



Analysis of Original Bill

Author: Committee on
Governance & Finance

Sponsor:

Bill Number: SB 790

Analyst: Elaine Warneke

Phone: (916) 845-7746

Introduced: March 21, 2019

Attorney: Shane Hofeling

Related Bills: See Legislative
History

Subject: State Only Election/Partnership Audit Adjustments

Summary

This bill would, under the Administration of Franchise and Income Tax Law (AFITL), clarify when the Franchise Tax Board (FTB) would be required to grant a partnership's request to make a state election to report federal audit adjustments different from its federal election.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to require that the FTB allow a partnership reporting election, as specified, that is different than that used for federal purposes.

Effective/Operative Date

This bill would be effective immediately upon enactment, and operative January 1, 2020.

Federal/State Law

Under current federal law, partnership audit rules under the Bipartisan Budget Act of 2015 (BBA) generally require adjustments of all items of income, gain, loss, deduction, or credit at the partnership level, with the partnership being liable for any resulting underpayment of tax. Under the centralized partnership audit regime, a partnership generally may elect to require its partners to pay the additional federal income tax that results from the partners, the "push-out election", including their share of the partnership audit adjustments on their own amended tax returns, in lieu of the partnership paying federal income tax on the net increase in partnership taxable income resulting from the audit adjustments.

Partnerships generally may elect out of the BBA rules only if:

- 1) Their partners are individuals, estates of a deceased partner, or S or C corporations (or foreign entities treated as a C corporation);
- 2) They issue no more than 100 Schedules K-1, *Partners Share of Income, Deductions, Credits, etc.*; and
- 3) They follow certain requirements as to the time and manner of making the election.

California generally conformed, with modifications, to the BBA rules, effective September 23, 2018, and operative for federal audit determinations subsequently finalized. The method for determining the partnership's California tax is based on a federal partnership-level adjustment. The partnership's push-out election, or decision not to make a push-out election, applies for California purposes, unless the FTB approves a separate election, except that:

- 1) If the partnership is part of a unitary group, any partner that is also part of the group is treated as having filed an amended return that reduces the partnership's tax liability and that partner must then actually file such an amended return; and
- 2) Any partnership can ask the FTB for permission to make a push-out election decision different from their federal push-out election decision, as long as the partnership establishes that its election will not impede the state's ability to collect taxes.

Where the partnership does not make a push-out election for California purposes, then the direct and indirect partners are not required to pay additional California tax with respect to the federal audit adjustments. Instead, a tax is imposed on the partnership. The partnership-level tax is calculated in a manner designed generally to approximate the amount of California tax that would be owed if a push-out election were made, by taking into account:

- 1) Whether the partners are corporations, resident individuals, non-resident individuals, partnerships or tax-exempt entities;
- 2) The federal audit adjustments that are allocable or sourced to California; and
- 3) The applicable tax rates are the highest rate that would be applicable to each type of partner (i.e., corporation or individual).

Additionally for federal purposes only the "partnership representative" has the authority to make decisions for the partnership, and these decisions will bind the direct and indirect partners of the partnership, regardless of whether they have consented to such decisions. The California partnership representative for each tax year under federal audit is also the partnership's federal partnership representative, unless another person is designated by the partnership. Unlike the federal rules, California does not require a partnership representative that is an entity to appoint a single individual to act on its behalf.

This Bill

This bill would require the FTB to grant a partnership's request to make a separate state election for purposes of reporting its federal audit adjustments, as follows.

In the case of a partnership with a federal election for alternative payment, requiring adjustments to be taken in account by the partners, provided that the partnership properly computes the amount of the California tax due.

In the case of partnership with adjustments that result in an imputed underpayment under Internal Revenue Code section 6225, provided the partnership is able to demonstrate to the FTB that the FTB's ability to collect any state income or franchise taxes would not be impeded and the partnership properly follows the partnership reporting provisions.

Implementation Considerations

Implementing this bill would require changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Consideration

The quotation mark on page 3, at the end of line 20, is unnecessary and should be removed.

Legislative History

SB 274 (Glazer, et al., Chapter 729, Statutes of 2018), under the AFITL, provided for the California assessment and reporting requirements for federal audit adjustments under the BBA federal partnership audit rules.

Other States' Information

Review of *Florida, Illinois, Massachusetts, Michigan, and New York* laws found no statutes addressing comparable federal conformity to the new partnership audit rules. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

This year the New York Legislature is considering legislation to conform to the new partnership audit rules.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill as introduced on March 21, 2019, would not impact state income or franchise tax revenue.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Legislative Staff Contact

Elaine Segarra Warneke
Legislative Analyst, FTB
(916) 845-7746

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484

Jahna Carlson
Acting Legislative Director, FTB
(916) 845-5683

elaine.warneke@ftb.ca.gov

jame.eiserman@ftb.ca.gov

jahna.carlson@ftb.ca.gov