

UNIFORMITY WITH REPORTING FEDERAL AUDIT ADJUSTMENTS TO STATES

Presentation to the NCSL's Taskforce on State and
Local Taxation

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Federal Audit Process

- ▶ Federal (IRS) corporate audits can take years
- ▶ IRS audit issues are often resolved at different times with some issues creating refunds and others creating liabilities
- ▶ Some audit adjustments may have no impact at the state level (e.g., some federal credit adjustments)
- ▶ All states imposing a tax using a taxpayer's federal tax liability as a starting point require the federal adjustments to be reported, regardless of whether the state's normal statute of limitations has closed
- ▶ Corporations must often make audit adjustments to multiple entities and require sufficient time to accurately report those changes to the states (and some states' local governments)
- ▶ General uniformity, clarity, and simplification (when reasonable) would mutually benefit state tax administrations and taxpayers (e.g., more accurate amended returns)

Problems with Reporting Federal Audit Adjustments

- ▶ Some require the filing of multiple amended returns when the IRS and taxpayers resolve issues separately
- ▶ It is difficult to make an “estimated payment” in some states to stop interest
- ▶ Some federal adjustments are *de minimis* but most states require full reporting, etc.
- ▶ The time and circumstances under which a taxpayer must file an amended state return to report federal adjustments varies among states, especially after the state statute of limitations has expired

COST, MTC and TEI Common Interests

► MISSION STATEMENTS –

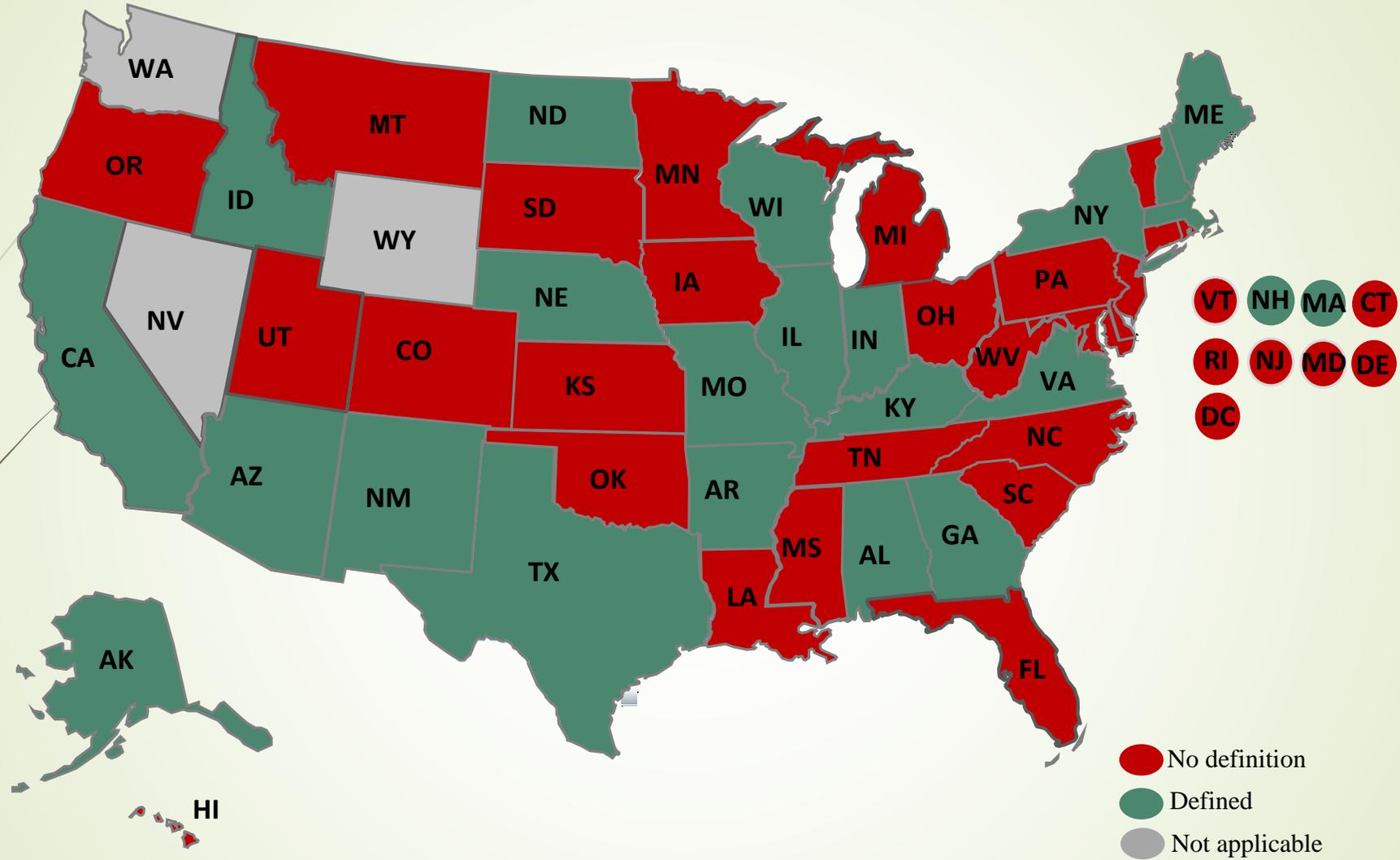
- **COST:** Preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities
 - **MTC:** Facilitate equitable apportionment; promote uniformity; facilitate taxpayer convenience
 - **TEI:** Enhance and improve the tax system; support the development of sound tax policy; minimize administration and compliance costs for the benefit of the government and taxpayers alike
- MTC is still determining whether it will adopt this as a uniformity project. However, interests of the states and industry are similar – improve efficiency of tax administration through uniformity, clarity, and simplification to improve compliance
- 2003 MTC model of “final determination” has not been widely adopted by the states – COST, TEI and other organizations would like to update definition to provide more clarity

Specific Example – When Must a Taxpayer File?

- Unclear what constitutes adequate notice of federal adjustment; inconsistent extensions of statutes of limitations after federal adjustment
 - Taxpayer files amended return
 - Written notice
 - Imputed when IRS issues Form 870
 - Partial settlement
 - Form 4549-A
 - Written guidance

- Are other changes reportable?
 - Other states
 - Foreign nations
 - Changes to financial statement
 - Federal adjustment with no effect on state liability

States with Definition of a Final Determination



Source: COST Administrative Scorecard, December 2016

Common Interest on When Amended Reports are Due

- ▶ MTC and industry models provide 180 days (or six months) to report final federal adjustments to the state (and local governments)
- ▶ Both models include a provision of reasonable information about the adjustment and provide some flexibility whether an amended return required is required
- ▶ Similar statutes of limitation re: assessments
- ▶ Similar consequences of failure to file report of federal adjustments; industry model has six year statute of limitation after final determination
- ▶ Time periods may be extended by agreement of parties

Proposed Solutions

- ▶ Revise the definition of “final determination” to be more comprehensive and to incorporate concepts from the internal revenue code and underlying regulations
- ▶ Allow taxpayers to file streamlined model report that could be filed in multiple states to report federal audit adjustments, in lieu of requiring taxpayers to file a complete amended state return
- ▶ Clarify that the filing of the report of federal audit changes will also qualify as a claim for refund

Proposed Solutions Continued

- ▶ Include an optional *de minimis* exception whereby taxpayers may notify the state of adjustments to taxable income resulting in an assessment or refund of less than \$250 in state tax without requiring an amended return or report of those changes (while providing states the option to nevertheless request such a report)
- ▶ Clarify statute of limitations to address instances where the taxpayer failed to file a report of federal changes
- ▶ Allow estimated payment to toll interest

Take Away Conclusions

- ▶ While this proposal is not final, we want to identify issues/concerns as legislative action will be required
- ▶ Industry is hopeful that the MTC will take this project up and is looking forward to work with them on revising the model statute
- ▶ Some areas, such as providing 180 days timeframe, can be acted upon immediately but the clarification of what is a “final determination” likely needs additional finessing and, ideally, uniformity among states
- ▶ Opportune time to amend state statues would be next year or the following year, in coordination with state conformity to new federal audit procedures imposed on partnerships and LLCs

Questions or
Comments?