



## State Reporting Requirements for Federal Tax Changes

### Policy Position

**Position:** *State<sup>1</sup> 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 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).*

**Explanation:** Large multistate businesses are often required to file hundreds, if not thousands, of amended returns/reports to the states when a federal tax change is made by the taxpayer and/or the Internal Revenue Service.<sup>2</sup> Effective compliance with these reporting requirements is best achieved when state governments adopt uniform and even-handed rules for reporting federal tax changes that are consistent regardless of whether a refund or payment results from the change. Filing interim reports of changes is not an efficient use of resources for either the state or taxpayers. The following are key elements of a fair and efficient state reporting procedure for federal tax changes:

- *Final Determination:* All states that require a taxpayer to report federal tax changes should link the filing requirement to a “final determination” of a taxpayer’s federal income tax liability. The absence of clear, consistent rules creates compliance problems and wrongfully subjects taxpayers to penalties and interest for noncompliance. Moreover, some states require “interim” or “serial” notifications prior to a final determination of federal tax liability or refund—a practice that needlessly creates additional confusion regarding taxpayers’ compliance responsibilities and potential traps for the unwary. In defining what constitutes a “final determination,” COST recommends that states adopt the definition of “Final Determination Date” in the Multistate Tax Commission model statute for reporting adjustments to federal taxable income and federal partnership audit adjustments (MTC Model),<sup>3</sup> which essentially provides that all issues must be resolved and all appeal rights extinguished at the federal level before an adjustment is considered final.

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<sup>1</sup> As used in this policy statement, “state” refers to both state and local jurisdictions impacted by federal tax change reporting requirements.

<sup>2</sup> Unless a state’s e-filing system easily facilitates such filings and payments, a state should not require e-filing for reporting federal changes.

<sup>3</sup> The entire MTC Model, including the partnership audit provisions, adopted January, 2019, is available at <https://www.mtc.gov/wp-content/uploads/MTCImages&Files/MTC/media/AUR/Proposed-Model-RAR-Statute-Technical-Corrections-10-25-20.pdf>. The MTC Model was developed in collaboration with several taxpayer groups including COST, AICPA, ABA Tax Section, TEI and IPT.

- Time Period for Reporting and Auditing:* Taxpayers need adequate time to report federal tax changes to the states. The necessary adjustments relating to federal tax changes, especially when taking into consideration the states' decoupling from certain Internal Revenue Code provisions such as bonus/accelerated depreciation and various provisions enacted as part of the federal Tax Cuts and Jobs Act of 2017, require sufficient time for analysis and accurate reporting. COST recommends a state's law provide at least 180 days (or six months) to report IRS adjustments to the state. States must also be flexible regarding the method of reporting the changes to avoid overly restrictive and inefficient filing requirements. For instance, when a federal tax change does not affect the taxable income reported to the state, a simplified method to report the close of the federal audit should be allowed. In addition, the time provided for a state to audit a taxpayer's adjusted liability (relating to a federal change) should not be greater than a taxpayer's right to claim a refund (related to the federal change). Finally, states are encouraged to adopt simplified procedures to report *de minimis* adjustments.
- MTC Model for Partnership Audit Adjustments:* States with income taxes need to amend their tax laws to address changes at the federal level regarding how partnerships must report and/or pay tax following an IRS audit under the new Centralized Partnership Audit Rules. States should substantially adopt the MTC Model for Reporting Federal Adjustments by allowing partnerships: 1) to make a separate state partnership representative election from that made at the federal level or in other states; 2) to make a different payment election than that made at the federal level or made in other states; 3) to provide tiered partnerships additional time to file and the ability to make an election that differs from the audited partnership; and, 4) to allow partnerships to use an alternative reporting and payment arrangement upon obtaining mutual agreement with the state's revenue agency.
- Prepayment Process:* Taxpayers should be allowed to submit advance payments relating to partial (agreed upon) federal tax changes without the filing of an amended return. This would permit taxpayers, if they so choose, to make tax payments to a state after a portion of the known federal issues are agreed upon, but prior to the final federal determination date. This change would allow taxpayers to reduce interest costs associated with reporting the federal tax change while the rest of the IRS audit process is completed. Currently, many states have statutes that prohibit (either intentionally or unintentionally) these types of advance payments.
- State Statutes of Limitation Waived Only for Federal Tax Changes:* When the normal time period for the state to assess additional tax and for a taxpayer to claim a refund has passed, a state should provide that only those items that are the subject of the federal tax change should be open for adjustment (tax due and refund). The statute of limitations should not remain open for any other issues, including items that are related to amended returns or audits in other states.