



W E S T V I R G I N I A

STATE TAX DEPARTMENT

Federal Partnership Audit
Regime Changes: West
Virginia's Response, So Far...

Before we get started

This presentation is meant to be a source of general information and not as a substitute for tax laws, rules, or regulations and may not be relied upon as legal or tax advice or to support specific instances not addressed.

The material presented may contain simplified explanations of potentially complex legal and tax concepts so as to apply generally across broad areas of tax practice, both legal and accounting, and is intended for general overview and application.

Individual comments by presenters are meant to be illustrative in nature and are not intended as official Tax Department policy.

Background

- Traditionally, pass-through entities have been assessed at the partner level, as opposed to the entity level.
- Over the years, there has been extraordinary growth, matched by decline in C corporations
- Between 2002-2011: Number of PS up 47% while number of C corporations down 22%
- Between 2002-2011: Number of large PS up 257% while value of assets held by large PS up 289%

Background

- Types of pass-through entities include partnerships, S corporations, limited liability companies, and master limited partnerships.
- A few types of pass-through entities came into existence during the past forty years. The first MLP was formed during 1981 by Apache Corporation (Section 7704 of the IRC later imposed limitations.) In 1992, West Virginia was the thirteenth state to enact a limited liability act (which was amended during 1996).

Background

It was extremely difficult and inefficient to audit at the entity level and assess at the partner level because...

- PS tend to disappear
- An audit representative for the PS must be found
- Sources of income in a multi-tiered PS must be found
- The audit must be completed in the specified timeframe, and
- Adjustments must be passed through to the ultimate partners

Summary of federal changes

Evolution of partnership
treatment over the past 40
years or so...

Summary of federal changes

- TEFRA (Tax Equity and Fiscal Responsibility Act of 1982): Due to falling tax revenues, this Act rescinded some of the effects of the Kemp-Roth Act passed the previous year. Repealed effective 2018.
- ELP (Electing Large Partners) was part of the Taxpayer Relief Act of 1997: Subtitle C addressed electing large partnerships and provided that large partnerships with over 100 direct partners could elect for audit to be made at the entity level. Repealed effective 2018.

Summary of federal changes

- 9/18/2014 The Government Accountability Office issued a report called “GAO-14-732 Large Partnerships: With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency” that depicted problems with how partnerships were being audited.
- BBA (Bipartisan Budget Act of 2015) included provisions that would make it easier for the Internal Revenue Service to audit large partnerships.

Summary of federal changes

- PATH (Protecting Americans from Tax Hikes Act of 2015). Technical corrections to the new audit rules were made in Section 411.
- Consolidated Appropriations Act of 2018: “Title II – Technical Corrections Related to Partnership Audit Rules” amends those provisions of the BBP that address partnership audits and coordinates the new partnership audit provisions with other sections of the Internal Revenue Code.
- Final regulations begin filtering through during early 2018.

Summary of federal changes

The provisions of the Bipartisan Budget Act of 2015 are effective for returns filed for partnerships tax years after December 31, 2017.

Summary of federal changes

- Election out not made on yearly return for “small” PS
- The PS is audited –
- The PR represents the PS
- The audit covers 1065s and K-1s
- Final audit report reviewed by PR
- Notice of Proposed PS Adjustment issued (highest rate of tax applied)

Summary of federal changes

- 270-day Modification period
- IRS will consider --
- information showing one or more partners have filed amended returns. If the adjustments are re-allocations, all affected partners must file amended returns; and
- Information of partners' tax exempt status.
- REMEMBER: The Omnibus bill added a process involving the partner paying his or her share of the adjustments, the partner agreeing to account for adjustments in his or her tax attributes, and the partner providing such information as the secretary requires.

Summary of federal changes

- Modified final PS adjustment (FPA) issued. The PR must decide whether -
- PS pays the partnership adjustment, or
- The PS “pushes out” adjustment to partners, or
- The PS contests the adjustment, or
- The PS contests and pushes out adjustments.
- NOTE: The adjustment year PS/partners pay the tax liability arising from reviewed year, several years prior.

Summary of federal changes

Once federal audit adjustments final, it is time for adjustments to be reported to the states.

Summary of state changes

However, most states had no process or authority to process changes arising from federal partnership audit changes during 2015.

Summary of state changes

The MTC created a workgroup of states and practitioners to develop model legislation, which West Virginia did utilize.

Summary of state changes

- Senate Bill 499 was passed during the regular legislative session on March 9, 2019.
- It amended provisions in Articles 10, 21, 24, and created Article 21A.

Summary of state changes

- SB 499 became effective July 1, 2019
- The following sections and the new article were effective as amended during 2019 for tax years after January 1, 2018: 11-10-18c, 11-21-3, 11-21-37a, 11-21-37b, 11-21-37c, and Article 21A.
- Sections 11-21-59, 11-21-59a, 11-21-71a, and 11-24-20 state the 2019 amendments were effective for final federal determinations after effective date of the 2019 amendments regardless of tax year.

Summary of state changes

Changes to Article 10, Chapter 11--

11-10-3. *Application of article.* Recently-enacted taxes that are administered under Article 10 were added, as well as numbering.

11-10-4. *Definitions.* The terms “C corporation”, “information return or report” and “pass-through entity” were added, the definition of “person” is expanded, and there is subsequent renumbering and minor updates, such as the addition of the term “fees” to some provisions.

Summary of state changes

11-10-7. *Assessment.* The term “taxpayer” is defined to include any pass-through entity that owes taxes pursuant to the new article and there are stylistic changes and other minor updates.

11-10-14. *Overpayments, credits, refunds and limitations.* These amendments update the statute of limitations for civil actions from 5 years to 2 years. There are stylistic and minor updates, and subdivision (l)(4) lists Articles, 21, 21A, and 24 as being subject to the provisions regarding overpayment of federal taxes.

Summary of state changes

11-10-15. *Limitations on assessment.* The new article is cited and there are stylistic changes and updates.

11-10-16. *Limitations on collection.* Subsection (c) addressing inheritance tax liens is stricken and there are stylistic changes.

11-10-18c. *Failure to file partnership return or report.* This is a new section that sets forth a penalty for failure to file a return or report or filing an incomplete return or report. This penalty is in addition to the additions set forth in section 11-10-18. This penalty is assessed against the entity and there is a formula to determine the amount, including an adjustment for inflation. Deficiency procedures will not apply, there is a rounding convention, and the effective date was January 1, 2018.

Summary of state changes

Changes to Article 21, Chapter 11--

11-21-3. *Imposition of tax; persons subject to tax.*

Minimum tax and the former effective date are stricken. Partnerships and pass-through entities that elect to pay additional West Virginia taxes owed per section 11-21A-3 are included, although partnerships are not subject to Personal Income Tax. The cross references are given citations and the effective date was January 1, 2018.

Summary of state changes

11-21-37a. *Allocation and apportionment of income of nonresidents from multistate business activity.* This is a new section and it provides for allocation and apportionment of business income derived from a pass-through entity in the same manner that corporate income is apportioned when there have been multistate business activities. In short, the payroll, property and double-weighted sales factors are compared at the state level versus the entity's total. This language mirrors the way that pass-through entity returns were being filed by practitioners. Businesses that only do business in West Virginia are also addressed, as well as types of income. The burden of proof for alternative methods is provided. The effective date was January 1, 2018.

Summary of state changes

11-21-37b. *Special apportionment rules.* This is a new section that addresses when the general apportionment rules are inappropriate. Motor carriers are specifically addressed. The commissioner retains rulemaking authority to set forth alternative methods and authority to require a specific method be used. The taxpayer can also petition that an alternative formula be used. The effective date was January 1, 2018.

11-21-37c. *Special apportionment rules – financial organizations.* This is a new section that sets forth the apportionment rules for financial organizations since the general formula is inappropriate. The effective date is January 1, 2018.

11-21-51a. *Composite returns.* Subsection (c) is amended so that an equity owner can sign a composite return as well as a partner. This amended section became effective for composite returns filed after December 31, 2018.

Summary of state changes

11-21-59. *Report of change in federal taxable income.* This section is re-numbered and there are stylistic changes. Subsection (b) is added and it provides for a two-year statute of limitations, or the statute of limitations set forth in section 11-10-14, whichever is later, to apply for a refund after federal adjustments. Subsection (c) addresses what is included in a final determination. Subsection (d) addresses when certain agreements have become final. Subsection (e) provides the tax commissioner is only required to issue refunds based upon final determinations. Subsection (f) provides if an amended federal return has been filed without an amended West Virginia return, then the statute of limitations reopens and expires three years after the delivery of the amended federal return to the tax commissioner by the taxpayer. The scope of the reopening is limited if the statute of limitations set forth in 11-10-15 has expired. Subsection (g) defines final determination. Subsection (h) makes these changes effective for final determinations, regardless of tax year, after the effective date of the amendments to this section in 2019.

Summary of state changes

11-21-59a. *Report of change in taxes paid to other states.* This is a new section and it provides that a taxpayer has one year to file an amended West Virginia return after either a credit for tax paid to another state has changed, or an amended return is filed with another state that changes West Virginia taxable income. The commissioner may promulgate rules that set forth exceptions. If the tax commissioner has sufficient information to compute additional tax owed and the tax has been paid, an amended return is not required when a credit has been claimed for tax paid to another state and the amount that was credited by West Virginia is changed by that state. Subsection (b) defines final determination and subsection (c) provides these provisions are effective without regard to the tax year for federal determinations that become effective after the effective date of this section enacted in 2019.

Summary of state changes

11-21-71a. *Withholding tax on West Virginia source income of nonresident partners, nonresident S corporation shareholders, and nonresident beneficiaries of estates and trusts.* The bill made stylistic changes to this section.

Subdivision (c)(5) exempts publicly-traded partnerships from withholding requirements as long as specified information is provided to the tax commissioner in an electronic format. In subsection (l), the definition of “partner” is expanded to include equity owner of a pass-through entity and the definition of “pass-through entity” is added. Subsection (n) provides that these changes are effective without regard to the tax years in which these taxes are owed attributable to federal determinations that become final or effective after the effective date of this section as amended during 2019.

Summary of state changes

Changes to Article 24, Chapter 11

11-24-20. *Report of change in federal taxable income.* This section is re-numbered and there are stylistic changes. Subsection (b) is added and it provides for a two-year statute of limitations, or the statute of limitations set forth in 11-10-14, whichever is later, to apply for a refund after federal adjustments. Subsections (c), (d), (e), and (g) address final determinations, (f) addresses amended returns, while (h) provides an effective date.

Summary of state changes

Article 21A, Chapter 11

11-21A-1. *Definitions.* The following terms are defined: administrative adjustment request, audited partnership, C corporation, composite return partner, corporate partner, date of each final federal determination, direct partner, entity, exempt partner, federal adjustment, federal adjustment request, federal election for alternative payment, federal partnership representative, final determination date, final federal adjustment, indirect partner, interest, Internal Revenue Code or IRC, Internal Revenue Service or IRS, nonresident partner, partner, partnership, partnership adjustment, partnership level audit, partnership-related item, pass-through entity, person, publicly traded partnership, reallocation adjustment, resident partner, reviewed year, S corporation, state imputed underpayment, state partnership adjustment, state partnership audit, state partnership representative, subsequent affected year, tax commissioner, taxpayer, this state or state, tiered partner, tiered partnership, unrelated business taxable income, West Virginia tax, withholding partner.

Summary of state changes

11-21A-2. *Reporting adjustments to federal taxable income-general rule.* With exceptions, final federal adjustments must be reported and paid to West Virginia within **180 days** of the final determination date. Subsection (b) provides that if there is a correction or change by the IRS, then the correction shall be reported to the tax commissioner within **six months** of each federal final determination.

Summary of state changes

11-21A-3. *Reporting federal adjustments-partnership level audit and administrative adjustment request.* Subsection (b) addresses the state partnership representative. The general rule is that the state partnership representative is the federal audit partnership representative unless the partnership designates otherwise. Subsection (c) sets forth the method to report final federal adjustments within **90 days**. Within **180 days** after final federal determination date, each direct partner is required to file a federal adjustment report and pay any additional tax due.

Summary of state changes

11-21A-3 *continued*. Subsection (d) sets forth the procedure for the partnership pays election. Subsection (e) provides that tiered partners are subject to 11-21A-3(b), (c). Rulemaking authority is granted. Subsection (f) provides for a modified report and payment method. Subsection (g) provides for payment of tax due. Subsection (h) addresses failure of an audited partnership or tiered partner to pay.

Summary of state changes

11-21A-4. *De Minimis exception.* The tax commissioner is granted rulemaking authority to set forth *de minimis* exceptions for when reporting and payment is not required.

11-21A-5. *Assessments of additional West Virginia tax, interest and additions to tax arising from adjustments to federal taxable income; statute of limitations.* There are provisions that address timely reported federal adjustments and untimely filed federal adjustments.

Summary of state changes

11-21A-6. *Estimated West Virginia tax payments during course of federal audit.* Estimated payments can be made to the state to avoid interest during the course of a federal audit.

11-21A-7. *Claims for refunds or credits of West Virginia tax arising from federal adjustments made by the IRS.* These claims must be made the latter of either one year from the date of the federal adjustment report or the provisions in section 11-10-14.

Summary of state changes

11-21A-8. *Scope of adjustments and extensions of time.* If the statutes of limitation set forth in sections 11-10-14 or 15 have expired, then the scope of adjustments is limited to changes in the taxpayer's tax liability arising from federal adjustments. This period can be extended by written agreement.

11-21A-9. *Effective date.* This article applies to adjustments with a final determination date after December 31, 2018

Summary of state changes

11-21A-10. *Legislative, Interpretive, and procedural rules.* Rulemaking authority is granted.

11-21A-11. *General procedure and administration.* The provisions of Article 10-Chapter 11 apply.

11-21A-12. *Crimes and penalties.* The provisions of Article 9, Chapter 11 apply.

Summary of state changes

In the future...

- Training for employees and taxpayers
- Coordinating with Internal Revenue Service so that information related to federal audit results can be shared
- New forms, programming and internal procedures
- There is potential that rules will be drafted



Thank you!

Questions?

Please send them in an email to:
Rebecca.L.Rodak@wv.gov