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BILL ANALYSIS

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Senate Bill 1035 (as introduced 7-23-20)
Sponsor: Senator Jim Runestad
Committee: Finance

Date Completed: 9-2-20

CONTENT

The bill would add Chapter 18 to the Income Tax Act to do the following:

- **Require partnerships and partners to report final Federal adjustments arising from a partnership level audit or an administrative adjustment request and to make payments as required.**
- **Specify that with respect to actions specified under the bill, the State partnership representative for the reviewed year would have the sole authority to act on behalf of the partnership.**
- **Allow the Department of Treasury to establish reasonable qualifications and procedures for designating a person, other than the Federal representative, to be the State representative.**
- **Prescribe the method for reporting final Federal adjustments.**
- **Prescribe the procedures for an audited partnership that chose to make an election and pay the applicable taxes under Chapter 18.**
- **Specify that if a taxpayer filed a Federal adjustments report or an amended return within the time period specified, the Department could not assess additional tax, interest, and penalties.**
- **Allow a taxpayer that expected to owe additional tax as a result of a partnership level audit to make payments before the report due date.**
- **Allow the Department to promulgate rules to implement Chapter 18.**

The bill also would amend the Act to specify that requirements to file an amended return would not apply to the reporting of a final Federal adjustment arising from a partnership level audit or an administrative adjustment request required to be reported under proposed Chapter 18.

The bill states that it is intended to be retroactive and apply to all tax years that begin on and after January 1, 2018.

Definitions

As used in proposed Chapter 18, the listed terms would have the following definitions.

"Audited partnership" would mean a partnership subject to a partnership level audit resulting in a Federal adjustment. "Partnership" would mean an entity subject to taxation under subchapter K of the Internal Revenue Code (IRC).

"Partnership level audit" would mean an examination by the Internal Revenue Service (IRS) at the partnership level pursuant to the IRC, which results in Federal adjustments.

"Federal adjustment" would mean a change to an item or amount determined under the IRC that is used by a taxpayer to compute tax liability under the Income Tax Act 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 tax due under the Act and is negative to the extent that it decreases the tax due under the Act.

"Partner" would mean a person that holds an interest directly or indirectly in a partnership or pass-through entity.

"Administrative adjustment request" would mean an administrative adjustment request filed by a partnership under the IRC.

"Federal adjustments report" would include methods or forms required by the Department for use by a taxpayer to report final Federal adjustments, including an amended tax return or information return.

"Federal partnership representative" would mean the person the partnership designates for the reviewed year as the partnership's representative, or the person the IRS has appointed to act as the Federal partnership representative, pursuant to the IRC.

"Final determination date" would mean the following:

- Except as provided below, if the Federal adjustment arises from a partnership level audit, the final determination date is the first day on which no Federal adjustments arising from that audit remain to be finally determined, whether by 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 Federal adjustments arising from a partnership level audit, if the taxpayer filed as a person included in a unitary business group, the term means the first day on which no related Federal adjustments arising from that audit remain to be finally determined for the entire unitary business group.
- If the Federal adjustment results from filing an administrative adjustment request, the term means the day on which the administrative adjustment request was filed.

"Final Federal adjustment" would mean a Federal adjustment after the final determination date for that Federal adjustment has passed.

"Pass-through entity" would mean an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company.

"Reviewed year" would mean the tax year of a partnership that is subject to a partnership level audit from which Federal adjustment arises.

Partnership & Partnership Level Audits

Under proposed Chapter 18, except for adjustment required to be reported for Federal purposes under the IRC, partnerships and partners would have to report final Federal adjustments arising from a partnership level audit or an administrative adjustment request, and would have to make payments as required.

With respect to an action required or permitted to be taken and any other proceeding or action permitted under Chapter 18 or the revenue Act, the State partnership representative for the

reviewed year would have the sole authority to act on behalf of the partnership and the partnership's direct partners and indirect partners would be bound by those actions. The representative for the reviewed year would be the partnership's Federal partnership representative unless the partnership designated another person as its State representative. The Department could establish reasonable qualifications and procedures for designating a person, other than the Federal representative to be the State representative.

Final Federal Adjustments

Except for final Federal adjustments subject to a properly made election as described below, final Federal adjustments would have to be reported as follows:

- Within 90 days after the final determination date, the partnership would have to do all of the following: a) file a completed Federal adjustments report, including information as required by the Department; b) report to each of its direct partners for the reviewed year their distributive share of the final Federal adjustments including information as required by the Department; c) submit a payment on behalf of any nonresident partner previously included on a composite return for the reviewed year for the additional amount of tax that would have been due had the final Federal adjustment been reported correctly.
- If the increase in the amount of tax due that resulted from the partnership level audit were \$25 or more, within 180 days after the final determination date, each direct partner for that reviewed year that was a corporate partner, resident partner, or nonresident partner that was not included in the payment on behalf of a nonresident partner would have to file a Federal adjustments report reporting that partner's share of the adjustments reported and pay any additional amount of tax due as if the adjustments had been properly reported, plus any penalty and interests as provided under the revenue Act.

Chapter 18 Elections

An audited partnership that made an election as specified below would be subject to the laws related to reporting, assessment, payment, and collection of tax calculated under the Income Tax Act and the revenue Act and, within 90 days after the final determination date, would have to file a completed Federal adjustments report and notify the Department that it was making the election.

An audited partnership that made an election, within 180 days after the final determination date, would have to pay an amount equal to the sum of the following, along with any penalty and interest instead of taxes owed by its direct and indirect partners:

- Exclude from final Federal adjustments both the share of these adjustments attributed to direct exempt partners not subject to tax under the Income Tax Act and, if reasonably identified by the audited partnership, the share of final Federal audit adjustments attributed to any direct or indirect corporate partner that was included in a unitary business group with the audited partnership for apportionment purposes.
- For the shares of the final Federal adjustments remaining after the exclusion above that were attributed to direct corporate partners, determine the amount of shares that were allocated or apportioned to the State and multiply that share amount by the tax rate imposed for the reviewed year.
- For the shares of the final Federal adjustments remaining after the above exclusions that were attributed to direct tiered partners as specified in the bill.
- For the shares of the final Federal adjustments remaining after the above exclusions that were attributed to direct partners subject to tax, determine the amount of shares that were allocated and apportioned to the State and multiply that share amount by the tax rate imposed for the reviewed year.

The direct and indirect partners of an audited partnership that were tiered partners, and all of the partners of those tiered partners that were subject to tax under the Income Tax Act would be subject to the reporting and payment requirements described above and the tiered partners would be entitled to make the specified elections. The tiered partners or their partners would have to make required reports and payments within 90 days after the time for filing and furnishing statements to tiered partners and their partners as established under the IRC.

An audited partnership or tiered partner would have to submit an application to the Department, in a form and manner it prescribed, for an alternative reporting and payment method within the time allowed for an election. After the application was approved, an audited partnership or tiered partner could enter into an agreement with the Department to use an alternative reporting and payment method, including applicable time requirements or any other provision, if the audited partnership or tiered partner demonstrated that the requested method would reasonably provide for the reporting and payments of taxes, penalties, and interest due.

An election made as specified above would be irrevocable, unless the Department, in its discretion, determined otherwise. If properly reported and paid by the audited partnership or tiered partner, amounts paid under an election would be considered 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 would be prohibited from taking any deduction or credit under the Act against this amount or from claiming a refund of the amount. These provisions would not preclude a direct resident partner from claiming a credit against taxes paid to the State under the Income Tax Act, any amounts paid by the audited partnership or tiered partner on the resident partner's behalf to another state or local tax jurisdiction. If a partnership or tiered partner failed to make a timely report or payment as required, the Department could assess direct partners or indirect partners for taxes owed as determined based on the best information available.

Penalties & Advance Payments

If a taxpayer filed a Federal adjustments report or an amended return as required and within the time period specified in the bill, the Department could not assess additional tax, interest, and penalties arising from final Federal adjustments after the limitations period specified in revenue Act expired. If a taxpayer failed to file the Federal adjustments report within the time period specified or the taxpayer filed a report that omitted adjustments or understated the correct amount of tax owed, the Department could assess additional tax, interest, and penalties arising from those adjustments if the Department issued a notice of assessment to the taxpayer within six years after the final determination date.

A taxpayer that expected to owe additional tax as a result of a pending partnership level audit could make payments, as prescribed by the Department, before the due date of the Federal adjustments report. The Department would have to credit any payments against any tax liability ultimately found to be due under the report and any payments made would limit the accrual of further statutory interest on that amount.

Except for final Federal adjustments required to be reported for Federal purposes under the IRC, a taxpayer could file a claim for a refund or credit of the overpayment of the tax arising from Federal adjustments made by the IRS before the statute of limitations expired. For a taxpayer that was a partnership, any claim for a refund or credit would have to be made within two years of the final determination date of the Federal adjustment.

The time periods provided in the bill could be extended as provided under either of the following:

- Automatically, upon written notice to the Department, by 60 days for an audited partnership or tiered partner that had 10,000 or more direct partners.
- By written agreement between the taxpayer and the Department.

Promulgation of Rules

The Department could promulgate rules to implement the bill and could establish procedures and interim time periods for the reports and payments required by tiered partners and their partners and for making elections. To the extent practicable, the Department would have to establish rules and regulations that conformed as closely as possible to the Federal rules and procedures.

Amended Returns

A taxpayer generally must file an amended return with the Department of Treasury showing any final alteration in, or modification of, the taxpayer's Federal income tax return that affects the taxpayer's taxable income or tax base and of any similarly related recomputation of tax or determination of deficiency under the Internal Revenue Code. Under the bill, these provisions would not apply to the reporting of a final Federal adjustment arising from a partnership level audit or an administrative adjustment required to be reported under Chapter 18.

For tax years that began on and after January 1, 2018, a partnership that was not subject to Chapter 18, but had determined that the partner's share of income, deductions, and credits previously reported to its partners and included in a filed return required adjustment, could, at the discretion of the Department, file a report with the Department and pay the tax due or claim a refund on behalf of its partners in a manner similar to the process set forth in Chapter 18.

MCL 206.325 et al.

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bill would have a negative fiscal impact on the Department of Treasury, a negligible fiscal impact on State revenue, and no fiscal impact on local units of government. The Department of Treasury would experience initial costs to create new tax filing forms, information technology costs, and costs for the staff training. These costs could be greater than current appropriations. After implementation, the bill likely would not have significant ongoing costs or savings for processing Federal adjustments for partnerships. Savings from a reduction in forms needed to adjust individual tax returns involved in partnerships likely would be spent on processing the joint adjustment forms.

It is unlikely that there would be an impact on State revenue beyond possible rounding differences from filling adjustments jointly as a partnership instead of filling individuals tax return adjustments.

Fiscal Analyst: Cory Savino
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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.