COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3553-01
Bill No.: SB 704
Subject: Taxation and Revenue - Income
Type: Original
Date: February 17, 2020

Bill Summary: This proposal modifies provisions relating to the taxation of partnerships.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2021	FY 2022	FY 2023
General Revenue	$0 or (Unknown) to Unknown	$0 or (Unknown) to Unknown	$0 or (Unknown) to Unknown
Total Estimated Net Effect on General Revenue	**$0 or (Unknown) to Unknown**	**$0 or (Unknown) to Unknown**	**$0 or (Unknown) to Unknown**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2021	FY 2022	FY 2023
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 7 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2021	FY 2022	FY 2023
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2021	FY 2022	FY 2023
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☐ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2021	FY 2022	FY 2023
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration - Budget and Planning Division (B&P)** state this proposal may increase Total State Revenue (TSR) and General Revenue (GR) by an unknown amount.

This proposal will not impact the calculation under Article X, Section 18(e).

Current Missouri law prohibits the Missouri Department of Revenue (DOR) from adjusting any returns filled by the individuals within a partnership based on an IRS audit at the entity level. This proposal would allow DOR to assess and collect taxes directly from the partnership entity following a federal audit.

With the passage of the Bipartisan Budget Act, the IRS began auditing partnerships at the entity level. If the IRS determines that the partnership owes taxes they will levy that additional tax on the entity itself, not pass the taxes owed to the individuals within the partnership. This change in federal audit rules began in Tax Year 2018.

This proposal would allow DOR to assess and collect taxes directly from the partnership entity following a federal audit. Without this change, DOR may be unable to collect (or refund) any taxes owed by a partnership following the findings of an audit by the IRS.

Therefore, this proposal may increase TSR and GR by an unknown amount if DOR is able to collected additional state taxes owed after a partnership has been audited by the IRS.

B&P notes that this will not impact the calculation under Article X, Section 18(e) as these are taxes that would otherwise be owed to the state. This proposal may enhance collections of such taxes.

Officials from the **Missouri Department of Revenue (DOR)** state the proposed legislation, broadly speaking, sets forth reporting and payment requirements for partnerships at the individual partner and/or entity level in the event of an entity-level audit by the IRS or other federal entity-level adjustment. This new IRS partnership audit regime, under which the IRS will generally audit and make changes to partnership items at the partnership level instead of flowing the changes through to individual partners, began on January 1, 2018.

The new partnership audit regime will affect IRS audits of Tax Year 2018 and Tax Year 2019 partnership tax returns, and onwards. The new regime applies to tax years beginning after

ASSUMPTION (continued)

December 31, 2017 and continues indefinitely. These tax returns started being filed in 2019. Thus, the IRS would begin auditing Tax Year 2018 returns, at earliest, sometime in Calendar Year 2019. (This does not take into consideration short tax years).

Partnerships were also given an option to opt-in to this new audit regime early; partnerships that made the election to opt-in early could have received partnership-level adjustments as a result of an IRS audit for partnership tax years beginning on or after November 2, 2015.

This proposal would allow DOR to assess and collect taxes directly from the partnership entity following a federal audit. Without this change, DOR may be unable to collect (or refund) any taxes owed by a partnership following the findings of an audit by the IRS. Therefore, this proposal may increase TSR and GR by an unknown amount if DOR is able to collect additional state taxes owed after a partnership has been audited by the IRS.

Oversight notes, currently, DOR may adjust tax on the returns of individual partners of partnerships upon findings through amended tax(es) filed by the individual partners themselves or through Discovery programs operated by DOR. These Discovery programs receive information from the IRS in relation to adjustments made to the federal tax filings of Missouri residents. If DOR believes it to be necessary, they will adjust individual partner's Missouri tax filing(s) to reflect those changes received from the IRS and assess or refund accordingly.

The United States Congress passed the Bipartisan Budget Act (2015) which entitles the IRS to audit partnerships at the entity level rather than passing the changes on to the individual partner level. If the IRS finds that adjustments are required, the IRS will make the necessary adjustments on the partnership return rather than passing the tax on to the individual partners.

Currently, DOR is unable to perform adjustments at the partnership level deemed necessary through their Discovery programs. This proposed legislation would allow DOR to make such adjustments. Oversight notes this proposed legislation is following the changes made at the IRS level under the Bipartisan Budget Act (2015). Oversight further notes it allows DOR to continue to adjust tax returns as they have in the past, but with new methods.

Oversight assumes without this change, DOR would no longer be able to collect the unreported changes to partnership returns recognized under DOR's Discovery programs, as they would no longer be reported at the individual (partner) level. Thus, TSR and GR could be reduced by an unknown amount.

ASSUMPTION (continued)

For purposes of this fiscal note, **Oversight** will show a fiscal impact of $0 or Unknown to (Unknown). Zero would be recognized if DOR received the additional tax assessments or made the additional tax refunds equal to the amounts in the past. Unknown would be recognized if DOR collects a greater amount of additional tax assessments due to the passage of this proposed legislation and (Unknown) would be recognized if DOR receives a lesser amount of additional tax assessments or must make a greater amount of refunds due to the passage of this proposed legislation.

Officials from the **Joint Committee on Administrative Rules (JCAR)** assume this proposal is not anticipated to cause a fiscal impact beyond current appropriations.

Oversight assumes JCAR will be able to administer any rules resulting from this proposal with existing resources.

Officials from the **Office of the Secretary of State (SOS)** state many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $5,000. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the SOS also recognizes that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what the office can sustain with the core budget. Therefore, the SOS reserves the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposal. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriation process.

FISCAL IMPACT - State Government	FY 2021 (10 Mo.)	FY 2022	FY 2023
GENERAL REVENUE			
Revenue - Section 143.425 - DOR change in assessments of partnership returns.	$0 or (Unknown) to Unknown	$0 or (Unknown) to Unknown	$0 or (Unknown) to Unknown
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0 or (Unknown) to Unknown**	**$0 or (Unknown) to Unknown**	**$0 or (Unknown) to Unknown**

FISCAL IMPACT - Local Government	FY 2021 (10 Mo.)	FY 2022	FY 2023
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposed legislation could impact any small business whose Missouri partnership return is adjusted due to adjustments made at the federal level. The impact to small businesses could be negative if the changes require an additional assessment of tax or the impact could be positive if the changes require a refund to be issued to the small business. (Section 143.425)

FISCAL DESCRIPTION

This act requires taxpayers in a partnership to report and pay any tax due as a result of federal adjustments from an audit or other action taken by the IRS or reported by the taxpayer on an amended federal income tax return. Such report shall be made to the Department of Revenue on forms prescribed by the Department, and payments of additional tax due shall be made no later than 180 days after the final determination date of the IRS action, as defined in the act. Partners and partnerships shall also report final federal adjustments as a result of partnership level audits or administrative adjustment requests, as defined in the act. Such payments shall be calculated and made as described in the act. Partnerships shall be represented in such actions by the partnership's state partnership representative, which shall be the partnership's federal partnership representative unless otherwise designated in writing.

Partners shall be prohibited from applying any deduction or credit on any amount determined to be owed under this act.

FISCAL DESCRIPTION (continued)

The Department shall assess additional tax, interest, and penalties due as a result of federal adjustments under this act no later than three years after the return was filed, as provided in current law, or one year following the filing of the federal adjustments report under this act. For taxpayers who fail to timely file the federal adjustments report as provided under this act, the Department shall assess additional tax, interest, and penalties either by three years after the return was filed, one year following the filing of the federal adjustments report, or six years after the final determination date, whichever is later.

Taxpayers may make estimated payments of the tax expected to result from a pending IRS audit. Such payments shall be credited against any tax liability ultimately found to be due. If the estimated payments made exceed the final tax liability, the taxpayer shall be entitled to a refund or credit for the excess amount, as described in the act.

The provisions of this act shall apply to any adjustments to a taxpayer's federal taxable income or federal adjusted gross income with a final determination date occurring on or after January 1, 2021. (Section 143.425)

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of Administration - Budget & Planning Division
Missouri Department of Revenue
Joint Committee on Administrative Rules
Missouri Secretary of State's Office

Julie Morff
Director
February 17, 2020

Ross Strope
Assistant Director
February 17, 2020

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