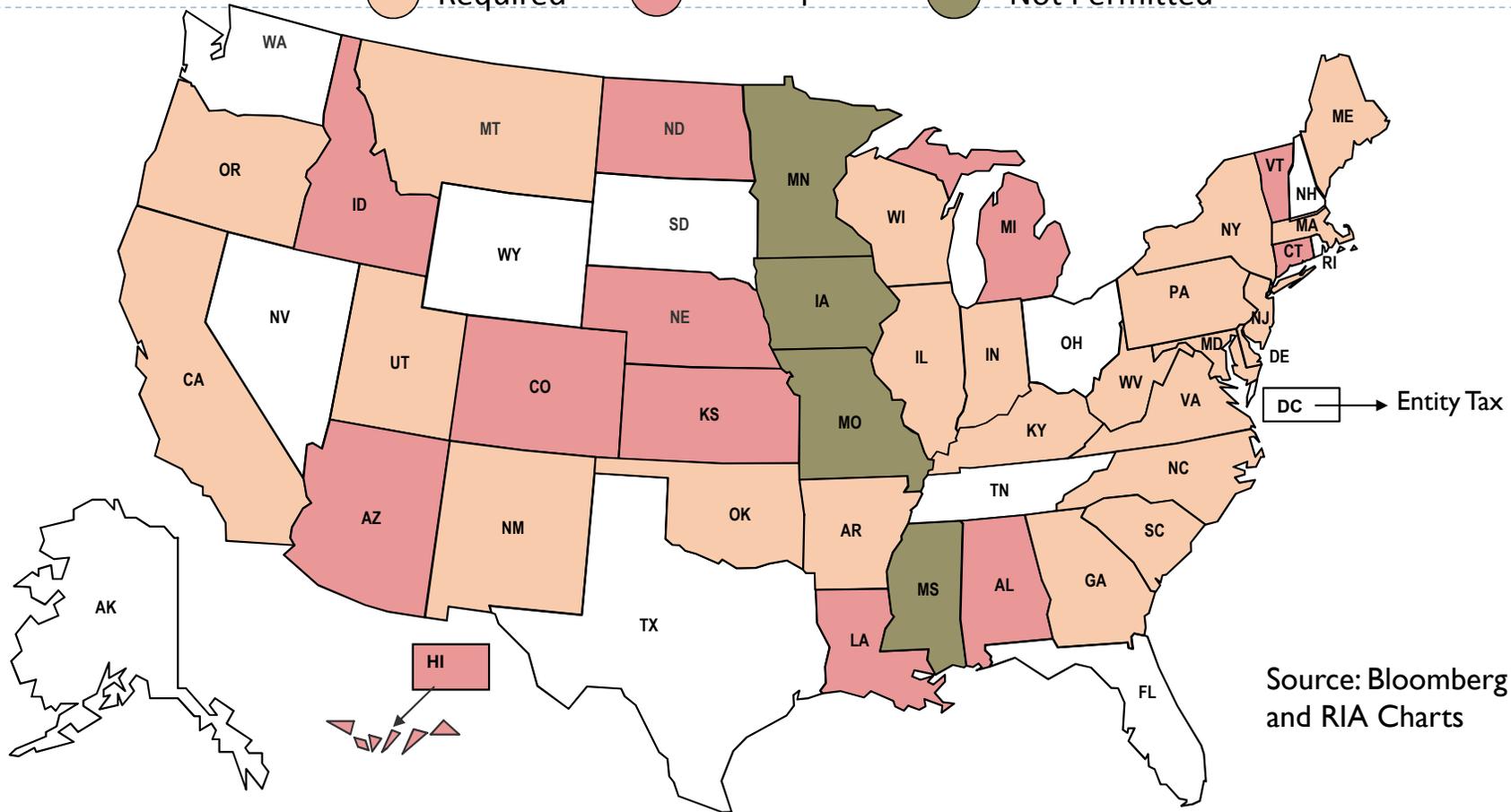


Source: Bloomberg Tax and RIA Charts

*Required withholding may be limited to certain circumstances

Withholding for Corporations

Required*
 Not Required
 Not Permitted



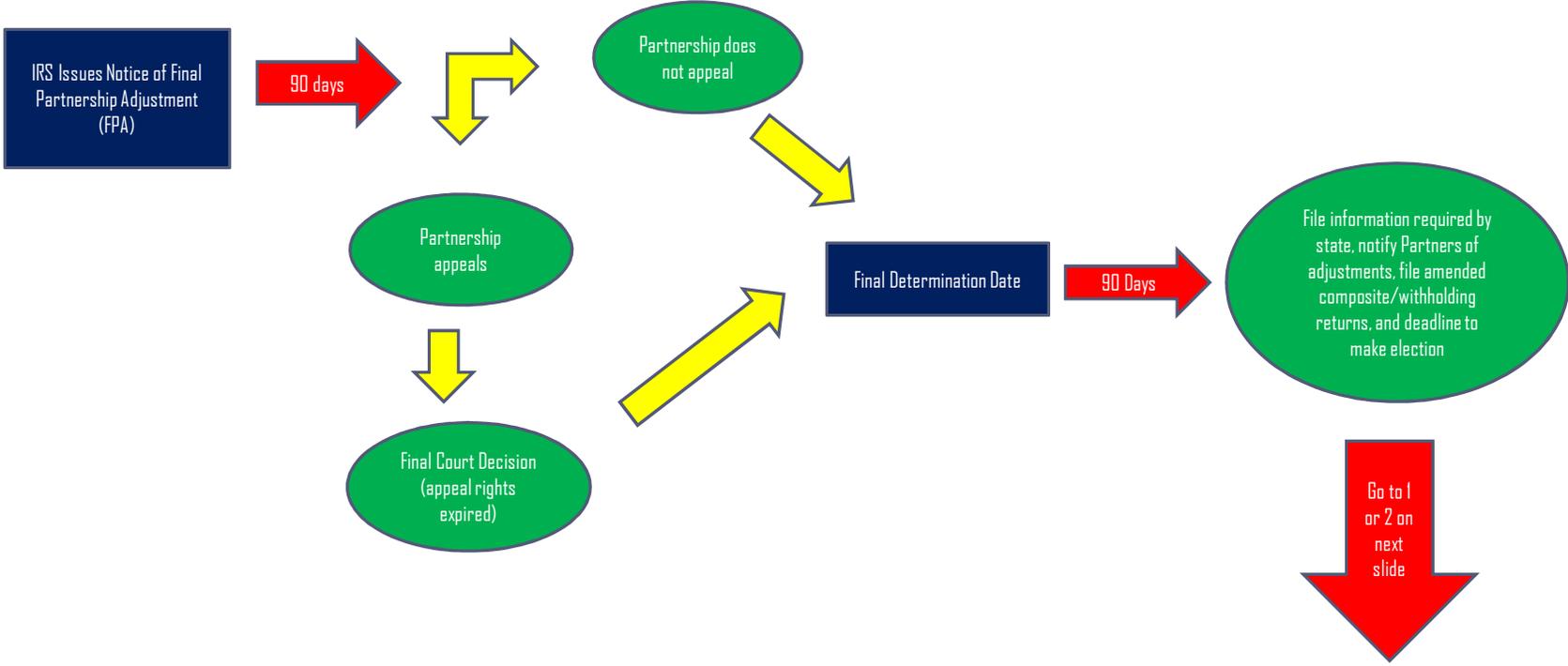
Source: Bloomberg Tax and RIA Charts

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

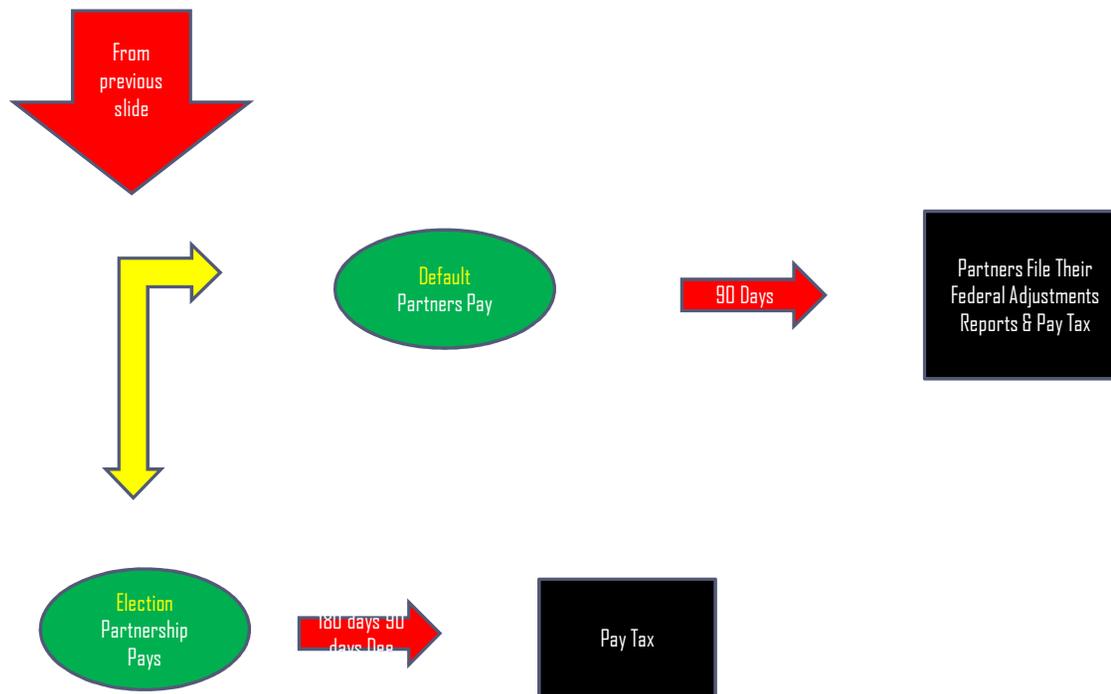
- ▶ Alternatively, Audited Partnership can make an election to pay the tax for Reviewed Years
- ▶ Within 90 days of Final Determination Date the Audited Partnership shall:
 - ▶ File a Federal Adjustments Report; and
 - ▶ Notify the state of the election
- ▶ Within 180 days of Final Determination Date, the Audited Partnership shall:
 - ▶ Pay tax for its Direct Partners based on calculation prescribed in Draft Model Statute
 - ▶ **Biggest issue at present time is addressing “indirect resident partners” and investment partnerships (where should the investment income be sourced?)**
- ▶ 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

Adjustment — Slide 1



Flow Chart following Federal Partnership Audit Adjustment – Slide 2



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)	“Push-out” option requires reporting and payment on an amended return for original (“reviewed”) year. Ability to report/pay tax on current year tax return unavailable (likely an administrative systems issue w/most states)
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

► Questions?

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