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January 29, 2020

**VIA EMAIL**

Wisconsin Senate Committee on Agriculture, Revenue and Financial Institutions
The Honorable Howard L. Marklein, Chair & The Honorable Jerry Petrowski (Vice-Chair)

**Re: COST Urges Amendments to Partnership Provisions of SB 720/AB 754**

Dear Chair Marklein, Vice-Chair Petrowski, and Members of the Committee,

On behalf of the Council On State Taxation (COST), I am writing to urge the Legislature modify the state audit provisions in SB 720/AB 754 (*see* sections 27-33, 37-43, and 47 of the bills). The state audit provisions are onerous and should more closely align with the new federal partnership audit regime under the federal Bipartisan Budget Act of 2015. COST does support the change to increase the time to report federal audit changes from 90 to 180 days (*see* sections 34 and 35 of the bill); however, the bills should be amended to incorporate other significant aspects of model legislation developed by the Multistate Tax Commission and several interested parties, including COST and the Association of International Certified Professional Accountants (AICPA).[1]

## About COST

COST is a nonprofit trade association consisting of approximately 550 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST has a significant number of members that own property, have employees, and are partners in pass-through entities in Wisconsin impacted by the state audit partnership legislation proposed in SB 720/AB 754.

## Support for Uniform State Reporting Requirements for Federal Tax Changes

The COST Board of Directors has adopted a formal policy statement addressing state reporting requirements for federal tax changes, recently updated to address the new federal partnership audit regime. The policy statement provides:

> *State reporting of federal tax changes imposes a significant compliance burden on multijurisdictional companies. A fair and efficient state procedure for reporting federal tax changes should include: 1) a clear definition of what constitutes a "final determination" that triggers a state reporting requirement; 2) a minimum period of at least 180 days (or six months) to report such changes to the state;* ***3) conformity to the Multistate Tax Commission model statute for reporting and payment of partnership audit adjustments****, 4) the ability to make advanced payments before a "final determination" triggers the filing responsibility for*

[1] The MTC model statute is available at: http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Model-RAR-Statute.pdf.aspx?lang=en-US. Many state tax administrators, staff at the Multistate Tax Commission, and associations such as COST, AICPA, TEI, IPT, and the EIC (formally MLPA) worked on developing the model.

*an amended return; and 5) a limitation on issues open for adjustment to those items that are altered as a result of the federal change (after the normal statute of limitations has expired).*[2]

The proposed change to increase the reporting period from 90 days to 180 days would conform Wisconsin's time period to report federal changes with both the MTC model and COST's policy statement. This issue is also noted in COST's recently revised Scorecard on the Best and Worst of State Tax Administration.[3] Modifications of the bill to more closely follow the MTC model would further improve Wisconsin's overall tax administrative practices and its corresponding grade.

**Problems with SB 720/AB 754 State Audit Procedure**

Unfortunately, SB 720/AB 754 fails to address the state impact of federal partnership audits. Specifically, the bills do not provide guidance on reporting requirements or elections available to partnerships audited by the IRS or the partners in these audited partnerships. Consideration should be given to the state reporting requirements at the audited partnership and partner level in addition to tax payments on any imputed underpayments at the audited partnership level. The MTC model statute addresses all these concerns and allows for the utilization of existing nonresident withholding (and/or composite return) statutes in this process.

The proposed state partnership audit mechanism proposed in SB 720/AB 754 is much narrower in scope than the new federal partnership audit regime. For instance, the state partnership audit proposal requires partnership entity level payment related to all adjustments outside of partnerships with five or less partners. The federal audit regime allows certain partnerships with less than 100 partners to elect out of the revised partnership audit regime entirely. Importantly, the federal partnership audit regime generally allows partnerships the ability to "push-out" adjustments to their partners rather than making payments at the partnership level on underpayment amounts. In this push-out scenario partners are liable for any imputed underpayment while the audited partnership provides underpayment information by partner to both the IRS and the impacted partners. Such a push-out election is key for many partnerships and other pass-through entities that may not have cash on hand to pay tax at the entity level or may be required to distribute cash via their partnership agreements. A state partnership audit regime should align, to the fullest extent possible, with the MTC model, including its elections.

**Conclusion**

COST urges the Committee to significantly amend the proposed state audit procedure in SB 720/AB 754 to more closely follow the federal audit regime and the MTC model. COST and other interested parties are willing to assist you in making these changes. Please let us know if you have any questions.

Respectfully,

Fred Nicely

Fredrick J. Nicely

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

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[2] COST Policy Statement is available at: https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/cost-federal-tax-changes-rar-policy-oct-2019.pdf.

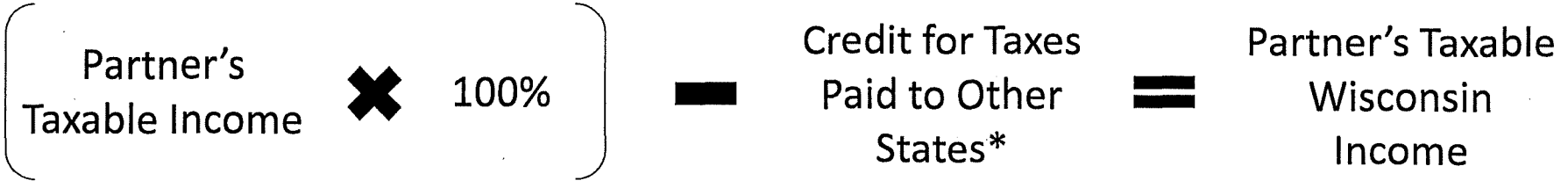
[3] COST Best and Worst of State Administration Scorecard is available at: https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/admin-scorecard-final-dec-2019.pdf. The overall grade for Wisconsin was a "B-", and if SB 720/AB 754 is modified to address our concerns, it would likely improve to at least a "B" grade.

# SENATE BILL 720 AND ASSEMBLY BILL 754:

*Uniform Taxation of Business Income Derived by Non-Residents*

January 29, 2020

# Existing Law: Wisconsin Residents




- Wisconsin residents generally pay tax on their worldwide income
- Wisconsin residents receive a limited credit for taxes paid to other states

*Credit generally limited to 7.65% of taxable income in the other state

# Existing Law: Non-Residents

Partner's Taxable Income × (**Partner's** Time Worked in Wisconsin / **Partner's** Time Worked Everywhere) = Partner's Taxable Wisconsin Income

- Under existing law, non-resident partners pay Wisconsin tax based on the time that individual partner spends working in Wisconsin

# Proposed change for Non-Residents

$$\text{Partner's Taxable Income} \times \frac{\text{Firm's Collections on Wisconsin Sourced Work}}{\text{Firm's Total Collections}} = \text{Partner's Taxable Wisconsin Income}$$

- Under AB 754 apportionment is based on firm-wide statistics, not the performance of individual partners

# How DOR is explaining change for Non-Residents

$$\text{Partner's Taxable Income} \times \frac{\underline{\textbf{Partner's}}\ \text{Time Worked on Wisconsin Sourced Work}}{\underline{\textbf{Partner's}}\ \text{Time Worked}} = \text{Partner's Taxable Wisconsin Income}$$

- The DOR explains that non-resident partners who do not do work for Wisconsin sourced work will have no change in their taxes
- Explanation is incorrect because under AB 754, apportionment works based on a firm-wide apportionment formula, not an individual partner formula

# DOR's Analogy: Professional Athletes

LeBron's Income × (**LeBron's** Duty Days in Wisconsin / **LeBron's** Total Duty Days) = LeBron's Taxable Wisconsin Income

- Wisconsin law already provides that professional athletes pay Wisconsin tax to the extent they physically are in the state of Wisconsin
- Provision is analogous to existing tax treatment for non-resident partners: they pay Wisconsin tax based on time spent performing services in the state of Wisconsin
- AB 754 will not change the taxation of professional athletes

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*Tony Evers*
*Governor*

*Peter W. Barca*
*Secretary of Revenue*

**Testimony on SB 720 by Peter Barca, Secretary of the Department of Revenue**
*Taxpayer Enhancement Package*
January 29, 2020

Chairman Marklein, Ranking Member Smith, Members of the Senate Committee on Agriculture, Revenue and Financial Institutions:
Thank you for allowing me to testify in favor of SB 720, which includes various changes to Wisconsin tax laws. We have called this omnibus bill the "Taxpayer Enhancement Package."

Early in my time as Secretary of Revenue, I met with groups who were interested in proposing changes that make tax laws more user friendly. For example, we met a developer who was running into difficulty with the sale of historic tax credits. We worked with staff to find a way to make changes to allow this important development tool to continue to function in communities that needed these developments. Additionally, we met with our Volunteer Income Tax Assistance (VITA) program coordinators who made the suggestion to assist retirees with obtaining a more robust homestead credit, by making the retirement exclusion optional. While this item is not currently in this bill, the suggestion served as the genesis for requesting DOR staff and stakeholders to bring forward ideas that would make positive changes in tax administration.

Another example of collaboration was the item which removes a section of the state tax code which forbids payments from counties to municipalities during the very time when counties are making payments to municipalities for lottery credit. The Wisconsin Counties Association suggested this item, and we agreed with them that there was no reason for such a prohibition and are today recommending its removal.

As part of our strategic planning our senior leadership team challenged staff to think creatively and identify statutory changes that would help the constituencies that we serve at DOR by bringing clarity and increasing compliance. We have staff that are constantly in contact with tax practitioners and have had requests for clarifications over time. We sought to modernize in some cases, clarify, or simplify administration in order to make the tax and compliance process more effective and efficient.

The Secretary's office waded through hundreds of proposals brought by staff and stakeholders over the first few months. Additionally, we solicited stakeholder input, and made changes according to the feedback we received with the goal of gaining support for the individual proposals. We also met with leaders of this committee of both parties to work together. Our goal was to bring forward proposals we believed would enjoy bi-partisan support.

I would like to thank the sponsors of the bill, Senators Marklein, Kooyenga and Smith and all of their staff for all of their hard work bringing these items before you today.

I will highlight a few of the key proposal items in SB 720.

- Simplifies the audit process for pass-through entities
- Allows tax payers more time to amend their WI taxes after an IRS or other state's audit (As recommended by the Multistate Tax Commission)

- Streamline the process for receiving a certificate of exemption for Not for Profit entities.
- Simplifies the shared revenue payments to local taxing jurisdictions
- Increases training requirements for those that make determinations on property tax assessments
- Grants access to sales tax information to Legislative Audit Bureau access

I would also like to take this opportunity to discuss an item that is currently not included in this bill but we are seeking to add the item in with a substitute amendment. We would like to include updates to the Internal Revenue Code (IRC). The state of Wisconsin generally follows the IRC, with some exceptions. The current Wisconsin tax code follows the December 2017 version of the IRC. There have been seven laws that have been passed by Congress and enacted since then that we are recommending be incorporated into Wisconsin tax law in order to avoid tax payer confusion. There is a chart that itemizes all of the updates that we are seeking be incorporated. The overwhelming majority of them are technical corrections, but there are eight provisions that are substantive and have fiscal impacts in Wisconsin.

With the support of Sens. Marklein, Kooyenga and Smith, the bill's sponsors, along with the sponsors in the other chamber, we are seeking to incorporate these changes into Wisconsin tax law.

In closing, SB 720 is a collection of taxpayer enhancements and common-sense changes that are an asset to the citizens of Wisconsin and the governments that serve them. We are honored at the bi-partisan support this package has received and are grateful to lead author Chairman Marklein and Senators Kooyenga and Smith in the Senate and Rep. Wittke, Chairman Macco, and Rep. Ohnstad for leading this package in the Assembly, as well as the Governor and his staff for their consultation.

Thank you again for hearing SB 720. At this time, I would be happy to offer myself and my staff for questions.

# Summary of SB 720

## Taxpayer Enhancement Package Proposals

*A series of clarifications, corrections, modernizations and changes to simplify the administration of our tax law, all to enhance the taxpayer experience and/or customer service with the Wisconsin Department of Revenue (DOR).*

### Simplify Administration

**DPI Consumer Price Index (CPI) Calculation** **Section 44**

*No fiscal impact*

Wisconsin law currently requires the DOR to provide a yearly Consumer Price Index (CPI) calculation to the Department of Public Instruction. DPI previously used CPI for calculation of school revenue limit. The revenue limits have recently been determined in the budget bills ($X per pupil for 2018-19, for example). The CPI calculation has not been applied to school revenue limits since the 2014-15 school year. DOR is seeking to change the code to make delivery of a CPI calculation to DPI upon request, instead of yearly. This is also an efficiency, as staff will no longer be tasked with sending a letter that provides information that is not necessary.

**Uniform Due Dates for Ad Valorem Companies** **Sections 52, 53**

*No fiscal impact*

The Wisconsin law currently has a different due date for filing annual reports for railroad companies (April 15), than other ad valorem companies (i.e., conservation and regulation company, air carrier, or pipeline companies filing by May 1st. The change seeks to allow due dates to be uniform, so that all companies file on the same date- May 1st.

Additionally, the Wisconsin law requires DOR to assess ad valorem companies on September 15th of each year, except that DOR is required to assess railroad companies by August 1st. The change seeks to adopt the September 15 date for all ad valorem companies.

**ERP Early Distribution** **Sections 72-74**

*No fiscal impact*

Allows DOR to assist a community who failed to timely file their required Expenditure Restraint Program (ERP) Worksheet. The assistance will come in the form of an early payment, but solely in the event the community timely files their next ERP worksheet and qualifies for ERP in the following year. This early payment will enable the community to apply half of the funds to the budget year where the ERP payment was missed, and the other half to the following year. This will allow the community to soften the brunt of losing the ERP payment.

**Consumer Price Index Timing** **Sections 4, 78, 79**

*No fiscal impact*

The Wisconsin law requires DOR to certify the appropriate percentage change in the consumer price index (CPI) that is to be used as the inflation factor by November 1 for the Expenditure Restraint Program.

DOR is seeking to change that date to October 1 in order to provide this measure sooner to municipalities which will allow them to construct their budgets earlier with greater accuracy.

Additionally, the change adjusts the inflation factor to be based on the 12 months ending in August 31, instead of September 30. To conform, DOR also seeks to make the change towards a CPI ending with August 31 under the levy limit's joint fire department exception.

**Simplification of Pass through Entity Audits** **Sections 27-33, 37-43, 47**

*The provision would result in a minimal decrease in administrative expenditures*

Under current law, the provisions for statutes of limitations, assessments, confidentiality, and appeals require the department to administer the audit of a pass-through entity (e.g., a partnership or tax-option (S) corporation) by contacting each separate member of the entity. This creates unnecessary work for both the department and taxpayers. Note that some department audits performed on pass-through entities have over 1,000 members. In addition, DOR has received numerous requests from pass-through entities wishing that their audit be entirely handled by the entity without the involvement of the members.

Effective for taxable years after December 31, 2017, the Internal Revenue Service (IRS) is administering new partnership audit procedures to allow the IRS to assess and collect tax at the partnership entity level. The IRS finds that their new procedures reduce the administrative burdens for both the IRS and taxpayers.

The bill seeks to join the IRS and 15 other states that have some form of entity-level audit adjustment procedures and adopt provisions to allow administrative functions relating to an audit of a pass-through entity to be centralized at the entity level.

**More time to amend WI returns after IRS / Other State Audits** **Sections 34, 35**

*No fiscal impact*

The proposed change allows taxpayers 180 days to amend their Wisconsin tax returns after an IRS audit (recommended by Multistate Tax Commission and other national tax groups). Many other states are also adopting the new 180-day standard. Wisconsin law currently provides 90 days to amend.

**Certificate of Exempt Status Simplification and Expansion** **Section 70**

*No fiscal impact*

Simplify the process for a Wisconsin nonprofit organization to apply for a Certificate of Exempt Status (CES) number, which allows the nonprofit to make all purchases exempt from tax. Under the proposal, in order to obtain a CES, a non-profit organization will only need demonstrate their determination letter from the IRS stating that they qualify as exempt under section 501(c)(3) of the IRC. The proposal also provides that the exemption applies to churches and religious organizations that are not required to obtain a determination letter from the IRS but meet the requirements of IRC 501(c)3.

**Elimination of Timing Restriction for Payments to Towns from Counties** **Section 3**

*No fiscal impact*

There are two sections of Wisconsin law that are in conflict. The first is a section that makes it unlawful for a county treasurer to make payments to a town treasurer from the 3rd Monday in March until 10 days after the annual town meeting, except upon the written order of the town board. The second is the mandate that lottery and gaming credit payments be distributed to municipalities by April 15 annually. In order to avoid the conflict, DOR seeks to remove the prohibition of payments, as we have been notified it is causing conflicts, and otherwise serves no useful purpose.

## Clarifications

**Transfers of Historic Rehabilitation Tax Credit** **Sections 21, 23-24**

*No fiscal impact*

Amend Wisconsin law to allow for the sale of HRT credits in one transaction, while at the same time clarifying that the HRT credits retain the limitation set by the federal government that HRT credits can only be *claimed* over a 5-year period, 20% per year for 5 years.

**Homestead Credit Clarification – Earned Income** **Sections 25-26, 80**

*Increased cost: $140,000*

This proposed change seeks to clarify eligibility for the homestead credit by adding the IRC definition of "earned income,", and creating a definition of "primary income from farming" in order to clarify which farming losses do not have to be added to household income. This will assist certain farmers, so they can successfully claim a homestead credit.

**Sales and Use Tax on Property Transferred with Certain Services** **Sections 68, 69**

*No fiscal impact*

This proposed change is not a change to current practice, but rather, a clarification to avoid misinterpretations of sales tax law as applied to the certain services impacted. The 4 certain services impacted (services where sales taxes to the consumer are applicable) are 1) printing; 2) photography; 3) landscaping; and 4) services to tangible personal property. There was a court case that interpreted "subject to tax" when an exemption was applied to the sale of printing services that could possibly create confusion. The department would like to clarify that persons providing these services may purchase their materials without tax, **even when their sales are not taxable** (e.g., sale is to a tax-exempt entity). Because this is already done in practice, there is no fiscal impact.

### Disability Income Subtraction — Sections 20

*No fiscal impact*

The proposal seeks to replace the citation to the 1983 version of the IRC with the actual language from the 1983 IRC. This version of the IRC is not easily found online, which is why we seek to adopt the full language into Wisconsin law. The federal government converted their disability income subtraction into a disability credit in 1984.

## Modernizations

### Uniform Taxation of Bus Income Derived in WI By NonRes — Sections 13-19, 22, 36, 80

*Fiscal impact indeterminate*

Wisconsin taxes business income from partnerships and tax-option (S) corporations differently. Business income passed through to nonresident shareholders of tax-option (S) corporations are taxable to Wisconsin based on the corporation's apportionment percentage. However, business income passed through to nonresident partners of a partnership are taxable to Wisconsin differently based on the type of income derived by the partnership. The following chart shows how various business income of a partnership may be taxed (inside or outside Wisconsin).

| Type of Partnership Income | Taxable Based on Situs of Property | Taxable Based on Residency of Partner | Taxable Based on Partnership's Appt. % |
|---|---|---|---|
| Business income (other than specified below) | | | X |
| Operation of any farm, mine, or quarry | X | | |
| Sale of real estate or tangible personal property | X | | |
| Rent or royalties from real estate or tangible personal property | X | | |
| Sale of stocks, bonds, and other intangible property | | X | |
| Interest | | X | |

| | | | |
|---|---|---|---|
| Dividends | | X | |

Other states tax the business income listed above in a consistent and simplified manner, using the pass-through entity's apportionment percentage, regardless of the type of business income derived by the pass-through entity. Essentially, other states do not allow income of nonresidents to escape taxation on certain types of business income because they are a nonresident partner of a partnership.

For example, Wisconsin is the only state that does not require a nonresident partner in a partnership to file a Wisconsin income tax return and pay tax on business income derived in Wisconsin from personal and professional services, if the nonresident does not physically come to Wisconsin to perform the services. Other states require Wisconsin residents to file returns and pay tax on partnership business income derived in the other state, even if the Wisconsin resident does not go to the other state to perform the service.

This bill proposes to create consistent tax treatment of partnership and tax-option (S) corporation income, by treating the same items of income (e.g., income from personal services, income from intangibles and rental) as business income, and to specify that the apportionment formula is used to determine how much business income is taxable to Wisconsin.

**Application of Shared Revenue Deductions** **Sections 1, 2, 5, 6, 7, 9, 12, 75-77, 80**

*No fiscal impact*

Current law allows deductions from Shared Revenue payments to counties and municipalities for the following items:

- Levy limit penalties
- Milwaukee county child welfare intercept
- Unpaid manufacturing assessment fees
- Department of Health Services medical transport deduction
- Milwaukee county basketball stadium
- Department of Administration mass transit grant
- TID annual report late filing fees

Under current law, certain penalties can only be deducted from certain pieces of shared revenue. In result, the state pays local governments shared revenue when they actually owe the state, only in a different/separate shared revenue account. The proposed change will allow any of the deductions to be applied against the total shared revenue to be paid. This would ensure county and municipal aid, utility aid and expenditure restraint program aids are not distributed to local governments with current state debts. It will also reduce confusion for local governments.

**Omitted Property** **Sections 48-51, 81**

*No fiscal impact*

2015 Wisconsin Act 317 amended the charge back law (opposite of omitted property). DOR now approves all charge back requests (unless in a positive tax incremental district), and the threshold for filing chargebacks with DOR was lowered to $250 per property. This proposal seeks to conform the omitted property process to the changes made for chargebacks. Currently, taxing jurisdictions are negatively impacted, as they are responsible for their portion of successful chargebacks, but not easily reimbursed when there is an omitted property. Under the proposal, the omitted process is simplified to match the chargeback process. In result, taxing jurisdictions are treated uniformly – funds are removed proportionally if there is a chargeback, and funds are provided proportionally when there is an omitted property.

**BOA filing fee** **Sections 10, 11, 81**

*Revenue increase: $31,000 of GPR-earned*

DOR conducts assessments and handles appeals for manufacturing property. The proposal seeks to increase the filing fee for an appeal for a manufacturing property from $45 to $200. The filing fee has never been increased. The cost to DOR for processing the appeals is substantially more than the filing fee. It is important to note that the law grants manufacturing properties a reprieve for subsequent filing fees if the prior appeal is pending.

**BOR Training Requirements** **Sections 8, 81**

*No fiscal impact*

The proposal updates state law to require all members of a local Board of Review (BOR) complete training every year. Training material is currently available online. Additionally, at least one member must attend an in-person training every year that is approved by DOR. Current law requires one member attend training every other year. In light of the important decisions that are being made by the BOR it is important that they have up-to-date information about property assessment law, assessment standards, appeals processes, etc. Annual training will assist BOR's with the decisions they make, which impact all the taxpayers in their jurisdictions.

**Assessor Certification Fee Increase** **Sections 45, 46**

*No fiscal impact*

The current fee for an assessor certification is $20. The certification is valid for a 5-year period. However, the exam vendor charges DOR $50 for each person taking a certification exam. The update will allow for the exam fee to reflect actual cost to administer the exams. We have included a cap on the fee of up to $75 (for the same 5-year certification). Re-certification fees will also be capped at up to $75. This proposed fee increase and increase in professionalism is welcome by the assessor community.

**Nexus for Remote Sellers** **Sections 60-67**

*Minimal fiscal impact*

The Wayfair decision established a 200 transaction or $100,000 threshold for sales tax nexus. Many states are realizing that having two standards for collecting tax for out-of-state online retailers is complex and could inhibit compliance and are moving to the sole $100,000 threshold. The DOR would like to follow suit, as auditing of companies with small taxable sales amounts may not be worth the resources expended.

**LAB Access to Sales Tax Information** **Section 71**

*No fiscal impact*

2019 WI Act 10 (Marketplace bill) gave the Legislative Reference Bureau (LAB) certain responsibilities with respect to certifying sales tax data. The proposal seeks to clarify in the law that LAB may have access to sales tax data so they may perform the duties assigned by the legislature.

## Corrections

**Refund Interest Rate** **Sections 54-59**

*Revenue increase: $25,000*

In 2015, the legislature changed the interest rate paid by DOR on refunds from 9% to 3%. It appears most parts of the law were included except for Chapter 76, which was left at 9%. We are assuming this was inadvertent and are proposing to change all refund rates to 3% for uniformity.

# Summary of SB 720

## Taxpayer Enhancement Package Proposals

*These proposals were recommended by the Department of Revenue to make tax laws easier to understand and follow for taxpayers, practitioners, and local governments in Wisconsin.*

**DPI Consumer Price Index (CPI) Calculation** *No fiscal impact* **Section 44**

Eliminates unnecessary automatic statutory calculation. Changes to per request by DPI.

**Uniform Due Dates for Ad Valorem Companies** *No fiscal impact* **Sections 52, 53**

Brings railroad due dates in line to other utility company deadlines.

**ERP Early Distribution** *No fiscal impact* **Sections 72-74**

Allows a community who failed to timely file required Expenditure Restraint Program Worksheet to receive subsequent qualified payments early.

**Consumer Price Index Timing** *No fiscal impact* **Sections 4, 78, 79**

Adjusts the timing of the consumer price index average to use the 12 months ending August 31.

**Simplification of Pass thru Entity Audits** *Minimal decrease in admin* **Sections 27-33, 37-43, 47**

Simplifies audits for partnerships and S corporations by providing an option for audits and correspondence to be made with only the entity, rather than issuing bills or correspondence to each partner/shareholder.

**More time to amend IRS filing changes** *No fiscal impact* **Sections 34, 35**

Also allows all taxpayers 180 days to amend their Wisconsin tax returns after an IRS audit (recommended by Multistate Tax Commission and other national tax groups).

**Certificate of Exempt Status Simplification and Expansion** *No fiscal impact* **Section 70**

Fully adopts IRC 501(c)3 requirements for tax exempt status for sales and use tax purposes.

**Elimination of Timing Restriction for Payments to Towns from Counties** **Section 3**

Allows counties to be in compliance with law when distributing lottery property tax credit to towns. *No fiscal impact*

**Transfers of Historic Rehabilitation Tax Credit** *No fiscal impact* **Sections 21, 23-24**

Allows for the sale of entire 5 years of HRT credits in one transaction, while retaining the 5 year claiming limitation.

**Homestead Credit Clarification – Earned Income** *Increase cost: $140,000* **Sections 25, 26, 80**

Clarifies eligibility by creating a definition of "earned income" using IRC, and clarifies which farming losses do not have to be added to household income by creating a definition of "primary income from farming."

**Sales and Use Tax on Property Transferred with Certain Services** **Sections 68, 69**

Allows certain taxable service providers to purchase items without tax, regardless of whether the sale to the customer is taxable or not. *No fiscal impact*

**Disability Income Subtraction** *No fiscal impact* **Section 20**

Adopts language from the 1983 version of the IRC related to the disability incomes subtraction. Our current code references the 1983 which is difficult to find.

**Uniform Taxation of Bus Income Derived in WI By NRs** **Sections 13-19, 22, 36, 80**
*Fiscal impact indeterminate*
Requires nonresident partners to pay Wisconsin income tax on their share of partnership business income derived in Wisconsin. Brings WI up to par with all other states that impose an individual income tax on partnership income by requiring the partnership to determine the allocation of income to the states based on an apportionment formula.

**Application of Shared Rev Deductions** *No fiscal impact* **Sections 1, 2, 5, 6, 7, 9, 12, 75-77, 80**

Allows DOR to remove all shared revenue deductions from the main shared revenue payments, regardless of order. Removes restrictions on deductions based on type of payments.

**Omitted Property** *No fiscal impact* **Sections 48-51, 81**

Requires that municipalities share revenue from omitted taxes with other taxing jurisdictions using the same guidelines as collecting refunded taxes from other taxing jurisdictions under the chargeback process.

**BOA filing fee** *Revenue increase: $31,000 of GPR-earned* **Sections 10, 11, 81**

Increases fee for manufacturing appeals to the department to $200 from $45.

**BOR Training Requirements** *No fiscal impact* **Sections 8, 81**

Requires that all members of a board of review must complete training every year (at least on-line), and at least one member must attend in-person training.

**Assessor Certification Fee Increase** *No fiscal impact* **Sections 45, 46**

Increases assessor certification fee to align with DOR costs to administer program up to $75.

**Nexus for Remote Sellers** *Minimal fiscal impact* **Section 60-67**

Eliminates 200 transaction threshold for sales tax nexus. Leaves sales tax nexus at $100K sales.

**LAB Access to Sales Tax Information** *No fiscal impact* **Section 71**

Allows LAB access to sales tax information. Necessary due to marketplace responsibilities.

**Refund Interest Rate** *Revenue increase: $25,000* **Sections 54-59**

Corrects interest refund rate paid to utilities, air carriers, RR, others to 3% from 9% to align refund rate DOR pays to others.

## Summary of IRC updates

Wisconsin generally conforms to the federal tax code. Wisconsin regularly adopts changes made to the IRC. Conforming to the IRC eliminates the complexity for taxpayers that results when Wisconsin law is not consistent with federal law. Wisconsin is currently following the IRC (with certain exceptions) as of 12/31/2017. There have been laws passed by Congress that amend the IRC since 12/31/2017:

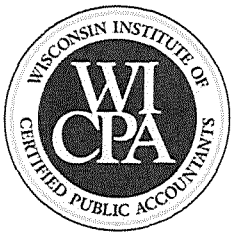
- Public Law 115-123 – Bipartisan Budget Act of 2018 enacted February 9, 2018
- Public Law 115-141 – Consolidated Appropriations Act enacted March 23, 2018
- Public Law 116-25 – Taxpayer First Act enacted July 1, 2019
- Public Law 116-91 – FUTURE Act enacted December 19, 2019
- Public Law 116-92 – National Defense Authorization Act for Fiscal Year 2020 enacted December 20, 2019
- Public Law 116-94 – Further Consolidated Appropriations Act, 2020 enacted December 20, 2019
- Public Law 116-98 – Virginia Beach Strong Act December 20, 2019

Provisions from the foregoing public laws that have a fiscal impact for Wisconsin.

| Public Law | Fed. Act § | Comments | Fiscal impact |
|---|---|---|---|
| Public Law 115-123 | 41115 | A provision certifying each population census track in Puerto Rico as a qualified opportunity zone. This affects Wisconsin, in that investments in opportunity zones are held by Wisconsin residents. | -$.7M |
| Public Law 115-123 | 41116 | A provision to allow those in the armed forces to qualify to take foreign earned income exclusions, foreign housing exclusion, and foreign housing deduction. | -$.6M |
| Public Law 115-123 | 41113 | Removes 6-month prohibition on making elective and employee contributions to a plan after receipt of a hardship distribution. | $.2M |
| Public Law 116-94 | 202(a) | Allows up to $100K distribution, without penalty, from a retirement plan made after a qualified disaster, up to 180 days after December 20, 2019. Must be repaid within 3 years. | -$.2M |
| Public Law 116-94 | 204(a) | The deduction for charitable contributions for qualified disaster relief is increased up to the taxpayers taxable income (corporate), or contribution base (individuals).* | -$1.7M |
| Public Law 116-94 | 204(b) | Increase the amount of casualty loss that can be claimed due to qualified disasters. | -$2M |
| Public Law 116-94 | 302 | Expand 529 education savings accounts to cover costs associated with registered apprenticeships and up to $10K of qualified student loan repayments. | -$.1M |
| Public Law 116-94 | 204(c) | For purposes of computing the earned income credit and child tax credit, the taxpayer may elect to use earned income from the preceding year. This applies to victims whose principal place of abode was in a qualified disaster zone or area for any taxable year which includes any portion of the incident period of the qualified disaster for a qualified disaster zone or any taxable year which includes any portion of the period the individual is located in a qualified disaster area.* | -$.9M |
| Total Impact | | | -$6M |

*It's important to note that the negative revenue impact in Section 204(a) is reduced to 0 (no impact) in year 2, and the change in Section 204(c) gets reduced to 0 (no impact) in year 3.

The rest of the provisions we are seeking to update have no fiscal impact on Wisconsin- and include extensions of existing credits, technical corrections, and corrections of spelling errors from prior bills. Each of the provisions is outlined in a separate chart available upon request from the Clerk.




**Wisconsin Institute of Certified Public Accountants**

January 29, 2020

As President & CEO of the Wisconsin Institute of Certified Public Accountants, we represent 12,000 licensed Certified Public Accountants across the state. The majority of our members work in large CPA firms and small ones alike.

In regard to Senate Bill 720 and Assembly Bill 754, which is the Department of Revenue's tax package, we believe a number of items in this legislation will have a significant negative impact on employers across Wisconsin, specifically CPA firms, law firms and financial advisors.

We have heard loud and clear from our members that this legislation is harmful. By removing certain provisions, highlighted in my letter before the committee (pass through entity tax, audits, partnership audits, pass through entity audits, additional assessment and refunds at the entity level, and sections related to situs of income derived from Wisconsin non-residents) would give us and other stakeholders time to consider the bill and its impacts on Wisconsin business. Specifically, we would greatly appreciate the opportunity to work with the Department of Revenue and the Legislature to discuss this legislation in further detail and evaluate foreseeable issues with the bill.

In the past we have had a strong relationship with the Department of Revenue and wish to continue our good works with them to come up with a better solution for Wisconsin.

Thank you for the opportunity to provide this information to the committee.

Sincerely,

Tammy J. Hofstede

Tammy J. Hofstede

WICPA President & CEO

DATE: January 27, 2020

TO: Senator Marklein, Chair, Senate Revenue Committee &
Representative Macco, Chair, Assembly Ways and Means Committee

FROM: Tammy Hofstede, Wisconsin Society of CPAs, President & CEO

RE: WICPA Comments on Assembly Bill 754 and Senate Bill 720

On behalf of the Wisconsin Institute of CPAs representing more than 12,000 licensed Certified Public Accountants across the state, I submit to you the following comments and concerns regarding the Department of Revenue's tax package (Assembly Bill 754 and Senate Bill 720). We hope to have a more detailed and thoughtful discussion with the Legislature and the DOR about the disadvantages, as we see it, in implementing the proposed language found in these bills. We regularly communicate with the DOR on such matters and want to continue the conversation in order to reach a mutual agreement on the issues identified below.

We are respectfully requesting the removal of sections related to the following, from both Assembly Bill 754 and Senate Bill 720:

- pass through entity tax
- audits
- partnership audits
- pass through entity audits
- additional assessments and refunds at an entity level, and
- sections related to situs of income derived in Wisconsin by nonresidents

The WICPA is sharing concerns raised on behalf of our members, the WICPA Federal and Wisconsin Taxation Committees, public accounting firms, law firms and financial advisor firms, who would all be negatively impacted by this legislation. On behalf of the members of WICPA, we believe if we are afforded the opportunity to work with Department of Revenue, better public policy with such broad reaching implications can be achieved.

Concerns with the current language regarding partnership audits and pass-through entity audits, additional assessments and refunds at the entity level are as follows and need further discussion:

- These partnership rules in Wisconsin are broader than partnerships by including S corps. Additionally, this is not for large shareholder groups but rather ownership groups of 5 or more. This is an issue we would like to further discuss with the DOR, because we are not able to gauge it's benefits to taxpayers and business.
- We have concerns from the S-Corp perspective that may have pro-rata distribution issues and not practitioner obligations to manage at entity level, merely to avoid auditing shareholders.
- The change in treatment of intangible income such as interest and dividends to tax as "business income" which is similar to the S-corp versus the current treatment of following domicile of the partner impacts nonresident partners.
- We would like to discuss further the differentiation between partnership and S-Corps domicile and what is subject to Wisconsin tax.
- We have concerns with the simplification of pass-through entity audits, specifically, the Wisconsin bill goes beyond what the IRS is doing currently in addition to subjecting S-Corps. This legislation does not provide the opt out that the federal provisions do
- We have both questions and concerns regarding the proposed changes to 71.04 Situs of income, allocation and apportionment, specifically the situs of intangible income of partnerships. Non-resident owners of S Corporations and partnerships are currently treated differently as to the situs of intangible income such as interest and dividends.
- Except when an election under s. 71.21 (6) (a) or 71.365 (4m) (a) is made, any adjustments to income, gain, loss, deduction, or credit made to the pass-through entity under this section are attributable to each pass-through member in a manner that is consistent with the treatment of such income, gain, loss, deduction, or credit to the pass-through entity.
- As we read Section 41 of the proposed law, only a partnership with less than 6 members would be allowed to avoid owing the tax at the entity level with a state audit. And, Section 32 imposes the tax at the highest tax rate. The federal BBA has a much higher threshold of 100 partners.
- The state audit provisions could also create a significant issue for large partnerships, including publicly traded partnerships (PTPs), if there is no option to push-out adjustments to the partners similar to the push-out option provided under the federal BBA provisions.
- For services businesses (such as CPA firms), it is much easier to situs revenues based upon where the service is performed than for where the benefit is received.
- We also believe it is not clear whether the partnership can report out any adjustments to partners after an assessment at the partnership level.
- A major issue of concern is whether nonresidents' home states would follow Wisconsin's method in determining the "other state tax credit" (OSTC) for the tax now sourced to Wisconsin. Unless this is settled properly, it could create a similar problem in Wisconsin for residents if there is not clarity on what is eligible for the OSTC in Wisconsin for CPAs performing services the benefit of which is sourced to other states under the other state law but maybe not for Wisconsin purposes. This looks like more opportunities for controversy.
- SECTION 40. 71.80 (26) - requires the proactive designation of a state "tax matters member." This statute references to "tax matters partner" should be updated to "partnership representative" as provided in the federal BBA rules, which do not require that such person is a partner in the partnership. We are not clear on why the state would not want to default to the federal partnership representative absent an election to use an alternative representative.

- SECTION 41. 71.80 (27): We think this section is electing out of the audit regime altogether (similar to the federal rules). Again, we think this should conform to the federal provisions.

On behalf of WICPA's members, we would appreciate the opportunity work with the Department of Revenue and the Wisconsin Legislature to find common ground to make this legislation stronger and not adversely affect business in Wisconsin. Further, we believe this legislative change is significant and will impact a number of employers in the state through compliance complexity and potentially added tax. The following types of businesses are greatly impacted this legislation:

- Public Accounting Firms
- Law Firms
- Financial Advisors

We appreciate your time and attention to this matter and look forward to working with the Legislature and the Department of Revenue on matters of mutual interest, such as Assembly Bill 754 and Senate Bill 720. Our members are eager to discuss this legislation and the implications it will have on their businesses and other businesses throughout Wisconsin.

# Model Uniform Statute for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments

*This draft was produced 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 well as a work group set up by the MTC uniformity committee. As of this date, this draft has not been officially endorsed by these organizations.*

This draft has been reformatted with line numbering as well as internal citations simplified and underlined to aid in the final review.

**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 Partnership Level Audit resulting in a Federal Adjustment.

**(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 Income[1]].

**(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 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 laws] and is negative to the extent that it decreases state taxable income as determined under [reference to State laws].

**(7) "Federal Adjustments Report"** includes methods or forms required by [State Tax Agency] for use by a Taxpayer to report Final Federal Adjustments, including an amended [State] tax return, information 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).

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

**(9) "Final Determination Date"** means the following:

(a) Except as provided in Section A(9)(b) and (c), if the Federal Adjustment arises from an IRS audit or other action by the IRS, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit or other action remain to be finally determined, whether by IRS decision with respect to which all rights of appeal have been waived or exhausted, 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.

(b) For Federal Adjustments arising from an IRS audit or other action by the IRS, 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, as described in Section A(9)(a), 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, or if it is a Federal Adjustment reported on an amended federal return or other similar report filed pursuant to IRC section 6225 (c), the Final Determination Date means the day on which the amended return, refund claim, Administrative Adjustment Request, or other similar report 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) "Non-Resident Partner"** means an individual, trust, or estate Partner that is not a Resident Partner.

**(15) "Partner"** means a person that holds an interest directly or indirectly in a Partnership or other Pass-Through Entity.

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[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."

**(16) "Partnership"** means an entity subject to taxation under Subchapter K of the IRC.

**(17) "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.

**(18) "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].

**(19) "Reallocation Adjustment"** means a Federal Adjustment resulting from a Partnership Level Audit or an Administrative Adjustment Request that changes the shares of one or more items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Reallocation Adjustment means the portion of a Reallocation Adjustment that would increase federal income for one or more Direct Partners, and a negative Reallocation Adjustment means the portion of a Reallocation Adjustment that would decrease federal income for one or more Direct Partners [pursuant to Regulations under IRC section 6225].

**(20) "Resident Partner"** means an individual, trust, or estate Partner that is a resident in [State] under [reference to state laws] for the relevant tax period.

**(21) "Reviewed Year"** means the taxable year of a Partnership that is subject to a Partnership Level Audit from which Federal Adjustments arise.

**(22) "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 Administrative Adjustment Request, as well as a Tiered Partner of that Partnership.

**(23) "Tiered Partner"** means any Partner that is a Partnership or Pass-Through Entity.

**(24) "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 that are required to be reported by a Partnership and its Partners using the procedures in Section C, and Final Federal Adjustments required to be reported for federal purposes under IRC section 6225(a)(2), a Taxpayer shall report and pay any [State] tax due with respect to Final Federal Adjustments arising from an audit or other action by the IRS or reported by the Taxpayer on a timely filed amended federal income tax return, including a return or other similar report filed pursuant to IRC section 6225(c)(2), or federal claim for refund by filing a Federal Adjustments Report with the [State Tax Agency] for the Reviewed Year and, if applicable, paying the additional [State] tax owed by the Taxpayer no later than 180 days after the Final Determination Date.

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

**Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Adjustment Request**

Except for adjustments required to reported for federal purposes pursuant to IRC section 6225(a)(2), and the distributive share of adjustments that have been reported as required under Section B, Partnerships and Partners shall report Final Federal Adjustments arising from a Partnership Level Audit or an Administrative Adjustment Request and make payments as required under this Section C.

(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 that action, the State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership, and the Partnership's Direct 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 Tax 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.** Final Federal Adjustments subject to the requirements of this Section C, except for those subject to a properly made election under Section C(3), shall be reported as follows:

(a) No later than 90 days after the Final Determination Date, the Partnership shall:

(i) File a completed Federal Adjustments Report, including information as required by [State Tax Agency regulation], with [State Tax Agency]; and

(ii) Notify each of its Direct Partners of their distributive share of the Final Federal Adjustments including information as required by the [State Tax Agency regulation]; 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 under [reference to State law(s)] that would have been due had the Final Federal Adjustments been reported properly as required.

(b) [Except as provided under State law for minimal tax liabilities][4], no later than 180 days after the Final Determination Date, each Direct Partner that is taxed under [reference to State law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:

(i) File a Federal Adjustments Report reporting their distributive share of the adjustments reported to them under Section C(2)(a)(ii) as required under [reference to State laws]; and

(ii) Pay any additional amount of tax due as if Final Federal Adjustments 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 under Section C(2)(a)(iii).

(3) **Election – Partnership Pays.** Subject to the limitations in Section C(3)(c), an Audited Partnership making an election under this Subsection (3) shall:

(a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustments Report, including information as required by the [State Tax Agency rule or instruction], and notify the [State Tax Agency] that it is making the election under this Subsection (3);

(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 and Indirect Partners:

(i) Exclude from Final Federal Adjustments the distributive share of these adjustments reported to a Direct Exempt Partner not subject to tax under [reference state law taxing certain income to tax-exempt entities].

(ii) For the total distributive shares of the remaining Final Federal Adjustments reported to Direct Corporate Partners subject to tax under [reference to State law] and to Direct Exempt Partners subject to tax under [reference state law taxing certain income to tax-exempt entities], apportion and allocate such adjustments as provided under [reference to existing multi-state business activity allocation/apportion law or regulation] and multiply the resulting amount by the highest tax rate under [reference to State law(s)];

(iii) For the total distributive shares of the remaining Final Federal Adjustments reported to Non-Resident Direct Partners subject to tax under [reference to State law applying to individuals and /or trusts], determine the amount of such adjustments which is [State]-source income under [reference to existing non-resident partner sourcing law or regulation], and multiply the resulting amount by the highest tax rate under

[4] DRAFTER'S NOTE: If the state adopts a de minimis rule as further set out in this model, then this section would need to be conditioned on a reference to that rule.

[reference to State law applying to individuals and/or trusts];

(iv) For the total distributive shares of the remaining Final Federal Adjustments reported to Tiered Partners:

(A) Determine the amount of such adjustments which is of a type that it would be subject to sourcing to the [State] under [reference to existing State rules for allocating/apportioning income of non-resident partners]; and then determine the portion of this amount that would be sourced to the state applying [these rules];

(B) Determine the amount of such adjustments which is of a type that it would not be subject to sourcing to the [State] by a Nonresident Partner under [reference to existing State rules for income fully sourced based on a taxpayer's residency];

(C) Determine the portion of the amount determined in Section C(3)(b)(iv)(B) that can be established, under regulation issued by [State Agency], to be properly allocable to Nonresident Indirect Partners or other Partners not subject to tax on the adjustments; or that can be excluded under procedures for Modified Reporting and Payment Method allowed under Paragraph (5).

(v) Multiply the total of the amounts determined in Section C(3)(b)(iv)(A) and (B) reduced by the amount determined in Section C(3)(b)(iv)(C) by the highest tax rate under [reference to State law applying to individuals and/or trusts];

(vi) For the total distributive shares of the remaining Final Federal Adjustments reported to Resident Direct Partners subject to tax under [reference to State law applying to individuals and /or trusts], multiply that amount by the highest tax rate under [reference to State law applying to individuals and/or trusts];

(vii) Add the amounts determined in Section C(3)(b)(ii), (iii), (v), and (vi), along with penalty and interest as provided in [reference to State law.

(c) Final Federal Adjustments subject to this election exclude:

DRAFTER'S NOTE: THE EXCLUSION IN (i) IS INTENDED TO ADDRESS THE PARTICULAR STATE'S LAW WITH RESPECT TO ADJUSTMENTS THAT WOULD FLOW THROUGH TO CORPORATE PARTNERS AND MIGHT BE TREATED AS PART OF THE UNITARY BUSINESS OF THE CORPORATION.

(i) The distributive share of Final Audit Adjustments that under [reference to State law] must be included in the unitary business income of any Direct or Indirect Corporate Partner, provided that the Audited Partnership can reasonably determine this; and

(ii) Any Final Federal Adjustments resulting from an Administrative Adjustment Request.

(d) {OPTIONAL PROVISIONS}

Option A - An Audited Partnership not otherwise subject to any reporting or payment

obligation to [State] that makes an election under this Subsection (3) consents to be subject to [State] laws related to reporting, assessment, payment, and collection of [State] tax calculated under the election.

Option B - An Audited Partnership not otherwise subject to any reporting or payment obligation to [State] may not make an election under this Subsection (3).

(4) **Tiered Partners.** The Direct and Indirect Partners of an Audited Partnership that are Tiered Partners, and all of the Partners of those Tiered Partners that are subject to tax under [reference to State laws imposing tax on individuals, trusts, corporations, etc.] are subject to the reporting and payment requirements of Section C(2) and the Tiered Partners are entitled to make the elections provided in Section C(3) and (5). The Tiered Partners or their Partners shall make required reports and payments no later than 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established under IRC section 6226 and the regulations thereunder. The [State Agency] may promulgate regulations to establish procedures and interim time periods for the reports and payments required by Tiered Partners and their Partners and for making the elections under this Section C.

(5) **Modified Reporting and Payment Method.** Under procedures adopted by and subject to the approval of the [State Agency], an Audited Partnership or Tiered Partner may enter into an agreement with the [State Agency] to utilize an alternative reporting and payment method, including applicable time requirements or any other provision of this Section C, 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 due under the provisions of this Section C. Application for approval of an alternative reporting and payment method must be made by the Audited Partnership or Tiered Partner within the time for election as provided in Section C(3) or (4), as appropriate.

(6) **Effect of Election by Audited Partnership or Tiered Partner and Payment of Amount Due.**

(a) The election made pursuant to Section C(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 Section C(3)(b), or similarly under an optional election under Section C(5), will be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the extent applicable, 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(C)(6) shall preclude a Direct Resident Partner 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 Partner on the Resident Partner's behalf

to another state or local tax jurisdiction in accordance with the provisions of [State law or regulation allowing credit for taxes paid to another state or locality].

(7) **Failure of Audited Partnership or Tiered Partner to Report or Pay.** Nothing in this Section C prevents the [State Agency] from assessing Direct Partners or Indirect Partners for taxes they owe, using the best information available, in the event that a Partnership or Tiered Partner fails to timely make any report or payment required by this Section C for any reason.

**SECTION D. De Minimis Exception**

The [State Agency] at its discretion may promulgate regulations to establish a de minimis amount upon which a taxpayer shall not be required to comply with Sections B and C of this [Chapter].

**SECTION E. Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income – Statute of Limitations**

The [State Agency] will assess additional tax, interest, and penalties arising from Final Federal 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 Sections B or C, the [State Agency] may assess any 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 Sections B or C, as appropriate, or the Federal Adjustments Report filed by the Taxpayer omits Final Federal Adjustments or understates the correct amount of 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 F. Estimated [State] Tax Payments During the Course of a Federal Audit**

A Taxpayer may make estimated payments to the [State Agency], following the process prescribed by the [State Agency], of the [State] tax expected to result from 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 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 tax payments exceed the final tax liability and statutory interest ultimately determined to be due, the Taxpayer is entitled to a refund or credit for the excess, provided the Taxpayer files a Federal Adjustments Report or claim for refund or credit of tax pursuant to [citation to State statute setting forth claim for refund requirements] no later than one year following the Final Determination Date.

**SECTION G. Claims for Refund or Credits of Tax Arising from Final Federal Adjustments Made by the IRS**

Except for Final Federal Adjustments required to be reported for federal purposes under IRC section 6225(a)(2), a Taxpayer may file a claim for refund or credit of tax arising 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 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 tax due, report a claim for refund or credit of tax, and make other adjustments (including to its net operating losses) resulting from adjustments to the Taxpayer's federal taxable income.

**SECTION H. 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 tax liability arising 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 tax arising from the adjustments

to federal taxable income and the period for filing a claim for refund or credit of taxes pursuant to [citation to State statute setting forth claim for refund requirements].

**SECTION I. 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].

## NOTES

Certain provisions of this model, particularly Section C, were drafted by the Commission's Uniformity Committee in anticipation of federal audits that will be done through the new centralized partnership audit regime beginning for 2018 tax years. These provisions are necessary because states otherwise lack the means to require reporting of, or to assess taxes related to, partnership audit adjustments where the federal tax is assessed to and paid by the partnership or is "pushed-out" to the partners in adjustment-year returns. This model also updates provisions of the Commission's 2003 Model Uniform Statute for Reporting Federal Tax Adjustments.

The drafters concluded that states could not effectively implement a "push-out" approach similar to the federal approach, for various reasons. But Section C does include a partnership-pays election for paying state taxes owed on federal partnership audit adjustments. In drafting the provisions of this election, it was recognized that, with respect to "tiered partners," the electing partnership may not have sufficient information to source the adjustments allocated to those partners—particularly information on the residency status of the tiered partner's individual partners ("indirect partners"). Therefore, if a federal audit adjustment relates to a type of income that is sourced 100% by the state based on residency (rather than apportioned), the calculation of the partnership-pays amount effectively assumes that indirect partners are residents so that 100% of the adjustment would be sourced to the state for those tiered partners. See Section C(3)(b)(iv)(B). Nor would the tiered partner's indirect partners be allowed a credit for taxes paid to another state. If the partnership wishes, instead, to apportion any part of these types of adjustments when allocated to tiered partners, it will have to provide information on the residency of the tiered partner's taxpaying partners. See Section C(3)(b)(iv)(C).

Throughout the model, references to existing state laws of the adopting state must be included. Particularly in the partnership pays election, there are references to state law governing the sourcing of multistate income (allocation and apportionment rules). The model does not

constrain the states in applying particular sourcing rules nor does it require the states to apply uniform rules. Those rules can also change over time. And, to the extent that there are specific rules for apportioning partnership income or certain types of income, those rules would apply in the partnership-pays election context. Such rules might also include equitable apportionment provisions. The only requirement is that the rules generally applicable in the reviewed year (audit year) be applied to adjustments for that year.

Note that certain provisions of the model specify that regulations should be promulgated to implement those provisions. Other regulations, or agency instructions, may be necessary, as well, to fully implement the model. The model was drafted in this manner, in part, to retain some flexibility, recognizing that the provisions related to partnership audit adjustments are new and untested. In addition to the provisions that specifically call for regulations, states may wish to consider regulations or instruction to:

- Define the precise information required to be provided in a federal adjustments report, generally, and specifically in the case of federal partnership adjustments that must be reported by the partnership under Section C(2).
- Specify the manner in which federal adjustments, and especially federal partnership adjustments, might need to be modified in order to conform to state tax laws (e.g. where an add-back statute might apply to an adjusted item or where that item has no impact at the state level) including how those modifications would be reported by the partnership.
- Specify the information that would be required for a partnership electing the partnership-pays approach to overcome the presumption that, in some cases, the indirect partners are residents, and the manner of requesting other adjustments in the partnership-pays approach. Section C(3)(b)(iv)(C) and Section C(5).

- Define how adjustments determined to be unitary business income of a corporate partner should be reported and treated by that partner where the partnership makes the partnership-pays election. Section C(3)(c).
- Determine the manner of allowing credits for taxes paid to other states by the partnership for its direct resident partners. Section C(6)(b).
- Specify the manner for making estimated payments as provided for in Section F during the course of a federal audit.

Finally, the partnership-pays election may potentially have revenue impacts. In some cases, the tax paid under that election to the state would be greater (primarily because of the use of the highest marginal rate to compute the tax). The revenue may also be greater if a partnership generates income that would ordinarily be sourced to the state of residence, and if that partnership has indirect partners. In that case, the indirect partners would be presumed to be resident partners for purposes of computing the partnership-pays amount unless the partnership provides information to demonstrate otherwise. In at least one case, however, the tax paid may be less. This is where the partnership generates income that would ordinarily be apportioned if earned by nonresidents. In that case, the partnership would apportion the share of the income that flows to indirect partners, even if some of those partners are residents (and would be entitled to a credit for taxes paid to another state, but not to apportioning their income).

During the drafting process, concerns were raised as to whether the partnership-pays election might be used to shift income or avoid state taxes. In particular, the concerns focused on federal partnership adjustments that would be allocated by the electing partnership to "tiered partners." The model's provisions to address indirect partners, Section C(3)(b)(iv), discussed above, along with state-specific sourcing rules and equitable apportionment authority, were determined to be sufficient to address these concerns. If a state lacked these other types of authority, however, it might consider adopting such authority for this

purpose. This, in turn, might influence the estimate of any revenue impacts.

# Model Uniform Statute for Reporting Adjustments to Federal Taxable Income and Federal Partnership Audit Adjustments

*This draft was produced 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 well as a work group set up by the MTC uniformity committee. As of this date, this draft has not been officially endorsed by these organizations.*

This draft has been reformatted with line numbering as well as internal citations simplified and underlined to aid in the final review.

**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 Partnership Level Audit resulting in a Federal Adjustment.

**(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 Income[1]].

**(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 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 laws] and is negative to the extent that it decreases state taxable income as determined under [reference to State laws].

**(7)** "**Federal Adjustments Report**" includes methods or forms required by [State Tax Agency] for use by a Taxpayer to report Final Federal Adjustments, including an amended [State] tax return, information 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).

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

**(9) "Final Determination Date"** means the following:

(a) Except as provided in Section A(9)(b) and (c), if the Federal Adjustment arises from an IRS audit or other action by the IRS, the Final Determination Date is the first day on which no Federal Adjustments arising from that audit or other action remain to be finally determined, whether by IRS decision with respect to which all rights of appeal have been waived or exhausted, 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.

(b) For Federal Adjustments arising from an IRS audit or other action by the IRS, 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, as described in Section A(9)(a), 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, or if it is a Federal Adjustment reported on an amended federal return or other similar report filed pursuant to IRC section 6225 (c), the Final Determination Date means the day on which the amended return, refund claim, Administrative Adjustment Request, or other similar report 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) "Non-Resident Partner"** means an individual, trust, or estate Partner that is not a Resident Partner.

**(15) "Partner"** means a person that holds an interest directly or indirectly in a Partnership or other Pass-Through Entity.

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[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."

**(16) "Partnership"** means an entity subject to taxation under Subchapter K of the IRC.

**(17) "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.

**(18) "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].

**(19) "Reallocation Adjustment"** means a Federal Adjustment resulting from a Partnership Level Audit or an Administrative Adjustment Request that changes the shares of one or more items of partnership income, gain, loss, expense, or credit allocated to Direct Partners. A positive Reallocation Adjustment means the portion of a Reallocation Adjustment that would increase federal income for one or more Direct Partners, and a negative Reallocation Adjustment means the portion of a Reallocation Adjustment that would decrease federal income for one or more Direct Partners [pursuant to Regulations under IRC section 6225].

**(20) "Resident Partner"** means an individual, trust, or estate Partner that is a resident in [State] under [reference to state laws] for the relevant tax period.

**(21) "Reviewed Year"** means the taxable year of a Partnership that is subject to a Partnership Level Audit from which Federal Adjustments arise.

**(22) "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 Administrative Adjustment Request, as well as a Tiered Partner of that Partnership.

**(23) "Tiered Partner"** means any Partner that is a Partnership or Pass-Through Entity.

**(24) "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 that are required to be reported by a Partnership and its Partners using the procedures in Section C, and Final Federal Adjustments required to be reported for federal purposes under IRC section 6225(a)(2), a Taxpayer shall report and pay any [State] tax due with respect to Final Federal Adjustments arising from an audit or other action by the IRS or reported by the Taxpayer on a timely filed amended federal income tax return, including a return or other similar report filed pursuant to IRC section 6225(c)(2), or federal claim for refund by filing a Federal Adjustments Report with the [State Tax Agency] for the Reviewed Year and, if applicable, paying the additional [State] tax owed by the Taxpayer no later than 180 days after the Final Determination Date.

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

**Section C. Reporting Federal Adjustments – Partnership Level Audit and Administrative Adjustment Request**

Except for adjustments required to reported for federal purposes pursuant to IRC section 6225(a)(2), and the distributive share of adjustments that have been reported as required under Section B, Partnerships and Partners shall report Final Federal Adjustments arising from a Partnership Level Audit or an Administrative Adjustment Request and make payments as required under this Section C.

(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 that action, the State Partnership Representative for the Reviewed Year shall have the sole authority to act on behalf of the Partnership, and the Partnership's Direct 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 Tax 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.** Final Federal Adjustments subject to the requirements of this Section C, except for those subject to a properly made election under Section C(3), shall be reported as follows:

(a) No later than 90 days after the Final Determination Date, the Partnership shall:

(i) File a completed Federal Adjustments Report, including information as required by [State Tax Agency regulation], with [State Tax Agency]; and

(ii) Notify each of its Direct Partners of their distributive share of the Final Federal Adjustments including information as required by the [State Tax Agency regulation]; 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 under [reference to State law(s)] that would have been due had the Final Federal Adjustments been reported properly as required.

(b) [Except as provided under State law for minimal tax liabilities][4], no later than 180 days after the Final Determination Date, each Direct Partner that is taxed under [reference to State law imposing tax on individuals, trusts, estates, C corporations, etc.] shall:

(i) File a Federal Adjustments Report reporting their distributive share of the adjustments reported to them under Section C(2)(a)(ii) as required under [reference to State laws]; and

(ii) Pay any additional amount of tax due as if Final Federal Adjustments 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 under Section C(2)(a)(iii).

(3) **Election – Partnership Pays.** Subject to the limitations in Section C(3)(c), an Audited Partnership making an election under this Subsection (3) shall:

(a) No later than 90 days after the Final Determination Date, file a completed Federal Adjustments Report, including information as required by the [State Tax Agency rule or instruction], and notify the [State Tax Agency] that it is making the election under this Subsection (3);

(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 and Indirect Partners:

(i) Exclude from Final Federal Adjustments the distributive share of these adjustments reported to a Direct Exempt Partner not subject to tax under [reference state law taxing certain income to tax-exempt entities].

(ii) For the total distributive shares of the remaining Final Federal Adjustments reported to Direct Corporate Partners subject to tax under [reference to State law] and to Direct Exempt Partners subject to tax under [reference state law taxing certain income to tax-exempt entities], apportion and allocate such adjustments as provided under [reference to existing multi-state business activity allocation/apportion law or regulation] and multiply the resulting amount by the highest tax rate under [reference to State law(s)];

(iii) For the total distributive shares of the remaining Final Federal Adjustments reported to Non-Resident Direct Partners subject to tax under [reference to State law applying to individuals and /or trusts], determine the amount of such adjustments which is [State]-source income under [reference to existing non-resident partner sourcing law or regulation], and multiply the resulting amount by the highest tax rate under

[4] DRAFTER'S NOTE: If the state adopts a de minimis rule as further set out in this model, then this section would need to be conditioned on a reference to that rule.

[reference to State law applying to individuals and/or trusts];

(iv) For the total distributive shares of the remaining Final Federal Adjustments reported to Tiered Partners:

(A) Determine the amount of such adjustments which is of a type that it would be subject to sourcing to the [State] under [reference to existing State rules for allocating/apportioning income of non-resident partners]; and then determine the portion of this amount that would be sourced to the state applying [these rules];

(B) Determine the amount of such adjustments which is of a type that it would not be subject to sourcing to the [State] by a Nonresident Partner under [reference to existing State rules for income fully sourced based on a taxpayer's residency];

(C) Determine the portion of the amount determined in Section C(3)(b)(iv)(B) that can be established, under regulation issued by [State Agency], to be properly allocable to Nonresident Indirect Partners or other Partners not subject to tax on the adjustments; or that can be excluded under procedures for Modified Reporting and Payment Method allowed under Paragraph (5).

(v) Multiply the total of the amounts determined in Section C(3)(b)(iv)(A) and (B) reduced by the amount determined in Section C(3)(b)(iv)(C) by the highest tax rate under [reference to State law applying to individuals and/or trusts];

(vi) For the total distributive shares of the remaining Final Federal Adjustments reported to Resident Direct Partners subject to tax under [reference to State law applying to individuals and /or trusts], multiply that amount by the highest tax rate under [reference to State law applying to individuals and/or trusts];

(vii) Add the amounts determined in Section C(3)(b)(ii), (iii), (v), and (vi), along with penalty and interest as provided in [reference to State law.

(c) Final Federal Adjustments subject to this election exclude:

DRAFTER'S NOTE: THE EXCLUSION IN (i) IS INTENDED TO ADDRESS THE PARTICULAR STATE'S LAW WITH RESPECT TO ADJUSTMENTS THAT WOULD FLOW THROUGH TO CORPORATE PARTNERS AND MIGHT BE TREATED AS PART OF THE UNITARY BUSINESS OF THE CORPORATION.

(i) The distributive share of Final Audit Adjustments that under [reference to State law] must be included in the unitary business income of any Direct or Indirect Corporate Partner, provided that the Audited Partnership can reasonably determine this; and

(ii) Any Final Federal Adjustments resulting from an Administrative Adjustment Request.

(d) {OPTIONAL PROVISIONS}

Option A - An Audited Partnership not otherwise subject to any reporting or payment

obligation to [State] that makes an election under this Subsection (3) consents to be subject to [State] laws related to reporting, assessment, payment, and collection of [State] tax calculated under the election.

Option B - An Audited Partnership not otherwise subject to any reporting or payment obligation to [State] may not make an election under this Subsection (3).

(4) **Tiered Partners.** The Direct and Indirect Partners of an Audited Partnership that are Tiered Partners, and all of the Partners of those Tiered Partners that are subject to tax under [reference to State laws imposing tax on individuals, trusts, corporations, etc.] are subject to the reporting and payment requirements of Section C(2) and the Tiered Partners are entitled to make the elections provided in Section C(3) and (5). The Tiered Partners or their Partners shall make required reports and payments no later than 90 days after the time for filing and furnishing statements to Tiered Partners and their Partners as established under IRC section 6226 and the regulations thereunder. The [State Agency] may promulgate regulations to establish procedures and interim time periods for the reports and payments required by Tiered Partners and their Partners and for making the elections under this Section C.

(5) **Modified Reporting and Payment Method.** Under procedures adopted by and subject to the approval of the [State Agency], an Audited Partnership or Tiered Partner may enter into an agreement with the [State Agency] to utilize an alternative reporting and payment method, including applicable time requirements or any other provision of this Section C, 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 due under the provisions of this Section C. Application for approval of an alternative reporting and payment method must be made by the Audited Partnership or Tiered Partner within the time for election as provided in Section C(3) or (4), as appropriate.

(6) **Effect of Election by Audited Partnership or Tiered Partner and Payment of Amount Due.**

(a) The election made pursuant to Section C(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 Section C(3)(b), or similarly under an optional election under Section C(5), will be treated as paid in lieu of taxes owed by its Direct and Indirect Partners, to the extent applicable, 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(C)(6) shall preclude a Direct Resident Partner 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 Partner on the Resident Partner's behalf

to another state or local tax jurisdiction in accordance with the provisions of [State law or regulation allowing credit for taxes paid to another state or locality].

(7) **Failure of Audited Partnership or Tiered Partner to Report or Pay.** Nothing in this Section C prevents the [State Agency] from assessing Direct Partners or Indirect Partners for taxes they owe, using the best information available, in the event that a Partnership or Tiered Partner fails to timely make any report or payment required by this Section C for any reason.

**SECTION D. De Minimis Exception**

The [State Agency] at its discretion may promulgate regulations to establish a de minimis amount upon which a taxpayer shall not be required to comply with Sections B and C of this [Chapter].

**SECTION E. Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income – Statute of Limitations**

The [State Agency] will assess additional tax, interest, and penalties arising from Final Federal 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 Sections B or C, the [State Agency] may assess any 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 Sections B or C, as appropriate, or the Federal Adjustments Report filed by the Taxpayer omits Final Federal Adjustments or understates the correct amount of 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 F. Estimated [State] Tax Payments During the Course of a Federal Audit**

A Taxpayer may make estimated payments to the [State Agency], following the process prescribed by the [State Agency], of the [State] tax expected to result from 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 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 tax payments exceed the final tax liability and statutory interest ultimately determined to be due, the Taxpayer is entitled to a refund or credit for the excess, provided the Taxpayer files a Federal Adjustments Report or claim for refund or credit of tax pursuant to [citation to State statute setting forth claim for refund requirements] no later than one year following the Final Determination Date.

**SECTION G. Claims for Refund or Credits of Tax Arising from Final Federal Adjustments Made by the IRS**

Except for Final Federal Adjustments required to be reported for federal purposes under IRC section 6225(a)(2), a Taxpayer may file a claim for refund or credit of tax arising 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 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 tax due, report a claim for refund or credit of tax, and make other adjustments (including to its net operating losses) resulting from adjustments to the Taxpayer's federal taxable income.

**SECTION H. 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 tax liability arising 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 tax arising from the adjustments

to federal taxable income and the period for filing a claim for refund or credit of taxes pursuant to [citation to State statute setting forth claim for refund requirements].

**SECTION I. 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].

## NOTES

Certain provisions of this model, particularly Section C, were drafted by the Commission's Uniformity Committee in anticipation of federal audits that will be done through the new centralized partnership audit regime beginning for 2018 tax years. These provisions are necessary because states otherwise lack the means to require reporting of, or to assess taxes related to, partnership audit adjustments where the federal tax is assessed to and paid by the partnership or is "pushed-out" to the partners in adjustment-year returns. This model also updates provisions of the Commission's 2003 Model Uniform Statute for Reporting Federal Tax Adjustments.

The drafters concluded that states could not effectively implement a "push-out" approach similar to the federal approach, for various reasons. But Section C does include a partnership-pays election for paying state taxes owed on federal partnership audit adjustments. In drafting the provisions of this election, it was recognized that, with respect to "tiered partners," the electing partnership may not have sufficient information to source the adjustments allocated to those partners—particularly information on the residency status of the tiered partner's individual partners ("indirect partners"). Therefore, if a federal audit adjustment relates to a type of income that is sourced 100% by the state based on residency (rather than apportioned), the calculation of the partnership-pays amount effectively assumes that indirect partners are residents so that 100% of the adjustment would be sourced to the state for those tiered partners. See Section C(3)(b)(iv)(B). Nor would the tiered partner's indirect partners be allowed a credit for taxes paid to another state. If the partnership wishes, instead, to apportion any part of these types of adjustments when allocated to tiered partners, it will have to provide information on the residency of the tiered partner's taxpaying partners. See Section C(3)(b)(iv)(C).

Throughout the model, references to existing state laws of the adopting state must be included. Particularly in the partnership pays election, there are references to state law governing the sourcing of multistate income (allocation and apportionment rules). The model does not

constrain the states in applying particular sourcing rules nor does it require the states to apply uniform rules. Those rules can also change over time. And, to the extent that there are specific rules for apportioning partnership income or certain types of income, those rules would apply in the partnership-pays election context. Such rules might also include equitable apportionment provisions. The only requirement is that the rules generally applicable in the reviewed year (audit year) be applied to adjustments for that year.

Note that certain provisions of the model specify that regulations should be promulgated to implement those provisions. Other regulations, or agency instructions, may be necessary, as well, to fully implement the model. The model was drafted in this manner, in part, to retain some flexibility, recognizing that the provisions related to partnership audit adjustments are new and untested. In addition to the provisions that specifically call for regulations, states may wish to consider regulations or instruction to:

- Define the precise information required to be provided in a federal adjustments report, generally, and specifically in the case of federal partnership adjustments that must be reported by the partnership under Section C(2).
- Specify the manner in which federal adjustments, and especially federal partnership adjustments, might need to be modified in order to conform to state tax laws (e.g. where an add-back statute might apply to an adjusted item or where that item has no impact at the state level) including how those modifications would be reported by the partnership.
- Specify the information that would be required for a partnership electing the partnership-pays approach to overcome the presumption that, in some cases, the indirect partners are residents, and the manner of requesting other adjustments in the partnership-pays approach. Section C(3)(b)(iv)(C) and Section C(5).

- Define how adjustments determined to be unitary business income of a corporate partner should be reported and treated by that partner where the partnership makes the partnership-pays election. Section C(3)(c).
- Determine the manner of allowing credits for taxes paid to other states by the partnership for its direct resident partners. Section C(6)(b).
- Specify the manner for making estimated payments as provided for in Section F during the course of a federal audit.

Finally, the partnership-pays election may potentially have revenue impacts. In some cases, the tax paid under that election to the state would be greater (primarily because of the use of the highest marginal rate to compute the tax). The revenue may also be greater if a partnership generates income that would ordinarily be sourced to the state of residence, and if that partnership has indirect partners. In that case, the indirect partners would be presumed to be resident partners for purposes of computing the partnership-pays amount unless the partnership provides information to demonstrate otherwise. In at least one case, however, the tax paid may be less. This is where the partnership generates income that would ordinarily be apportioned if earned by nonresidents. In that case, the partnership would apportion the share of the income that flows to indirect partners, even if some of those partners are residents (and would be entitled to a credit for taxes paid to another state, but not to apportioning their income).

During the drafting process, concerns were raised as to whether the partnership-pays election might be used to shift income or avoid state taxes. In particular, the concerns focused on federal partnership adjustments that would be allocated by the electing partnership to "tiered partners." The model's provisions to address indirect partners, Section C(3)(b)(iv), discussed above, along with state-specific sourcing rules and equitable apportionment authority, were determined to be sufficient to address these concerns. If a state lacked these other types of authority, however, it might consider adopting such authority for this

purpose. This, in turn, might influence the estimate of any revenue impacts.

HOWARD MARKLEIN
STATE SENATOR • 17TH SENATE DISTRICT

# January 29, 2020
# Senate Committee on Agriculture, Revenue & Financial Institutions
# Testimony on Senate Bill 720

Good Morning!

Thank you committee members for hearing Senate Bill 720 (SB 720) that makes various changes to the laws administered and enforced by the Department of Revenue (DOR).

Rep. Wittke and I introduced SB 720 at the request of the Department of Revenue (DOR). This bill makes several technical corrections and minor policy changes that are intended to be revenue neutral or have minimal fiscal impacts.

SB 720 is intended to streamline the processes for both taxpayers and state government. One example is intended to simplify the process for a Wisconsin nonprofit organization to apply for a Certificate of Exempt Status (CES) number, which allows the nonprofit to make all purchases exempt from tax. Under the proposal, in order to obtain a CES, a non-profit organization will only need demonstrate their determination letter from the Internal Revenue Service (IRS) stating that they qualify as exempt under section 501(c)(3) of the Internal Revenue Code (IRC).

In 2018, Wisconsin adopted changes in state law as a result of the U.S. Supreme Court decision in South Dakota v. Wayfair. The Wayfair decision established a 200 transaction or $100,000 threshold for sales tax nexus. Many states are realizing that having two standards for collecting tax for out-of-state online retailers is complex and could inhibit compliance and are moving to the sole $100,000 threshold. SB 720 removes the 200 transaction component for sales tax nexus.

Another provision seeks to clarify eligibility for the homestead credit by adding the IRC definition of "earned income", and creating a definition of "primary income from farming" in order to clarify which farming losses do not have to be added to household income. This will assist certain farmers, so they can successfully claim a homestead credit.

The bill also includes minor policy changes such as the refund interest rate. In 2015, the legislature changed the interest rate paid by DOR on refunds from 9% to 3%. It appears most parts of the law were included except for Chapter 76 – Taxation of Public Utilities and Insurers, which was left at 9%. This would align the refund interest rate for utilities, air carriers and railroads with the refund rate DOR pays to other taxpayers.

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Since this bill was introduced, we have heard some concerns from taxpayers with various provisions in the bill. We will be reviewing the concerns that have been raised and intend to draft an amendment prior to this bill being scheduled for an executive session.

Following my testimony, you will hear from DOR Secretary Peter Barca, who will discuss each of the provisions in greater detail.

Thank you again for hearing SB 720, and your timely action on this proposal.

WMC

WISCONSIN MANUFACTURERS & COMMERCE

To: Senate Committee on Agriculture, Revenue, and Financial Institutions

From: Cory Fish, General Counsel and Director of Tax

Date: January 29, 2020

Re: Testimony on Senate Bill 720

Thank you Chair Marklein and members of the Senate Committee on Agriculture, Revenue, and Financial Institutions for hearing my testimony on Senate Bill 720 (SB 720). Wisconsin Manufacturers and Commerce (WMC) is generally supportive of many of the changes made in SB 720 to Wisconsin's tax code. However, WMC is concerned that the bill contains a handful of potentially harmful provisions to taxpayers.

WMC is the state chamber of commerce and largest general business association in Wisconsin. We were founded over 100 years ago, and are proud to represent approximately 3,800 member companies of all sizes, and from every sector of our economy. Our mission is to make Wisconsin the most competitive state in the nation in which to do business. One way WMC works to make our mission a reality is to advocate for a fair and effective taxation system.

**WMC respectfully requests that the Legislature remove provisions regarding adopting new procedures for pass-through entity audits and nonresident income taxation. Further WMC requests a technical correction is made to Wisconsin's Dividends Received Deduction, which the Department of Revenue (DOR) has been wrongfully denying to taxpayers.**

**Provisions the Legislature Should Remove From SB 720**

- **Pass-Through Entity Audits:** WMC has a few concerns with the audit provisions in SB 720 (Sections 27-33, 37-43, and 47). While DOR appears to attempt to apply portions of the Federal Partnership Audit Rules, in general these rules have been unfavorably received by the business community throughout the IRS's rule promulgation process. These rules – and the relevant provisions in SB 720 – make it harder for individual taxpayers who are members of partnerships to appeal their tax bill. SB 720 goes further than the IRS rules because it includes S-Corporations and because the opt-out provision is significantly smaller than the federal version. Many business taxpayers believe the federal opt-out provision is too limited, and it allows for a partnership with 100 or fewer partners to opt-out. SB 720 only allows for partnerships/S-Corporations with five or few partners to opt-out. **The pass-through entity audit changes proposed by DOR in SB**

**720 do little to nothing to help taxpayers and should be removed from the legislation.**

If the Legislature is interested in changing procedures for pass-through entity audits WMC respectfully recommends it be done in a more methodical manner with all relevant stakeholders engaged. WMC further recommends using the "Model Uniform Statute for Reporting Adjustment to Federal Taxable Income and Federal Partnership Audit Adjustments" as a starting point for legislation on this topic.[1]

- **Nonresident Income:** While it may not have been DOR's intent, the relevant language in SB 720 has the potential to affect certain service providers (including law firms, public accounting firms, financial advisors) in a manner broader than taxing out-of-state workers who do work in Wisconsin. The bill requires out-of-state partners to pay income tax in Wisconsin even if they do not engage in business in Wisconsin (either physically or through a remote presence) if their partnership derived income from conducting business in the state. This could result in substantial distortions in how much income a non-resident partner is required to recognize in Wisconsin. While changes to Wisconsin's nonresident income statute may be needed, the potential compliance, complexity and uncertainty this change would cause is significant. **This provision should be removed from the legislation and should be revisited in a more methodical manner.**

## Provision the Legislature Should Amend Into SB 720

- **Clarify the Scope of the Dividends Received Deduction:** Provide clarity to the interpretation of Wisconsin's dividends received deduction (DRD) (Wis. Stat. § 71.26(3)(j)).

  Income of a foreign corporate subsidiary is taxable by Wisconsin when it is paid as a dividend to the subsidiary's domestic parent company. In order to not discriminate against foreign commerce Wisconsin allows a dividends received deduction if the domestic parent owns 70% or more of the foreign subsidiary's common stock. DOR used to allow the deduction to be taken by the parent company if the foreign subsidiary elected to be taxed as a corporation regardless of what its legal structure actually was (it could be a partnership for instance). Without a statutory or regulatory change, DOR has changed its interpretation so that the foreign entity must be organized as a corporation under the foreign nation's law in order for the domestic parent company to get the deduction for any dividends received. This shift in DOR policy discriminates against entities that are *taxed the same* based on how they're legally structured and disincentivizes U.S. parent companies from repatriating foreign income and investing it in Wisconsin. **To ensure DOR applies a consistent interpretation,**

[1] http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Model-RAR-Statute.pdf.aspx?lang=en-US

**the statute should be clarified in the budget so that the deduction is still allowed, as intended, when the entity elects to be taxed as if it were a corporation.**

Attached to this testimony is a memo that outlines WMC's concern with the DRD in more detail as well as a memo from the non-partisan Council on State Taxation raising similar concerns regarding the pass-through entity audit provisions.

Thank you again Chair Marklein and Committee members for allowing me to testify. If you have any questions regarding this testimony, please do not hesitate to reach out to me at cfish@wmc.org or (608) 661-6935.

WISCONSIN COUNTIES ASSOCIATION

LEAGUE OF WISCONSIN MUNICIPALITIES

To: Senate Committee on Agriculture, Revenue, and Financial Institutions
From: Curt Witynski, J.D., Deputy Executive Director, League of Wisconsin Municipalities
Kyle Christianson, Director of Government Affairs, Wisconsin Counties Association
Date: January 29, 2020
**Re: SB 720, Various changes to the laws administered and enforced by the Department of Revenue**

The League of Wisconsin Municipalities and the Wisconsin Counties Association generally support SB 720, making changes to laws administered by the Department of Revenue, many of which impact local governments. We appreciate that the Department reached out to our associations and sought feedback on the proposed changes in this bill early in the process.

We also appreciate that the Department listened to our concerns and added a few items at our request, including changing the date of determining the inflation factor for the Expenditure Restraint Program to better align with the local budgeting process and changes to inconsistent statutory mandates on local governments.

The technical changes made by SB 720 make sense and are good public policy. We urge you to recommend passage of the bill. Thanks for considering our comments.

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