



STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Committee on Governance & Finance Bill Number: SB 790

Subject: State Only Election/Partnership Audit Adjustments

Summary

This bill would, under the Administration of Franchise and Income Tax Law, 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.

Reason for the Bill

The reason for the bill is to clarify the circumstances when the FTB must grant a partnership's or tiered partnership's request to make a state election to report federal audit adjustments different from the federal election to report those adjustments.

Effective/Operative Date

This bill would be effective 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. A partnership generally may elect to require its partners to pay the federal income tax that results from the partners 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. This is called the "push-out election."

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 California tax with respect to the federal audit adjustments. Instead, the 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 rate at 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

- (1) This bill would require the FTB to grant a partnership's or a tiered partnership's request to make a separate state election for purposes of reporting its federal audit adjustments under the following circumstances:
- (2) Where an audited partnership or a tiered partnership makes a federal election for alternative payment, which requires adjustments to be taken into account by the partners, provided that the partnership or tiered partnership properly computes the amount of the California tax due; or
- (3) Where an audited partnership or a tiered partnership pays the tax at the federal level, provided that the partnership or tiered partnership can demonstrate to the FTB that the FTB's ability to collect any state income or franchise taxes would not be impeded and the partnership or tiered partnership properly follows the partnership reporting provisions.

Legislative History

SB 274 (Glazer, et al., Chapter 729, Statutes of 2018), under the Administration of Franchise and Income Tax Laws, 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

Staff estimates a cost of approximately \$30,000 in fiscal year 2019/2020 (and ongoing costs of \$56,000) to develop, program, and test revisions to existing systems for this bill. The department will pursue a budget change proposal if necessary.

Economic Impact

Revenue Estimate

This bill as introduced on March 21, 2019, and amended June 20, 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.

Appointments

None.

Votes

Location	Date	Yes Votes	No Votes
Concurrence	August 30, 2019	37	0
Assembly Floor	August 22, 2019	75	0
Senate Floor	May 9, 2019	38	0

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