

Part III - Administrative, Procedural, and Miscellaneous

Request for Comments Regarding Implementation of the New Partnership Audit Regime Enacted as Part of the Bipartisan Budget Act of 2015

Notice 2016-23

I. PURPOSE

The purpose of this Notice is to solicit comments regarding implementation of section 1101 of the Bipartisan Budget Act of 2015, Pub. L. No. 114-74 (“the BBA”), which was enacted into law on November 2, 2015. Section 1101 of the BBA repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level.

The repeal of the current partnership audit rules and implementation of the new partnership audit regime are generally effective for partnership taxable years beginning after December 31, 2017. See section 1101(g)(1) of the BBA. However, section 1101(g)(4) generally provides that a partnership may elect (at such time and in such form and manner as the Secretary may prescribe) for parts of the new regime to apply to partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

The Department of the Treasury (“Treasury Department”) and the Internal

Revenue Service (“IRS”) intend to issue guidance implementing the new partnership audit regime. Specifically, guidance describing procedures for making the election to have parts of the new regime apply to taxable years beginning after November 2, 2015 and before January 1, 2018 is expected to be published in the near future. Partnerships that wish to make this election should wait until that guidance is published to ensure the election complies with the requirements for making a valid election. The guidance will be effective for taxable years beginning after November 2, 2015 and before January 1, 2018.

II. BACKGROUND

Section 1101(a) of the BBA removes subchapter C of chapter 63 of the Internal Revenue Code (“the Code”) effective for partnership taxable years beginning after December 31, 2017. Subchapter C of chapter 63 contains the unified partnership audit and litigation rules that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248. These partnership audit and litigation rules are commonly referred to as the TEFRA partnership procedures.

Section 1101(b) of the BBA also removes subchapter D of chapter 63 and part IV of subchapter K of chapter 1 of the Code, rules applicable to electing large partnerships, effective for partnership taxable years beginning after December 31, 2017. Subchapter D contains the audit rules for electing large partnerships, and part IV of subchapter K prescribes the income tax treatment for such partnerships.

Section 1101(c) of the BBA replaces the rules to be removed by sections 1101(a)

and (b) with a new partnership audit regime. Section 1101(c) adds a new subchapter C to chapter 63 of the Code, including amended Code sections 6221-6241. The BBA also makes related and conforming amendments to other provisions of the Code.

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q (“PATH Act”). Section 411 of the PATH Act corrects and clarifies certain amendments made by the BBA. The amendments under the PATH Act are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

Section 6221(a) as amended by the BBA provides that, in general, any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year (and any partner’s distributive share thereof) shall be determined, and any tax attributable thereto shall be assessed and collected, at the partnership level. The applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item or share shall also be determined at the partnership level. Section 6221(b) as amended by the BBA provides rules for partnerships that are required to furnish 100 or fewer Schedules K-1, *Partner’s Share of Income, Deductions, Credits, etc.* to elect out of this new regime. Generally, a partnership may elect out of the new regime only if each of its partners is an individual, corporation (including certain types of foreign entities), or estate. Special rules apply for purposes of determining the number of partners in the case of a partner that is an S corporation. Section 6221(b)(2)(C) provides that the Secretary by regulation or other

guidance may prescribe rules for purposes of the 100-or-fewer-Schedule K-1 requirement similar to the rules for S corporations with respect to any partner that is not an individual, corporation, or estate.

Section 6222 as amended by the BBA provides rules generally requiring a partner's return to be consistent with the partnership's return.

Section 6223 as amended by the BBA sets forth the rules for designation of a partnership representative. Under this provision, a partnership representative must be a partner (or other person) with a substantial presence in the United States. If a designation is not in effect, the IRS may select any person as a partnership representative.

Section 6225 as amended by the BBA generally addresses partnership adjustments made by the IRS and the calculation of any resulting imputed underpayment. Section 6225(a) generally provides that the amount of any imputed underpayment resulting from an adjustment must be paid by the partnership. Section 6225(b) describes how an imputed underpayment is determined, and section 6225(c) describes modifications that, if approved by the IRS, may reduce the amount of an imputed underpayment. The PATH Act added to section 6225(c) a special rule addressing certain passive losses of publicly traded partnerships. Section 6233 provides rules for computation of interest and penalties on an imputed underpayment.

Section 6226 as amended by the BBA provides an exception to the general rule under section 6225(a)(1) that the partnership must pay the imputed underpayment.

Under section 6226, the partnership may elect to have the reviewed year partners take into account the adjustments made by the IRS and pay any tax due as a result of those adjustments. In this case, the partnership is not required to pay the imputed underpayment. Section 6225(d)(1) defines the reviewed year to mean the partnership taxable year to which the item(s) being adjusted relates.

Under section 6227 as amended by the BBA, the partnership may request an administrative adjustment, which is taken into account in the year the administrative adjustment request is made. The partnership generally has three years from the date of filing the return to make an administrative adjustment request for that year, but may not make an administrative adjustment request for a partnership taxable year after the IRS has mailed the partnership a notice of an administrative proceeding with respect to the taxable year.

Section 6241(4) as amended by the BBA provides that no deduction is allowed under subtitle A for any payment required to be made by a partnership under the new partnership audit regime.

Section 6231 as amended by the BBA describes notices of proceedings and adjustments, including certain time frames for mailing the notices and the authority to rescind any notice of adjustment with the partnership's consent. Section 6232(a) provides that any imputed underpayment is assessed and collected in the same manner as if it were a tax imposed for the adjustment year by subtitle A, except that in the case of an administrative adjustment request that reports an underpayment that the

partnership elects to pay, the underpayment shall be paid when the request is filed.

Section 6234 as amended by the BBA generally provides that a partnership may seek judicial review of the adjustments within 90 days of the date the notice of final partnership adjustment is mailed. Section 6235 provides the period of limitations on making adjustments. Section 6241 provides definitions and special rules, including rules addressing bankruptcy and treatment when a partnership ceases to exist.

III. REQUEST FOR COMMENTS

.01 The Treasury Department and the IRS intend to issue guidance to implement the new partnership audit regime under sections 6221-6241 of the Code, as amended by section 1101 of the BBA and section 411 of the PATH Act. To assist in the development of this guidance, this Notice requests public comments on issues that the guidance should address. In particular, the Treasury Department and the IRS request comments on the following issues:

- (1) The election out of the new centralized partnership audit regime under section 6221(b) for partnerships that are required to furnish 100 or fewer Schedules K-1, including whether any type of partner, other than those types of partners specifically identified in section 6221(b)(1)(C), should be treated under rules similar to the special rules applicable to S corporations.
- (2) Designation of the partnership representative under section 6223, including:
 - a. Any limitations on who may be designated as a partnership representative;

- b. The definition of substantial presence in the United States; and
 - c. Designation of the partnership representative by the IRS in cases where the partnership fails to designate a representative or the designation is not in effect.
- (3) The determination of the imputed underpayment under section 6225, including:
- a. How the netting calculation under section 6225(b)(1) should work; and
 - b. How character changes, restrictions, and limitations under the Code are taken into account.
- (4) Modification of the imputed underpayment under section 6225(c), including:
- a. The mechanics and timing for requesting modification and documentation to be provided to support the request for modification;
 - b. Implementation of the modification, with respect to publicly-traded partnerships, for certain specified passive losses under section 469;
 - c. The effect of unrelated business taxable income of a tax-exempt entity on the modification procedure relating to tax-exempt partners; and
 - d. Any other issues and factors that should be considered when formulating the modification procedures.
- (5) How an adjustment made by the IRS under section 6225 that does not result in an imputed underpayment should be taken into account by the partnership.
- (6) The election to use the alternative to payment of the imputed underpayment

by the partnership under section 6226, including:

- a. How to make the election, the time for providing information to the IRS, the information that should be required to be included with the election, and the form and content of the statement of adjustments to be provided to the partners and the IRS;
- b. When the statements should be filed with the IRS and furnished to partners;
- c. How the adjustments in the final notice of partnership adjustment should be reflected if the adjustments are changed as a result of a court proceeding;
- d. Generally, how tax attributes should be taken into account for intervening years between the reviewed year and the adjustment years;
- e. How adjustments are taken into account by partners under the alternative to payment of the imputed underpayment by the partnership under section 6226; and
- f. The consequences that result when a partner fails to account for adjustments as required under section 6226(b), including how tax attributable to those adjustments is assessed and collected.

(7) How a partnership makes an administrative adjustment request ("AAR") under section 6227 and the effect of such a request, including:

- a. The circumstances in which a partnership may want to file an AAR;
 - b. The mechanics for how to file an AAR and pay any imputed underpayment;
 - c. How partnerships should account for adjustments requested as part of an AAR;
 - d. What steps the IRS should take upon receipt of an AAR; and
 - e. What opportunities the partnership has for review of IRS actions taken with respect to an AAR.
- (8) The effect of adjustments on the basis of the partners in their partnership interests and the basis of the partnership in its assets.
- (9) The rules for consistent filing of partner returns, including:
- a. The rules for notifying the IRS of an inconsistent position;
 - b. The treatment of partners that properly file such notification; and
 - c. Whether, and to what extent, the existing framework for inconsistent partner returns and notification of inconsistent partner returns under TEFRA should apply.
- (10) The effect of bankruptcy and the treatment under the new partnership audit rules where a partnership ceases to exist.
- (11) Procedural rules, including:
- a. Notices of proceedings and adjustment;
 - b. Rules regarding assessment, collection, and payment of the imputed

underpayment;

- c. The computation of penalties and interest;
- d. Judicial review of partnership adjustments; and
- e. The period of limitations on making adjustments under section 6235.

(12) Any other issues relevant to the implementation of the new partnership audit rules, including topics related to any of the above listed issues but not specifically identified in the list above, e.g., the interaction of these rules with international tax provisions.

.02 The new partnership audit rules are generally effective for tax years beginning after December 31, 2017. However, partnerships are permitted to elect to have parts of the new regime apply to tax years beginning after November 2, 2015 and before January 1, 2018. Given the scope of the guidance anticipated to be necessary to implement these rules, and the need to expedite the guidance process in light of the statutory effective dates, written comments in response to this Notice are requested by April 15, 2016.

IV. ADDRESS TO SEND COMMENTS

.01 Comments responding to this Notice should be sent to:

- Internal Revenue Service
- CC:PA:LPD:PR (Notice 2016-23)
- Room 5203

- P.O. Box 7604
- Ben Franklin Station
- Washington, DC 20044

Please include "Notice 2016-23" on the cover page.

.02 Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

- Internal Revenue Service
- Courier's Desk
- 1111 Constitution Ave., N.W.
- Washington, DC 20224
- Attn: CC:PA:LPD:PR
- (Notice 2016-23)

.03 Submissions may also be sent electronically to the following e-mail address: Notice.Comments@irsounsel.treas.gov. Please include "Notice 2016-23" in the subject line.

All comments will be available for public inspection and copying.

V. DRAFTING INFORMATION

The principal author of this notice is Joy E. Gerdy Zogby of the Office of

Associate Chief Counsel (Procedure & Administration). For further information regarding this notice contact Joy E. Gerdy Zogby on (202) 317-6834 (not a toll-free call).

Caplin & Drysdale,
Chartered