REPORT OF THE STATE AFFAIRS COMMITTEE
September 29, 2017

The State Affairs Committee provides the following report to the Membership.

Over the course of the last year, MLPA has continued efforts to protect the interests of its members at the state level. The politics of change impacting the federal government has unquestionably carried over into state legislative bodies throughout the country. In some respects, the environment at the state level has become even more contentious for a variety of reasons, driving 20 states to hold special sessions to resolve issues ranging from budgets to social matters. We cannot recall another time in recent history when more special sessions have been held.

Despite regaining ground lost during the last recession nearly a decade ago, many states continue to struggle with financial matters. Tax revenue collections continue to lag, having not kept pace with either spending or inflation. This has been compounded by the low cost of energy and commodity prices. Coming into the 2017 legislative season, more than half the states faced budget shortfalls. A majority of those expect to experience shortfalls going into the 2018 fiscal year.

While tax revenues have slowed, the obligations states face continue to grow. In addition to the continued cry for significant increases in education and health and human services funding, particularly the states' share of Medicaid, unfunded pension burdens in excess of $1 trillion further plague the states' future outlooks. This has resulted in many legislative leaders rethinking their states' tax structure, evaluating the need to "rebalance" tax rates, credits and the overall dependence on certain types of taxes to fund programs. As a result, policies once engrained are now being reconsidered or reworked.

As with previous years, the efforts of MLPA have focused on composite returns and withholding. However, the recent efforts have worked to further address lower-tier partnerships as well as the impact of the pending federal partnership audit provisions. Given state budget situations, the increasing activities of the Multi-State Tax Commission ("MTC"), and the new federal large partnership audit regime, we expect the next year to be one of our busiest with regard to state tax matters.

Below is a summary of issues in states and at the MTC in which MLPA has engaged/monitored or continues to engage/monitor:

Multi-State Tax Commission (MTC)

The MTC has established a working group to develop model legislation to assist states with the implementation of the new federal partnership audit regime requirements. MTC members recently voted to use a proposal developed by a group of interested stakeholders as the starting document. We expect the draft to evolve over the coming months as comments are solicited from all stakeholders. The MTC is hoping to complete this process within the next 12 months. MLPA has actively participated in meetings regarding the development of this policy, and will continue to do so as it moves forward.

Alaska

Alaska is one of the few states that has not adopted a personal or corporate income tax. The State now faces a $1+ billion shortfall and the budget deficit continues to worsen as the price of oil remains low and the level of production declines. For the first time in recent history, the legislature has considered enacting a state income tax and corresponding composite return and withholding provision. The governor has called the legislature back for its fourth special session, which will convene in October. MLPA is monitoring the situation and will engage further, if necessary.

California

MLPA has actively worked on several issues in California recently. The first relates to the minimum payment of the California franchise tax by members of a limited liability company. This issue, ongoing for nearly seven years, was resolved in January when the California Court of Appeal for the Fifth Appellate District affirmed the decision of the California Superior Court in *Swart Enterprises, Inc. v. Franchise Tax Board*. The ruling clarifies that the partners of a limited liability company that were not actively doing business in California are not subject to the tax. The Franchise Tax Board opted to not further appeal the decision to the California Supreme Court.

The second issue relates to a proposed rulemaking by the Franchise Tax Board to significantly revise its current composite return and withholding provisions. PTPs currently have the ability to secure an exemption from the requirements after filing a petition with the Board. However, the new proposal would eliminate that option in addition to adding extensive reporting and withholding requirements for upper and lower-tier partnerships and their partners. MLPA is actively working to develop comments to the proposal, which are due in early October.

Georgia

Georgia was one of three states to introduce legislation to enact policy relating to the federal partnership audit rules. After hearing from numerous stakeholder groups that the language was premature, the language addressing the federal partnership audit rules was deleted from the legislation.

Louisiana

Louisiana has experienced a significant deficit as a result of the economic downturn and specifically the price of natural gas and oil. Last year the legislature took several steps to address the looming deficit through the adoption of tax increases. With an ongoing deficit, the governor offered one proposal that would have created a new business tax similar to the Texas margins tax. There was little support for the new tax and the proposal was ultimately withdrawn.

Minnesota
Minnesota was the second of three states to introduce legislation to enact policy relating to the federal partnership audit rules. Two separate bills, both of which failed to pass, were introduced that addressed various aspects of the federal rules, including the payment of additional tax through the composite returns and the federal procedures.

Montana
Three bills were proposed by legislators this year that would have directly impacted PTPs. Two related to composite returns and withholding, and one related to the federal partnership audit rules. The only bill to pass pertained to a technical change to the definition of "domestic corporation" for the purposes of composite returns.

The Association expects provisions relating to the current composite return and withholding requirements to be reviewed during the legislative interim. The Department of Revenue has also just issued a rulemaking relating to partnerships. We will be reviewing the draft and submitting comments as appropriate.

Ohio
Ohio is seeking to revise its existing composite return and withholding statute. MLPA has worked closely with legislative members and the Department of Taxes to secure and continue the exemption for PTPs as well as a new provision addressing the treatment of lower-tier partnerships. Ultimately, legislative deadlines and the end of session in 2016 resulted in the legislation failing to pass. However, we do expect the legislation to be reintroduced later this year.

Oklahoma
Oklahoma has two statutes that deal with composite returns and withholding- one relating to income tax and the other relating to royalty withholding. The royalty withholding had not posed a problem until recently as the Tax Commission changed informal internal policies. While the legislation failed to pass due to issues out of our control in 2016, the legislature successfully passed the bill earlier this year that provides the same exemption for PTPs from the withholding requirements on royalties.

Texas
Like other states, Texas continues to face a substantial budget shortfall due to the downturn in oil and gas activity. Despite this, legislative leaders have taken the initial steps to pass legislation that seeks to eliminate the franchise tax as it is currently assessed. While several proposals were introduced to eliminate the franchise tax during the recent legislative session, the efforts ultimately failed to pass due to a lack of funds available.

Vermont
MLPA coordinated with several member companies and related associations to pass legislation in 2015 to recodify a long- standing policy by the Department of Taxation that exempted PTPs from composite return and withholding requirements. Even after passing the legislation in the spring of 2015, PTPs have continued to receive notices indicating unresolved tax liability. MLPA has reengaged several associations as well as the Department with the hope of resolving the notices permanently. We are currently waiting on a formal response from the Department before taking

additional steps.