



State Tax Implications of an IRS Audit

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Agenda

Background: Revenue Agent's Report

State impact of IRS audit adjustments

State filing requirements and deadlines

Statute of Limitations

Hot Topics / Trends

Q & A

Background:
Revenue agent's report

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What is a Revenue Agent's Report?

- When the IRS modifies federal taxable income, a Revenue Agent's Report ("RAR") is issued summarizing the audit adjustments being made to previously reported federal taxable income
- What forms are commonly used by the IRS?
 - Form 870
 - Form 870-AD
 - Form 4549
 - Form 4549-A
 - Closing Agreement

State impact of IRS audit adjustments

State impact of IRS audit adjustments

- An IRS audit can result in need to file hundreds / thousands of state amended returns
- What is the impact of an RAR for state purposes?
 - Re-determine state tax liabilities taking into account IRS adjustments
 - Impact beyond federal taxable income
 - Modifications
 - Non-business income
 - NOLs, credits, and other limitations and carryovers
 - Apportionment

State filing requirements and deadlines

- What are the deadlines and procedures for reporting federal adjustments to states?
 - Time period for reporting varies by state (30 days to more than a year)
 - Time period for a specific state can also vary based upon:
 - Whether federal adjustments result in refund or additional tax due (Illinois, Iowa, Maryland)
 - Whether federal adjustments are related to IRS audit or taxpayer-initiated filing of federal form 1120X (Oregon)
 - Combined versus separate company filing (New York)
 - States may require filing of amended returns even if federal adjustments do not change the state tax liability
 - Non-filing may permit statute of limitations to remain open indefinitely (ASC 740 impact)

Filing format

- Taxpayers must file amended state returns using state accepted formats and attaching necessary documents
- Amended return form versus an alternative format
 - Form types: Original, “X” (year specific/generic), IRS specific
 - Spreadsheet with IRS documents (may not meet states requirements)
- Attachments to the amended filing
 - IRS documentation
 - Original or previous amended filing (exclude for MI)
 - Other supporting schedules to support the amended filing
 - File “As Amended” original form in “X” Form states???
 - Unlike Federal 1120x (exception = IN)

State tax implications of IRS audit

- What constitutes the “final determination” of an IRS audit?
 - “Starts the clock ticking” with respect to states’ time period for reporting adjustments
 - Challenging as many states provide little or no guidance
 - States that have a definition often list series of events (including references to IRS Form 870/870-AD, payment of tax, etc.)
 - Uncertainty often remains regarding what constitutes “agreement” or “acceptance” / “execution”
 - Partial agreements may be viewed as “final determinations” for agreed items (additional filing burden)

State compliance: Issues and challenges

- Determining starting point (*i.e., incorporating audits/notices and previous state amended returns*)
 - Impact of lump-sum prior state audit settlements
- Unique and varied forms and addresses
- Impact on state modifications or other items on state return
- Adjustments may affect later years not currently under audit by reducing certain carryforward items (*e.g., NOLs*)

State compliance: Issues and challenges (cont.)

- Quantifying impact of adjustments for members of consolidated groups
 - IRS audit adjustments not “pushed down” to underlying legal entities
- State amnesty programs (*benefits / considerations*)

State compliance: Issues and challenges (cont.)

Penalties and Interest

- Most states apply general penalty provisions
- Interest may apply from the due date of the originally filed return
- Application of payments and credits can be important
- Request a transcript
- Netting of underpayments and overpayments of tax and interest between tax years
- Different rates may apply to overpayment / underpayment

Statute of limitations

Federal statute of limitations waivers

- Generally, the federal statute of limitations on assessment expires three years from when the tax return is due or filed, whichever is later
- A claim for credit or refund must generally be filed within three years from the date the return was filed or two years from when the tax was paid, whichever is later
- Taxpayers can waive the statute of limitations through either an open-ended or a fixed-date consent.
 - Both can contain language that limits extension to only one or more specified issues (which can have state implications)

What is competent authority (“CA”)?

Requested under the Mutual Agreement Procedure (“MAP”) Article contained in relevant Tax Treaty

- Available when actions of U.S. or treaty country result or will result in taxation that is contrary to provisions of the treaty (“double taxation”)
 - Adjustment must be initiated by a tax authority, not voluntary
- Only available if U.S. has Tax Treaty with relevant country
 - MAP Article broader than just transfer pricing
 - Many treaties contain time limits for requesting relief (typically beyond normal statute of limitations)

State impact of CA agreements (“CAA”)

- If a CAA does not require a taxpayer to amend its federal tax return and if related adjustments are not rolled into an ongoing IRS audit, no state amended returns are necessary, but prospective changes must be tracked.
- When a CAA requires a taxpayer to amend its federal tax return:
 - If the “normal” federal/state statutes of limitations are open, taxpayers follow traditional state amended return procedures.
 - If the state statute of limitations on assessment has closed, the state statute may *not* automatically reopen by virtue of the reopening of the federal statute of limitations.

Competent authority – protective claims

- Any U.S. CAA will be implemented notwithstanding any time limits or other procedural limitations in the domestic law of either country.
- A CA request can be treated as a protective claim.
 - Statute of limitations on assessment can expire if U.S. CA assistance is declined or if no agreement is reached.
- Some other protective measures include:
 - filing protective claims for refund or credit;
 - extending any period of limitations on assessment or refund;
 - avoiding the lapse or termination of right to appeal; or
 - contesting an adjustment or seeking an appropriate correlative adjustment with respect to the U.S. or treaty country tax.

State implications of federal waivers

- Limited State Guidance

- CA: Unrestricted waiver opens entire year for 6 months beyond federal
- St. Louis: Federal waiver not respected (refunds must be claimed within 3 years; tax due assessed within 5 years)

- State Statutes of Limitations Provisions

- General statute of limitations (Typically 3 or 4 year statute)
- Statute of limitations applicable to a federal waiver
- State of limitations applicable to the filing of an amended return

- Considerations

- Which statute applies?
- Can adjustments other than RAR be incorporated?

Hot topics / current trends

Hot topics / trends

- Refund denials
 - Definition of final determination
 - Reporting self-initiated / federal form 1120X adjustments
 - More stringent requirements regarding forms, schedules, and attachments
- Assessment of penalties
- Compliance Assurance Process
 - Similar state reporting and filing obligations apply
- Increased scrutiny regarding forms and attachments
- E-filing

Question and answer

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