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November 21, 2017

Ms. Diane Deatherage  
Legislative Services Bureau  
California Franchise Tax Board

Delivery Method: *via email*

**Re: Comments on California Franchise Tax Board Legislative Proposal F**

Dear Ms. Deatherage:

On behalf of the Council On State Taxation (COST), I am writing to provide feedback regarding the Franchise Tax Board's (FTB) 2018 Legislative Proposal F, which attempts to conform California to certain partnership audit provisions in the Bipartisan Budget Act of 2015 (BBA). While COST understands the FTB's reasons for suggesting conformity with respect to these provisions in the BBA, the relevant provisions of the BBA for most federal partnership audits will not apply until after the 2018 partnership returns are filed in 2019 (at the earliest). Further, as the FTB is aware, COST and several other organizations, including the Multistate Tax Commission (MTC), are close to finalizing a model conformity statute. Thus, COST cautions the FTB that if California were to adopt the provisions as contemplated in 2018 Legislative Proposal F, it will likely be out of step with other states that adopt the model statute later in 2018 or in 2019.

**About COST**

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

**Conformity to the BBA Provisions Are Not Required for 2018**

With Legislative Proposal F, the FTB is proposing the following legislative concept for 2018:

Amend existing law to specify that a partnership's federal election regarding audit rules is binding for state purposes, prescribe the method for determining the California tax based on a federal partnership-level adjustment, and clarify the partnership's and partners' requirements for reporting federal adjustments to the state.

COST understands that the FTB wishes to adopt legislation that would conform California's law to the new federal partnership audit procedures and, more importantly, the federal provisions that allow a partnership to be assessed tax following a federal audit.

The FTB's actions, however, are premature. Most of the new federal partnership audit provisions are effective for tax years beginning on or after January 1, 2018, applicable to partnership returns (Form 1065) due in 2019. Thus, the earliest that these provisions could be applied to most partnership audits (and the states) is in 2019, and more likely 2020 and beyond.

Thus, while COST understands the need for California law to conform to the BBA, there is no urgency for the State to act immediately on this issue. We urge the FTB to reconsider advancing its legislative proposal at this time.

### **The FTB's Current Proposal is Likely Unworkable and is Out of Step with Current Conformity Efforts**

As drafted, the FTB's Legislative Proposal F is likely unworkable. Specifically, as drafted, the proposal appears to contemplate complete conformity with the BBA's partnership audit provisions. In other words, a partnership subject to a federal audit under these new rules, which provide several choices regarding assessment and payment at the federal level, would be required to comply with those choices for California purposes as well. Most state and local tax professionals, including Multistate Tax Commission (MTC) staff and other taxing agency personnel who have reviewed the new federal audit procedures, agree that the state assessment procedures likely need to differ from the federal audit assessment procedures in the BBA.

COST and several other interested parties, including the American Bar Association's State and Local Taxes Committee, the American Institute of Certified Public Accountants, the Tax Executives Institute, and the Institute for Professionals in Taxation, have been working together and with the MTC on a model statute that addresses the specific state issues raised in the new audit/assessment of tax procedures of the BBA. This model is being designed to provide taxpayers and the states with flexibility so that taxpayers and states can more quickly and efficiently deal with the results of an audit under these new BBA provisions. This model has recently been revised by MTC staff, and the interested parties will be revising their draft and provide it to the MTC within the next few weeks. The interested parties and MTC are hopeful that a final draft will be ready by early next year.<sup>1</sup>

Again, COST understands the FTB's concerns and its desire to conform to the BBA partnership audit provisions; however, a brief delay would allow the FTB to consider model conformity legislation and thereby improve its recommendation. Further, voluntary compliance will increase with the number of states adopting the model legislation, providing taxpayers with a uniform procedure for reporting federal partnership audit results. This is a benefit both to taxpayers as well as the states.

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<sup>1</sup> COST anticipates early to mid-January 2018 as a reasonable timeframe for the model to be finalized.

I thank you for the opportunity to provide comments on the FTB's Legislative Proposal F, and please do not hesitate to contact me if you have any questions or if you would like to discuss these comments further.

Sincerely,

A handwritten signature in black ink, appearing to read "Nikki E. Dobay". The signature is written in a cursive, flowing style.

Nikki E. Dobay

cc: COST Board of Directors  
Douglas L. Lindholm, COST President & Executive Director