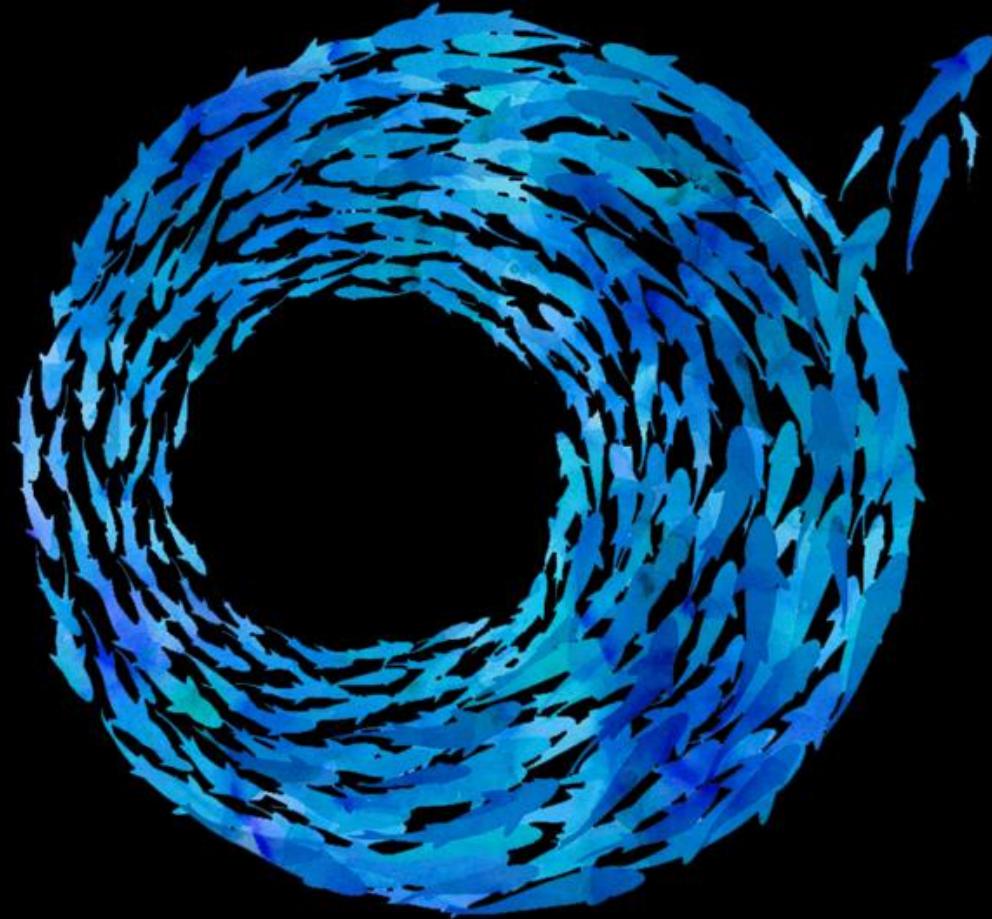


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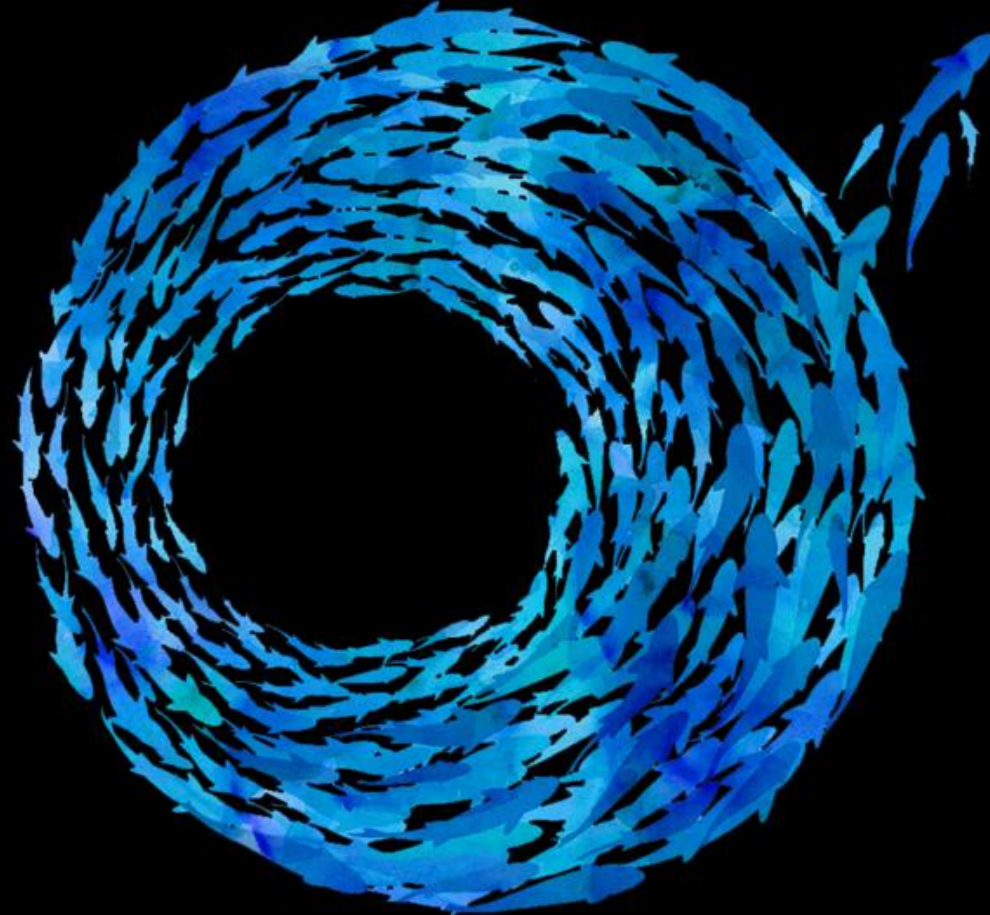


**The 2018 National  
Multistate Tax Symposium**

Take the lead—Tax reform and fortifying state positions

February 7-9, 2018





## **State tax Implications of IRS controversies**

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February 7-9, 2018

# Agenda

- Why should state tax professionals be involved in my federal audit?
  - Obligations under tax sharing/tax separation agreements
  - Federal audit settlements
  - Controversies
- Federal cases impacting state audits
- Reporting federal audit adjustments to the states
- Tax reform

**Why should state tax professionals  
be involved in my federal audit?**

## Why should state tax professionals be involved in my federal audit?

- State tax audits could be negatively impacted by the responses provided to the IRS and the specific development of federal audit issues.
- The use of state tax savings as a reason to support the federal treatment of a transaction may put similar state treatment at risk.
- Federal adjustments may generate DITS that are currently taxable in certain states.
- Federal adjustments may be consolidated/booked on the parent entity.
- May be able to impact which federal adjustments are assessed.
- May be able to mitigate the state impacts of federal audit issues.

# Why should state tax professionals be involved in my federal audit?

- Obligations under tax sharing/tax separation agreements
  - May be different for federal/state
- Audit settlement implications
  - What specific issues are driving the adjustments?
  - Where in the group should the final adjustments be reflected for state purposes?
- Controversy implications
  - What specific issues are being appealed/litigated?
  - What state defenses are incremental to the federal defense?

## Federal cases impacting state audits

### *Altera Corp. and Subs. v. Comm’r*, 145 T.C. 91 (July 27, 2015)

- Altera Corp. and its foreign subsidiary entered into a technology license agreement and a research and development cost-sharing agreement (CSA).
- Altera Corp. granted stock-based compensation (SBC) to certain employees who performed research and development under the CSA, but did not include the SBC in the shared cost pool.
- The IRS issued notices of deficiency based on the inclusion of the SBC in the shared cost pool.
- IRC § 482 authorizes the IRS to allocate income and expenses among related entities to clearly reflect income relating to transactions between the related entities.
- Treas. Reg. §1.482-1 explains that the standard to be applied is that of a taxpayer dealing at arm’s length with an unrelated taxpayer.
- Treas. Reg. §1.482-7(d)(2) requires related parties entering into CSAs to share SBC costs.

# Federal cases impacting state audits

## *Altera Corp. and Subs. v. Comm’r*, 145 T.C. 91 (July 27, 2015) (*cont.*)

### **Issues**

- Legislative versus interpretive regulations
  - The Administrative Procedure Act (APA) sets forth requirements that must be met for legislative regulations, including notice, comment, and consideration.
- *Chevron* standard of review
  - *Chevron* two-step test asks (1) whether Congress has addressed the question at issue and, if not, (2) whether an agency’s interpretation is arbitrary or capricious.

### **Reasoned decision-making**

- Reasoned decision-making requires an agency “to examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.”
- Court found that the IRS did not engage in fact finding and did not adequately support its belief that unrelated parties would share SBC in the context of a CSA.
- Court found that the IRS failed to meaningfully respond to numerous relevant and significant comments.
- Court found that the regulation was contrary to the evidence before the IRS when it was issued.



# Reporting federal audit adjustments to the states

## Considerations

- State statutes of limitations
- Impact on refunds and assessments
- Off-sets / equitable recoupment
- Partnership audit rules
  - Current year adjustments
  - Resident v. non-resident partners
  - Tiered partnerships

# Tax reform

## Considerations

- Transition tax
  - Subpart F?
- GILTI
  - Subpart F?
- 163(j)
- Future correction bills

## Contact information

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