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**SB-274 Administration of taxes: notice of deficiency assessment.** (2017-2018)

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**Senate Bill No. 274**

**CHAPTER 729**

An act to amend Section 19311 of, and to add Section 18622.5 to, the Revenue and Taxation Code, relating to taxation, and declaring the urgency thereof, to take effect immediately.

[ Approved by Governor September 23, 2018. Filed with Secretary of State September 23, 2018. ]

**LEGISLATIVE COUNSEL'S DIGEST**

SB 274, Glazer. Administration of taxes: notice of deficiency assessment.

Existing law requires an individual taxpayer to notify the Franchise Tax Board of any change in the amount of gross income or deductions, as reported on the individual's federal tax return, within 6 months of the final determination, as defined, of that change, unless the change does not increase the amount of California income tax due. Existing law authorizes the Franchise Tax Board, within 2 years of the date of a final determination, to allow a credit, make a refund, or mail to the taxpayer a notice of proposed overpayment resulting from the final federal determination, as specified.

This bill would require a partnership, if any item required to be shown on a federal partnership return is changed or corrected by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, and the partnership is issued an adjustment or made a federal election for alternative to payment, to report each change or correction to the Franchise Tax Board for the reviewed year within 6 months after the date of each final federal determination, as specified.

This bill would declare that it is to take effect immediately as an urgency statute.

Vote: 2/3 Appropriation: no Fiscal Committee: yes Local Program: no

**THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:**

**SECTION 1.** Section 18622.5 is added to the Revenue and Taxation Code, to read:

**18622.5.** (a) Notwithstanding Section 18622, if any item required to be shown on a federal partnership return, including any gross income, deduction, penalty, credit, or tax for any year of any partnership, including any amount of any partner's distributive share, is changed or corrected by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, and the partnership is issued an adjustment under Section 6225 of the Internal Revenue Code or makes a federal election for alternative payment with the Internal Revenue Service as part of a Partnership Level Audit, the partnership shall report each change or correction to the Franchise Tax Board for the reviewed year within six months after the date of each final federal determination. The report of adjustments or return reporting the adjustments shall be sufficiently detailed to allow computation of the California tax change resulting from the federal adjustment and shall be reported in the form and manner as prescribed by the Franchise Tax Board.

(b) For purposes of this section the following terms have the following meanings:

(1) "Administrative adjustment request" means an administrative adjustment request filed by a partnership under Section 6227 of the Internal Revenue Code, as in effect January 1, 2018.

(2) "California share of the adjustments" means the adjustments described in subdivision (a), subject to the provisions of Chapter 11 (commencing with Section 17951) of Part 10 and the provisions of Chapter 17 (commencing with Section 25101) of Part 11.

(3) "Date of each final federal determination" means the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to Section 6203 of the Internal Revenue Code.

(4) "Direct partner" means a partner that holds an interest directly in a partnership or pass-through entity."

(5) "Federal adjustment" means a change to an item or amount determined under the Internal Revenue Code that is used by a partner or partnership to compute state tax owed for the reviewed year whether that change results from action by the Internal Revenue Service, including a Partnership Level Audit, or the filing of a federal refund claim, or an Administrative Adjustment Request by the partnership. A Federal Adjustment is positive to the extent that it increases taxable income as determined under Part 10 (commencing with Section 17001) or net income as determined under Part 11 (commencing with Section 23001) and is negative to the extent that it decreases taxable income as determined under Part 10 (commencing with Section 17001) or net income as determined under Part 11 (commencing with Section 23001).

(6) "Federal election for alternative payment" refers to the election described in Section 6226 of the Internal Revenue Code, relating to alternative to payment of imputed underpayment by partnership, as in effect January 1, 2018.

(7) "Indirect partner" means a partner in a partnership or pass-through entity that itself holds an interest directly, or through another indirect partner, in a partnership or pass-through entity.

(8) "Partnership level audit" means an examination by the Internal Revenue Service at the partnership level pursuant to Subchapter C of Chapter 63 of Subtitle F of Title 26 of the Internal Revenue Code, as in effect January 1, 2018, which results in a federal adjustment.

(9) "Publicly traded partnership" means either of the following:

(A) A partnership that is a publicly traded partnership within the meaning of Section 7704 of the Internal Revenue Code.

(B) Any other partnership where more than 10 percent of the profits or capital interest is owned directly or indirectly by a partnership described in paragraph (A).

(10) "Reallocation adjustment" means a federal adjustment that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to direct partners. A positive reallocation adjustment means a reallocation adjustment that would increase state taxable income for direct partners, and a negative reallocation adjustment means a reallocation adjustment that would decrease state taxable income for direct partners.

(11) "Reviewed year" has the meaning provided in Section 6225(d)(1) of the Internal Revenue Code, as in effect January 1, 2018.

(12) "Tiered partner" means any partner that is a partnership or pass-through entity.

(c) (1) Notwithstanding Section 17024.5, and except as otherwise provided in this subdivision, any election made for federal purposes under the provisions of Subchapter C of Chapter 63 of the Internal Revenue Code (commencing with Section 6221), as in effect January 1, 2018, shall be applicable for purposes of Part 10 (commencing with Section 17001), this part, and Part 11 (commencing with Section 23001), and a separate election shall not be allowed.

(2) In the case of any unitary partner whose distributive share of a partnership's income and apportionment factors would properly be included in the computation of that partner's business income (within the meaning of subdivision (a) of Section 25120) apportioned to California on that partner's original California franchise or income tax return, subparagraph (A) of paragraph (1) of subdivision (d) shall not apply and instead such partner shall be treated as having filed an amended return within the meaning of Section 6225(c)(2) of the Internal Revenue Code for purposes of this section and that partner shall file an amended return to separately report its California share of the adjustments under Section 18622.

(3) Notwithstanding paragraph (1), and subject to the requirement of paragraph (2), a partnership may file a request, in the form and manner specified by the Franchise Tax Board, to make an election different from their federal election under this section, and the Franchise Tax Board shall grant such request, provided that the partnership is able to establish to the satisfaction of the Franchise Tax Board that the Franchise Tax Board's ability to collect any state income or franchise taxes would not be

impeded, and the partnership properly computes the amount of tax due under the provisions specified in subparagraph (A) of paragraph (1) of subdivision (d) or properly follows the provisions specified in paragraph (2) of subdivision (d) as appropriate.

(4) (A) Each tiered partner and each indirect partner of an audited partnership shall be subject to the applicable election, reporting and payment requirements for audited partnerships and their direct partners under this section.

(B) Each tiered partner and indirect partner must make all reports and payments required to be made by such partners under this section no later than 90 days after the time for filing and furnishing statements to tiered partners and their partners, as required under Section 6226 of the Internal Revenue Code and any regulations thereunder.

(d) (1) (A) If the change or correction described in subdivision (a) results in an increase of the amount of tax payable under Part 10 (commencing with Section 17001), this part, or Part 11 (commencing with Section 23001), and if paragraph (2) does not apply, then a tax is hereby imposed on the partnership determined as follows, in lieu of taxes owed by its direct partners and indirect partners:

(i) Exclude from federal adjustments and any positive reallocation adjustments the distributive share of these adjustments made to a tax-exempt partner that is not unrelated business taxable income within the meaning of Section 23731.

(ii) Exclude from federal adjustments and any positive reallocation adjustments the distributive share of the adjustments made to a partner that has previously filed an amended return under Section 18622 reporting the distributive share and paid any additional state tax liability due.

(iii) With respect to any corporate partner or tax-exempt partner that is not excluded under paragraph (2) of subdivision (c) or clauses (i) or (ii), determine the total distributive share of all federal adjustments and positive reallocation adjustments, and apportion and allocate the adjustments as provided in Chapter 17 (commencing with Section 25101) of Part 11, and multiply that amount by the highest marginal tax rate provided in Sections 23151 or 23501, as applicable, for the reviewed year.

(iv) With respect to all tiered partners, nonresident individual partners, or nonresident fiduciary partners not excluded under paragraph (2) of subdivision (c) or clause (i) or (ii) or taken into account under clause (iii), determine the total distributive share of all federal adjustments and positive reallocation adjustments and compute the amount of California source income attributable to the adjustments as provided in Chapter 11 (commencing with Section 17951) of Part 10 and the provisions of Chapter 17 (commencing with Section 25101) of Part 11, and multiply that amount by the highest marginal tax rate applicable to individuals for the reviewed year.

(v) With respect to all resident partners, resident fiduciary partners, or any other partners not excluded under paragraph (2) of subdivision (c) or clauses (i) or (ii) or taken into account under clauses (iii) or (iv), determine the total distributive share of all federal adjustments and positive reallocation adjustments that are subject to tax under subdivisions (a) or (c) of Section 17041, and multiply that amount by the highest marginal tax rate applicable to individuals for the reviewed year.

(vi) The total tax imposed under this paragraph shall be equal to the sum of the amounts determined under clauses (iii), (iv), and (v). The tax imposed under this subdivision shall be due and payable as provided in Section 19001 and treated as if imposed under Part 10 (commencing with Section 17001).

(B) Penalties and interest, as applicable, shall be imposed under Article 6 of Chapter 4 (commencing with Section 19101) and Article 7 of Chapter 4 (commencing with Section 19131) from the original due date of the partnership return for the reviewed year.

(2) If the partnership makes a federal election for alternative payment under Section 6226 of the Internal Revenue Code, then the partnership shall file an amended California Nonresident Group Return for all nonresident direct partners under Section 18535 and pay the additional amount of tax due that would have been due had the federal adjustments been reported properly as required. For any partners not included in the amended California Nonresident Group Return, the amount reported to each partner shall be an adjustment to the partner's share of partnership items as a result of the change or correction in subdivision (a) and each partner shall report any adjustments in accordance with Section 18622.

(e) Subject to the approval of the Franchise Tax Board, an audited partnership or tiered partner may enter into an alternative agreement with the Franchise Tax Board regarding any issue resulting from a federal audit adjustment, amended federal return, or administrative adjustment that would otherwise be subject to this section, including, but not limited to, the reporting and payment of tax, applicable time requirements, or any other provision that will provide, to the satisfaction of the Franchise Tax Board, for the reporting and payment of any taxes, penalties, and interest due pursuant to this section.

(f) (1) If a partnership files a report or return as required under subdivision (a) after the six-month period specified in subdivision (a) or if the partnership or partner does not pay the tax required under subdivision (c) when due and payable, the Franchise Tax Board shall mail notice to the partnership of the deficiency proposed to be assessed pursuant to Section 19033. The deficiency proposed to be assessed must be mailed within four years from the date the change or correction was reported pursuant to subdivision (a), the return or payment was due, or within four years from the date the return was filed, whichever period expires later.

(2) If a partnership files a report, or files a return required under subdivision (a) within six months of the final federal determination, the Franchise Tax Board shall mail notice to the partnership of the deficiency proposed to be assessed pursuant to Section 19033. The deficiency proposed to be assessed must be mailed within two years from the date the change or correction was reported pursuant to subdivision (a).

(3) If the partnership fails to file a report or return as required by subdivision (a), a notice of proposed deficiency assessment resulting from the federal determination may be made at any time.

(g) (1) Nothing in this section is intended to prevent the Franchise Tax Board from assessing direct partners or indirect partners for taxes they owe in the event that an audited partnership or tiered partner fails to timely make any report or payment required by this section for any reason.

(2) If a partnership's report of the California tax changes resulting from the adjustments filed pursuant to subdivision (a) results in an overstatement of California taxable or net income, the adjustment shall be applied as follows:

(A) If the original adjustments were passed through to the partners under paragraph (2) of subdivision (c), the revised adjustment shall be passed through to the partners. The partnership shall file or amend the return as described in subdivision (a).

(B) If the tax on the adjustments was originally paid by the partnership under paragraph (1) of subdivision (c), the partnership may amend the return filed under paragraph (1) of subdivision (c) to claim a refund of that overpayment within the time periods provided by Section 19311. This subparagraph shall not allow a partnership to claim an overpayment for amounts not actually paid by the partnership.

(3) If properly reported and paid by the partnership or tiered partner, the amount determined in subparagraph (A) of paragraph (1) of subdivision (d) or similarly under an optional election, will be treated as paid in satisfaction of taxes owed by its direct and indirect partners on the same federal adjustments. The direct partners or indirect partners may not take any deduction or credit for this amount or claim a refund of the amount in this state. Nothing in this subdivision shall preclude a partner from claiming a credit against taxes paid to this state pursuant to Chapter 12 (commencing with Section 18001) of Part 10 of Division 2, with respect to any amount paid by the partnership, or any amount paid by any tiered partnership that is a direct partner or indirect partner in the partnership, on that partner's behalf to another state.

(h) (1) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to this section, including any requirements or procedures necessary to seek a written consent under paragraph (3) of subdivision (g).

(2) The Franchise Tax Board may prescribe regulations necessary or appropriate to implement the purposes of this section, including regulations to determine the California share of adjustments.

(i) A publicly traded partnership that is otherwise in compliance with this section shall not be subject to paragraph (2) of subdivision (d). For purposes of the reporting requirements set forth in subdivision (a), a publicly traded partnership shall only be required to report their direct partners' distributive share of a federal adjustment to the Franchise Tax Board. A publicly traded partnership shall be deemed to have made a federal election for alternative payment pursuant to Section 6226 of the Internal Revenue Code unless the publicly traded partnership files a request to make an election different from their federal election pursuant to paragraph (3) of subdivision (c).

(j) In order to reduce the administrative burden on taxpayers that may be imposed by additional filings and payments that do not contribute materially to revenue, the Franchise Tax Board shall convene a meeting or meetings of interested parties for the purpose of determining appropriate de minimis partner reporting and payment requirements as the result of a partnership level audit.

(k) (1) With respect to an action required or permitted to be taken by a partnership under this section and a proceeding under this part with respect to federal adjustments arising from a partnership level audit or an administrative adjustment request, the state partnership representative for the reviewed year shall have the sole authority to act on behalf of the partnership, and its partners and indirect partners shall be bound by those actions.

(2) The state partnership representative for the reviewed year is the partnership's federal partnership representative, unless the partnership designates in writing another person as its state partnership representative.

(3) The Franchise Tax Board may establish reasonable qualifications for and procedures for designating a person, other than the federal partnership representative, to be the state partnership representative.

(l) This section shall apply to final federal determinations assessed pursuant to amendments made to Subchapter C of Chapter 63 of the Internal Revenue Code as in effect January 1, 2018.

**SEC. 2.** Section 19311 of the Revenue and Taxation Code is amended to read:

**19311.** (a) (1) If a change or correction is made or allowed by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, a claim for credit or refund resulting from the adjustment may be filed by the taxpayer within two years from the date of the final federal determination (as defined in Section 18622), or within the period provided in Section 19306, 19307, 19308, or 19316, whichever period expires later.

(2) Within two years of the date of the final determination (as defined in Section 18622 or 18622.5) or within the period provided in Section 19306, 19307, or 19308, whichever period expires later, the Franchise Tax Board may allow a credit, make a refund, or mail to the taxpayer a notice of proposed overpayment resulting from the final federal determination.

(b) The amendments made by the act adding this paragraph shall apply, without regard to taxable year, to federal determinations that become final on or after the effective date of the act adding this paragraph.

(c) (1) For adjustments resulting in a tax imposed under paragraph (1) of subdivision (c) of Section 18622.5, paragraph (1) of subdivision (a) is modified by substituting "partnership" for "taxpayer."

(2) This subdivision shall apply to final federal determinations assessed pursuant to amendments made to Subchapter C of Chapter 63 of the Internal Revenue Code as in effect January 1, 2018.

**SEC. 3.** This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the California Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order to provide much needed tax administration relief to taxpayers in conformity with federal tax law changes enacted in 2015 and to alleviate costly administrative burdens on state tax agencies, it is necessary that this act go into immediate effect.