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NEW TAX LAWS RELATING TO IRS EXAMINATION OF AND TAX COLLECTION FROM PARTNERSHIPS: UNDERSTANDING THE NUANCES OF THE NEW LEGISLATION

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AGENDA

- Why Was TEFRA Repealed and Replaced with BBA Provisions?
- Overview of Statutory Regime
- IRS Notice 2016-23
- The JCT Blue Book – What Was Revealed?
- Other Nuances
- How Does The New Law Help Tax Administration?



**WHY WAS TEFRA
REPEALED AND
REPLACED WITH
BBA PROVISIONS?**

WHY WAS TEFRA REPEALED AND REPLACED WITH BBA PROVISIONS?

- TEFRA was enacted to address duplicative audits and inconsistent tax results among partners
 - Under TEFRA, determinations made in a single, unified proceeding and results are applied to individual partners
- Growth in both the use and size of partnerships complicated application of TEFRA
 - 1997 enactment of Electing Large Partnership provisions
 - 2014 GAO Report
- Burdensome for IRS to make adjustments and collect tax from large number of partners and in cases of tiered partnerships



Overview of Statutory Regime

Caplin & Drysdale,
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OVERVIEW OF STATUTORY REGIME

- TEFRA Repealed
 - Bipartisan Budget Act of 2015

TEFRA RIP

TITLE XI—REVENUE PROVISIONS RELATED TO TAX COMPLIANCE

SEC. 1101. PARTNERSHIP AUDITS AND ADJUSTMENTS.

(a) **REPEAL OF TEFRA PARTNERSHIP AUDIT RULES.**—Chapter 63 of the Internal Revenue Code of 1986 is amended by striking subchapter C (and by striking the item relating to such subchapter in the table of subchapters for such chapter).

(b) **REPEAL OF ELECTING LARGE PARTNERSHIP RULES.**—

(1) **IN GENERAL.**—Subchapter K of chapter 1 of such Code is amended by striking part IV (and by striking the item relating to such part in the table of parts for such subchapter).

(2) **ASSESSMENT RULES RELATING TO ELECTING LARGE PARTNERSHIPS.**—Chapter 63 of such Code is amended by striking subchapter D (and by striking the item relating to such subchapter in the table of subchapters for such chapter).

(c) **PARTNERSHIP AUDIT REFORM.**—

(1) **IN GENERAL.**—Chapter 63 of such Code, as amended by the preceding provisions of this section, is amended by inserting after subchapter B the following new subchapter:

OVERVIEW OF STATUTORY REGIME

- New Terms of Art
 - Partnership Representative
 - Imputed Underpayment
 - Reviewed Year
 - Adjustment Year

- New Tax Collection Concepts
 - Collecting from Partnership – Default
 - Partner Amended Returns within 270 Days of Notice of Proposed Adjustment\
 - Revised K-1 Procedure within 45 Days of Final Notice
 - > “Special” K-1
 - > “Push Out”
 - Electing Out on Timely Filed Return

OVERVIEW OF STATUTORY REGIME

- New Terms of Art
 - Partnership Representative (section 6223)
 - > Party selected to represent partnership before IRS and make tax decisions
 - > Sole authority
 - > Not required to be a partner
 - > Person with substantial U.S. presence (under section 7701(a)(1)), includes individual, trust, estate, partnership, association, company, or corporation
 - > IRS will appoint if partnership does not
 - > Unlike TEFRA, partners do not have the right to participate in the proceedings or receive notice of proceedings from IRS. Section 6231.

OVERVIEW OF STATUTORY REGIME

➤ New Terms of Art

- Imputed Underpayment – Net non-favorable adjustments to partnership tax year multiplied by the highest applicable tax rate
- Reviewed Year (section 6225(d)(1)) – Partnership tax year under audit.
- Adjustment Year (section 6225(d)(2)) – Year in which the adjustment for the reviewed year is made
 - > Year in which partnership adjustment becomes final under a court decision
 - > Year in which adjustment is made pursuant to an administrative adjustment request
 - > Year in which final partnership adjustment (FPA) is made (all other cases)
- Statute of Limitations on Assessment – only determined at the partnership level. Section 6235.

OVERVIEW OF STATUTORY REGIME

- Collecting from Partnership – Default Rule (section 6225)
 - As under TEFRA, tax adjustments will continue to be made at the partnership level.
 - However, unlike under TEFRA, unless a partnership is eligible to make an annual election and does in fact make the election, the tax attributable to an adjustment, and related interest and penalties, will be collected at the partnership level.
 - When the IRS makes a tax adjustment, the partnership’s current partners (the “adjustment year” partners) will effectively pay the tax for the persons who were partners in the taxable year for which the adjustment was made (the “reviewed year” partners).
 - The tax to be paid is based on the “imputed underpayment”.
 - Penalties (and defenses) determined at partnership level. Section 6233.

OVERVIEW OF STATUTORY REGIME

- Collecting from Partnership – Default (section 6225)
 - Generally, the imputed underpayment is calculated at the highest marginal tax rate for the reviewed year (39.6%).
 - Reduction to Imputed Underpayment - A partnership can reduce the amount of the “imputed underpayment” or actual tax by:
 - > The “reviewed year” partners who file amended returns and pay the tax attributable to their allocable adjustment amounts. The partnership must submit information to the IRS sufficient to modify the “imputed payment amount” within 270 days after the notice of proposed adjustments.
 - > Regulations will provide for taking into account a lower rate of tax with respect to (a) ordinary income of a C corporation, (b) capital gain and qualified dividends of an individual, and (c) tax exempt partners (0% tax rate).
 - > IRS must approve modifications.

OVERVIEW OF STATUTORY REGIME

- Revised K-1 Procedure (section 6226).
 - Within 45 days of receiving a notice of final partnership adjustment, any partnership, regardless of size, may elect out of the “imputed underpayment” process so long as it provides the IRS with “a statement of each partner’s share of any adjustment to income, gain, loss, deduction, or credit (as determined in the notice of final partnership adjustment).”
 - Under this procedure, “reviewed year” partners calculate their share of additional tax due based on the statement (*i.e.*, amended Schedule K-1) and the “reviewed year” partner will pay the additional amount with their respective current year individual tax return.
 - The added tax due from the partner is computed as if it were an amended return for the “reviewed year “ with adjustments for tax attributes for later years.
 - An election under this provision increases the applicable underpayment interest rate by two percentage points.
 - Partners also liable for penalties.
 - Reviewed year partners have no right to an administrative or judicial review.

OVERVIEW OF STATUTORY REGIME

- Elect Out on Timely Filed Return (section 6221(b))
 - If a partnership has fewer than 100 partners and no partner is itself a partnership (or an entity that has elected to be treated as a partnership, like a limited liability company), then the partnership can make an annual “opt out” election on a timely filed tax return.
 - > Year-by-year election
 - > Provide name and TIN of each partner
 - > Query whether can elect out if partner is a grantor trust.
 - If a partnership elects out of the new regime, the partnership and partners will be examined under the rules applicable to individual taxpayers. Section 6221(b).

OVERVIEW OF STATUTORY REGIME

- Partnership Request for Administrative Adjustment (section 6227).
 - Partnership method for requesting adjustments to tax year
 - > No more amending tax returns (1065X).
 - Filed within 3 years from later of date that return was filed or unextended due date of return.
 - If AAR shows Imputed Underpayment, then
 - > Partnership pays Imputed Underpayment with the request consistent with calculation under section 6225; or
 - > Push out/issue revised K-1s consistent with the rules under section 6226.
 - If AAR does not show Imputed Underpayment, then partnership should push out/issue revised K-1s.



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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)

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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

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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;

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- 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

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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:

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- 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

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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

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- The regulation process update
- What is the IRS looking for?
- What was the response from practitioners?



The JCT Blue Book – What Was Revealed?

THE JCT BLUE BOOK – WHAT WAS REVEALED?

[JOINT COMMITTEE PRINT]

**GENERAL EXPLANATION OF
TAX LEGISLATION ENACTED IN 2015**

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION



MARCH 2016

JCS-1-16

THE JCT BLUE BOOK – WHAT WAS REVEALED?

- Election out examples (page 59)
- Modification of imputed underpayment when partners file amended returns (page 66)
- Interplay of revised K-1 procedure with Tax Court proceedings (page 69)
- Revised K-1 procedure – treatment of tiered partnerships (page 70)
- Partnership ceases to exist (page 80)
- How does the AAR process work?

THE JCT BLUE BOOK – WHAT WAS REVEALED?

Treatment of tiered partnerships and other tiered entities

Tiered partnerships.—In the case of tiered partnerships, a partnership that receives a statement from the audited partnership is treated similarly to an individual²²¹ who receives a statement from the audited partnership. That is, the recipient partnership takes into account the aggregate of the adjustment amounts determined for the partner's taxable year including the end of the reviewed year, plus the adjustments to tax attributes in the following taxable years of the recipient partnership. The recipient partnership pays the tax attributable to adjustments with respect to the reviewed year and the intervening years, calculated as if it were an individual (consistently with section 703), for the taxable year that includes the date of the statement. The recipient partnership, its partners in the taxable year that is the reviewed year of the audited partnership, and its partners in the year that includes the date of the statement, may have entered into indemnification agreements under the partnership agreement with respect to the risk of tax liability of reviewed year partners being borne economically by partners in the year that includes the date of the statement. Because the payment of tax by a partnership under the centralized system is nondeductible, payments under an indemnification or similar agreement with respect to the tax are nondeductible.

Deficiency dividends.—A recipient partner that is a RIC or REIT and that receives a statement from an audited partnership including adjustments for a prior (reviewed) year may wish to make a deficiency dividend²²² with respect to the reviewed year. Guidance coordinating the receipt of a statement from an audited partnership by a RIC or REIT with the deficiency dividend procedures is expected to be issued by the Secretary.

Administrative adjustment request by partnership

A partnership may file a request for an administrative adjustment in the amount of one or more items of income, gain, loss, deduction, or credit of the partnership for a partnership taxable year.²²³ Following the filing of the administrative adjustment request, the partnership may apply most of the procedures for modification²²⁴ in a manner similar to modification of an imputed underpayment under new section 6225(c). Like the partnership audit, tax resulting from the adjustment may be paid by the partners in

the manner in which a partnership pays an imputed underpayment in the adjustment year under new section 6225. Alternatively, the adjustment may be taken into account by the partnership and partners, and the tax paid by reviewed year partners upon receipt of statements showing the adjustments, similar to new section 6226.²²⁵ However, in the case of an adjustment (pursuant to a partnership's administrative adjustment request) that would not result in an imputed underpayment, any refund is not paid to the partnership; rather, procedures similar to the procedure for furnishing reviewed year partners with statements reflecting the requested adjustment apply, with appropriate adjustments.

Time for making administrative adjustment request

A partnership may not file an administrative adjustment request more than three years after the later of (1) the date on which the partnership return for the year in question is filed, or (2) the last day for filing the partnership return for that year (without extensions).

In no event may a partnership file an administrative adjustment request after a notice of an administrative proceeding with respect to the taxable year is mailed.

Tiered partnerships

In the case of tiered partnerships, a partnership's partners that are themselves partnerships may choose to file an administrative adjustment request with respect to their distributive shares of an adjustment. The partners and indirect partners that are themselves partnerships may choose to coordinate the filing of administrative adjustment requests as a group to the extent permitted by the Secretary.



Other Nuances

OTHER NUANCES

- Who can be a partnership representative?
 - > TEFRA
 - > The tax matters partner has certain statutory powers to bind other partners
 - > Regulations set out who can qualify as TMP
 - > BBA
 - > The partnership representative has the sole authority to act on behalf of partnership
 - > A partner (or other person) with a substantial presence in the US

- Does it make sense for the partnership to pay the imputed underpayment in all cases?
- What obligations does a partnership have with respect to implementing the revised K-1 procedure?



How Does The New Law Help Tax Administration?