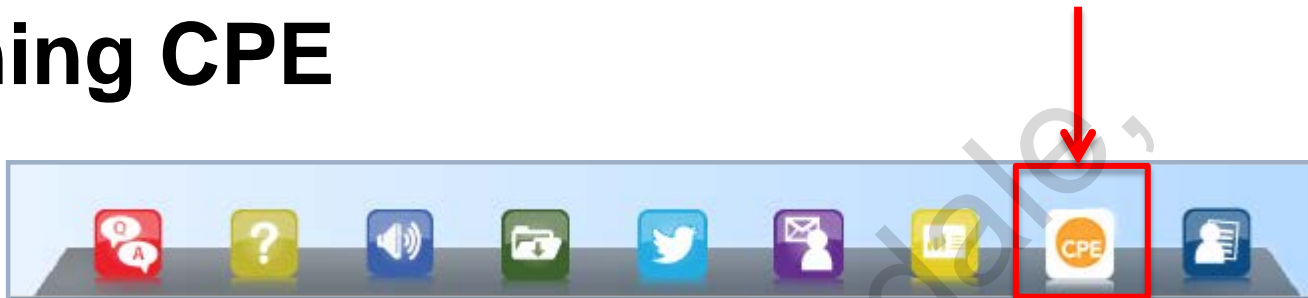


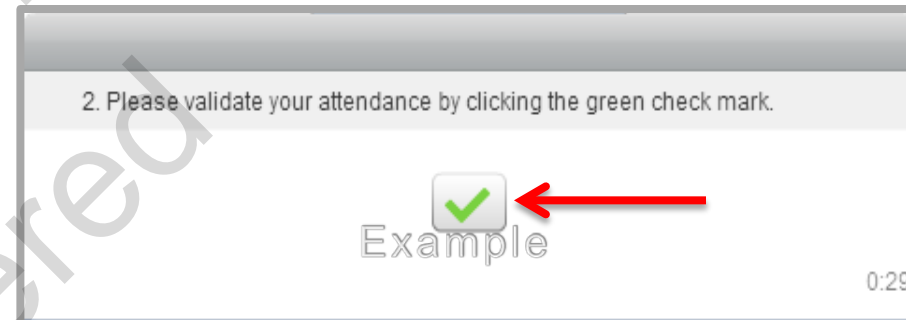
New Tax Laws Relating to IRS Examination of and Tax Collection from Partnerships

Caplin & Drysdale,
Chartered

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Today's Speakers

Drita Tonuzi

Associate Chief Counsel

IRS Office of Associate Chief Counsel, Procedure & Administration

Brendan O'Dell

Attorney-Advisor

Office of Tax Policy, U.S. Department of Treasury

Charles Ruchelman

Member

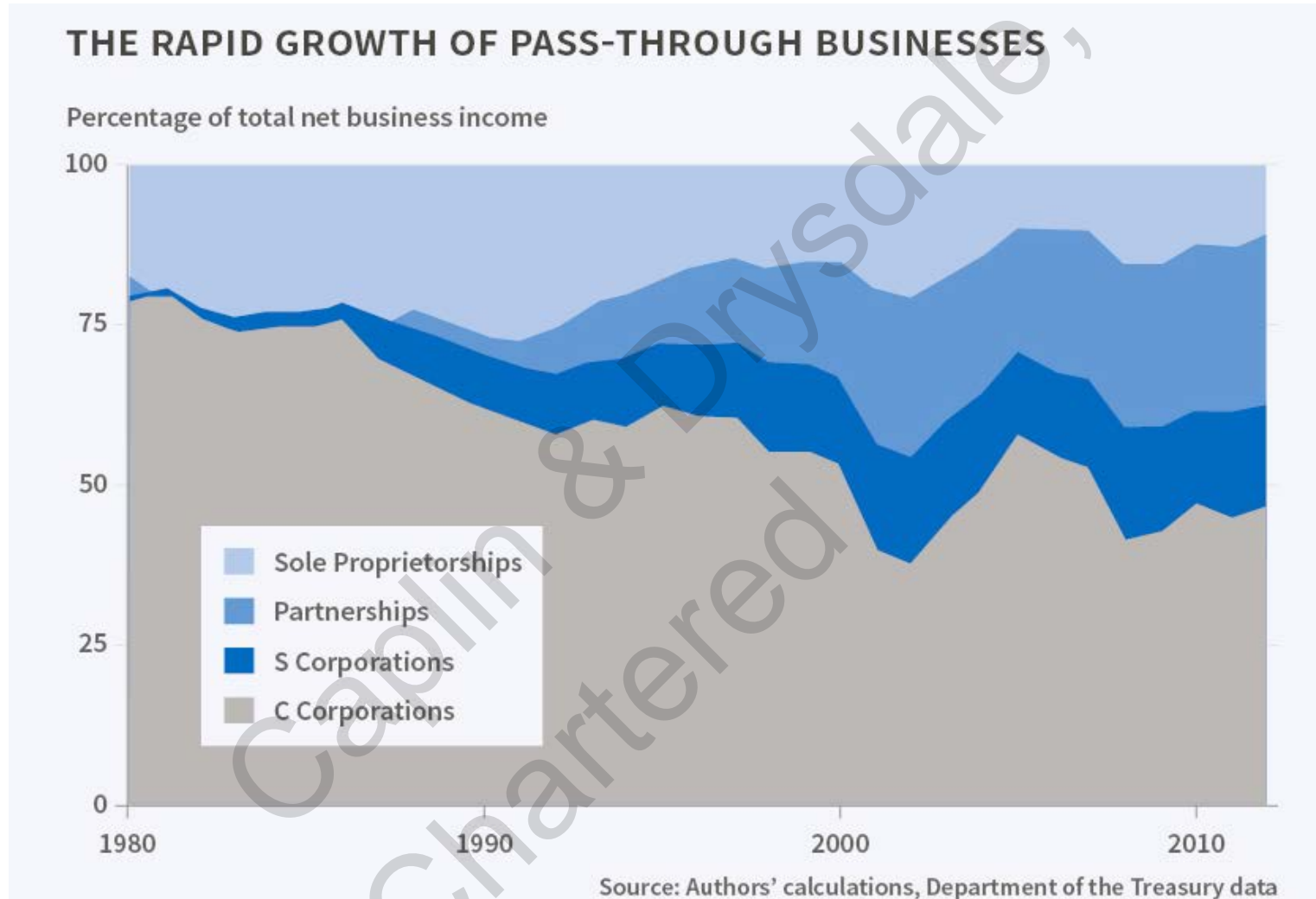
Caplin & Drysdale, Washington, D.C.

Outline

- Reason for Change
- Overview of Statutory Provisions
- Notice 2016-23 and Regulation Project
- Blue Book Insights
- Benefits of Paying at Partnership Level
- Specific Questions For Practitioners
- IRS Enforcement Issues

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Reason for Change



Reason for Change

Examination		Returns Examined	Returns Filed in Prior CY	Coverage Rates
Small Corp Returns	FY 2013	17,604	1,849,758	0.95%
	FY 2014	17,257	1,812,140	0.95%
	FY 2015	16,460	1,797,366	0.92%
Large Corp Returns	FY 2013	9,876	62,347	15.84%
	FY 2014	7,858	64,261	12.23%
	FY 2015	7,410	66,484	11.15%
Subchapter S Returns	FY 2013	18,670	4,476,307	0.42%
	FY 2014	16,317	4,518,765	0.36%
	FY 2015	18,595	4,605,766	0.40%
Partnership Returns	FY 2013	14,870	3,550,071	0.42%
	FY 2014	15,779	3,649,385	0.43%
	FY 2015	19,212	3,766,567	0.51%

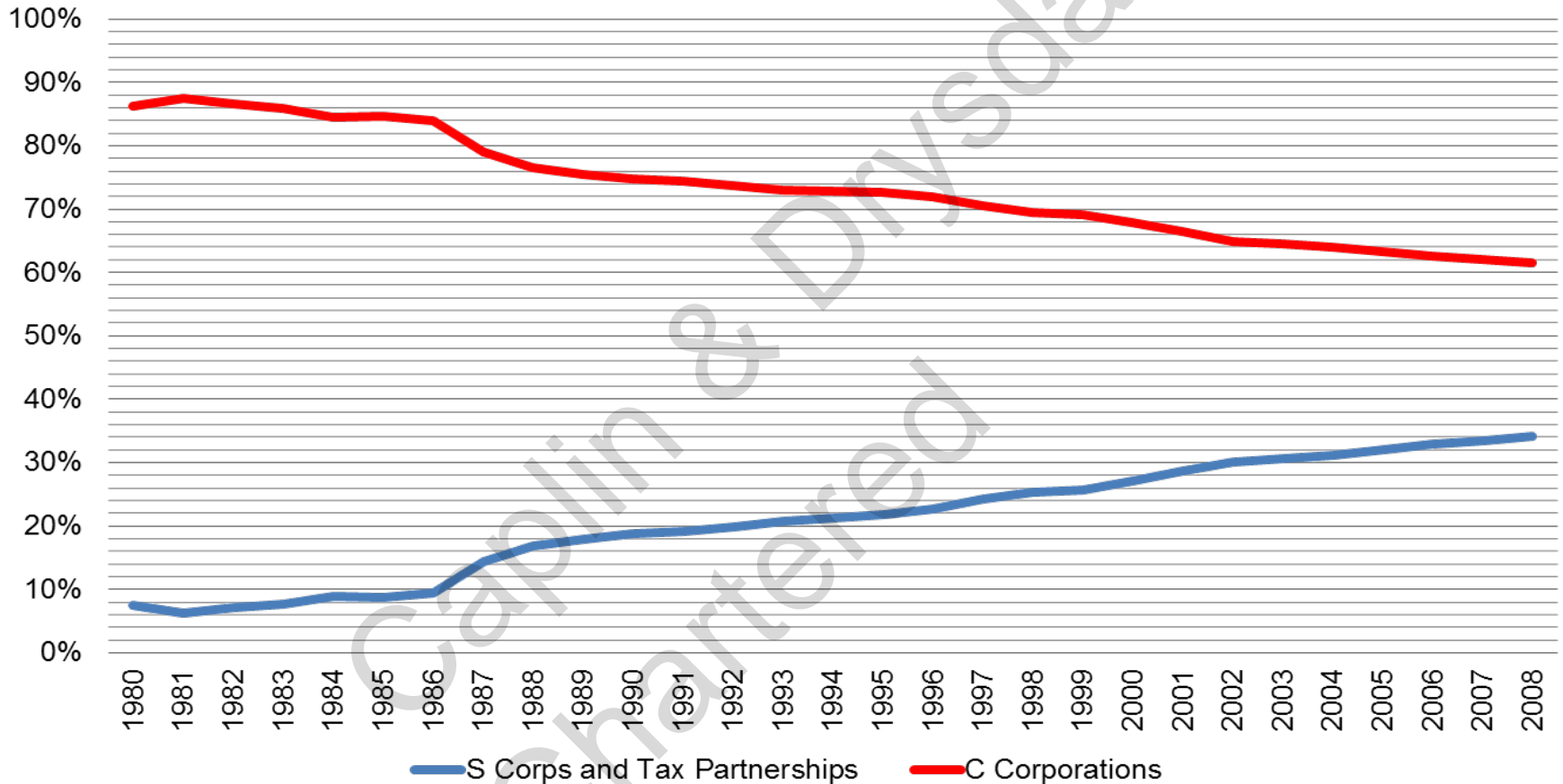
Reason for Change

	Returns Examined	Returns Filed in Prior CY	Coverage Rates
FY 2006	9,752	2,720,290	0.36%
FY 2007	12,195	2,934,597	0.42%
FY 2008	13,203	3,146,994	0.42%
FY 2009	12,855	3,348,845	0.38%
FY 2010	12,406	3,423,583	0.36%
FY 2011	13,770	3,434,905	0.40%
FY 2012	16,691	3,524,808	0.47%
FY 2013	14,870	3,550,071	0.42%
FY 2014	15,779	3,649,385	0.43%
FY 2015	19,212	3,766,567	0.51%

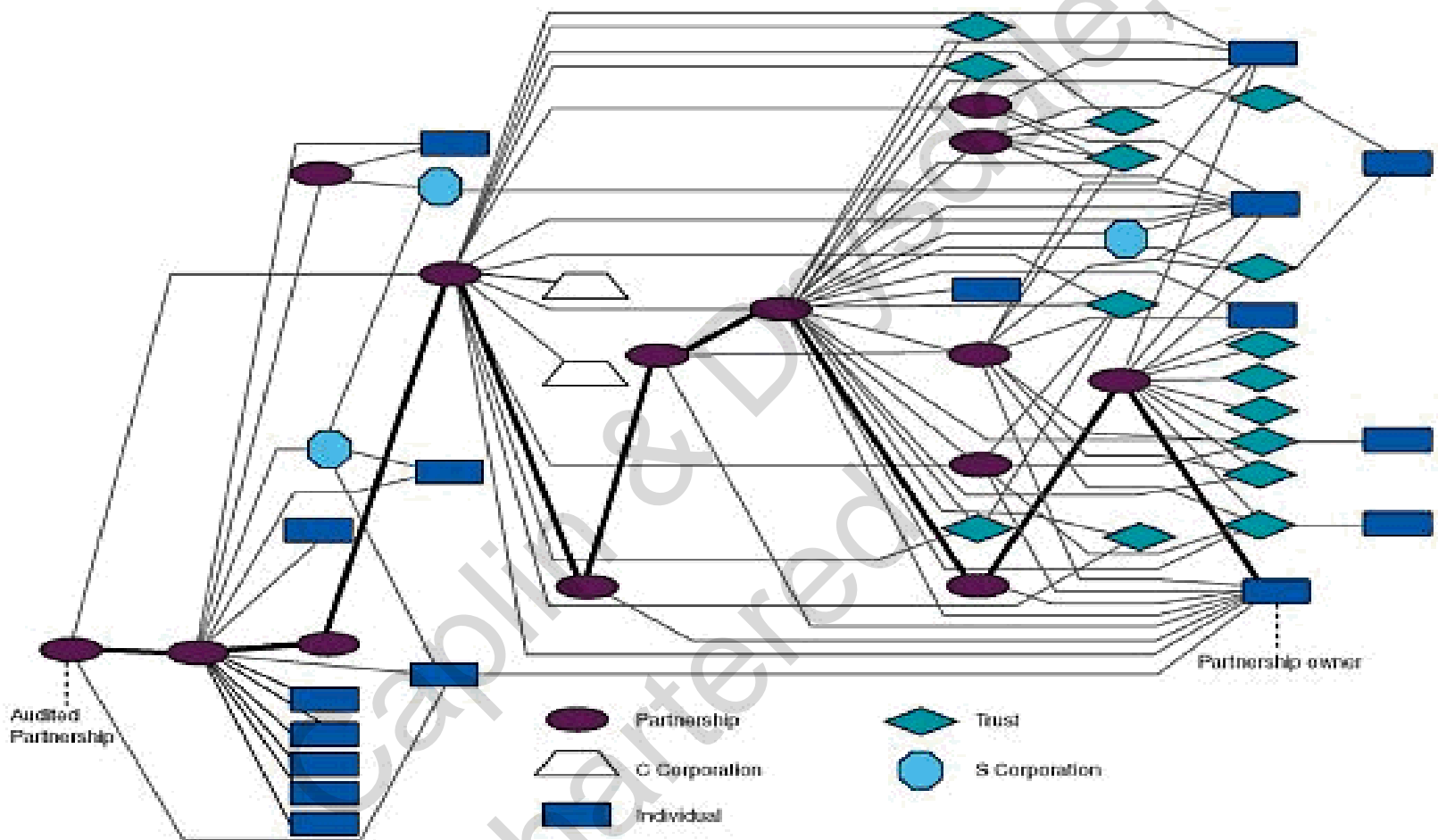
Reason for Change

Percent of total business receipts
C corporations versus tax partnerships and S corporations

Source: IRS Statistics of Income



Reason for Change



Reason for Change

- Proliferation of Partnerships and LLCs
- TEFRA Complexity

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Overview of Statutory Provisions

- 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 Provisions

- 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
 - Election to Push Adjustments out to Partners within 45 Days of Final Notice
 - Revised K-1 Procedure within 45 Days of Final Notice
 - “Special” K-1
 - “Push Out”

Overview of Statutory Provisions

- 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 presence in the U.S. (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 Provisions

- New Terms of Art
 - Partnership Representative
 - 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 Provisions

- Collecting from Partnership – Default (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 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 Provisions

- Elect Out on Timely Filed Return (section 6221(b))
 - If a partnership has 100 partners or fewer than 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 Provisions

- Push Out 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.

Overview of Statutory Provisions

- Push Out Procedure (section 6226).
 - 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 Provisions

- 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.
 - Can not file AAR once an audit has commenced.

Overview of Statutory Provisions

- Partner Must Report Consistently with Partnership
 - General rule (section 6222)
 - Bound by actions of Partnership Representative (section 6223 (b))
 - Section 6225(c) modification procedure
 - Section 6226(b) push-out procedure
 - Section 6227 administrative adjustment request

Notice 2016-23 and Regulation Project

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)

Notice 2016-23 and Regulation Project

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.

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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

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;

Notice 2016-23 and Regulation Project

- 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:

Notice 2016-23 and Regulation Project

- 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

Notice 2016-23 and Regulation Project

- 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.

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Notice 2016-23 and Regulation Project

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 - 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.

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

Notice 2016-23 and Regulation Project

- 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@irs.counsel.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).

Blue Book Joint Committee on Taxation

[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

Blue Book Joint Committee on Taxation

100 or Fewer Statements

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statements criterion,¹⁹⁰ each direct and indirect interest in the partnership of any person to which a statement (comparable to the partner statement under section 6031(b)) is required to be furnished by any person. Such guidance may also take into account any person with respect to which a comparable statement is not required to be furnished but which has an interest (direct or indirect) in the partnership. Further, such guidance shall require the partnership to disclose to the Secretary the name and taxpayer identification number of each person with respect to which a statement (comparable to the partner statement under section 6031(b)) is required to be furnished and of other persons with an interest (direct or indirect) in the partnership.

Examples

For example, assume that a partner of a partnership is a disregarded entity such as a State-law limited liability company ("LLC") with only one member, a domestic corporation. Such guidance may provide that the partnership can make the election if the partnership includes (in the manner prescribed by the Secretary) a disclosure of the name and taxpayer identification number of each of the disregarded entity and the corporation that is its sole member, and each of them is taken into account as if each were a statement recipient in determining whether the 100-or-fewer-statements criterion is met.

As another example, such guidance may provide that a partnership with a trust as a partner can make the election if the partnership includes (in the manner prescribed by the Secretary) a disclosure of the name and taxpayer identification number of the trustee, each person who is or is deemed to be an owner of the trust, and any other person that the Secretary determines to be necessary and appropriate, and each one of such persons is taken into account as if each were a statement recipient in determining whether the 100-or-fewer-statements criterion is met. Similar guidance may be provided with respect to a partnership with a partner that is a grantor trust, a former grantor trust that continues in existence for the two-year period following the death of the deemed owner, or a trust receiving property from a decedent's estate for a two-year period.

As a further example, to the extent that such rules are consistent with prompt and efficient collection of tax attributable to the income of partnerships and partners, such guidance may provide rules permitting election out in the case of a partnership (the first partnership) with one or more direct or indirect partners which are themselves partnerships. Under any such guidance with respect to tiered partnerships, the sum of all direct and indirect partners (including each partnership and its partners) may not exceed 100 persons with respect to which a section 6031(b) statement must be furnished, and each partner must be identified. That is, eligibility of the first partnership to make the election requires the first partnership to include (in the manner prescribed by the Secretary) a disclosure of the name and taxpayer identification number of each direct partner of the first partnership and each indirect partner (in-

Blue Book Joint Committee on Taxation

Modification Procedures: Amended Returns

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efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners.

Anything required to be submitted pursuant to the modification of the amount of an imputed underpayment must be submitted to the Secretary not later than the close of the 270-day period beginning on the date the notice of a proposed partnership adjustment is mailed, unless the 270-day period is extended with the consent of the Secretary.

Any modification of the amount of an imputed underpayment is made only upon approval of the modification by the Secretary.

Modification procedures: amended returns of reviewed year partners

Payments made by reviewed year partners with amended returns can reduce the amount of an imputed underpayment.²⁰⁸ Procedures for modification provide that the amount of an imputed underpayment is determined without regard to the portion of the underpayment taken into account by payment of tax included with amended returns of the reviewed year partners. The amended return relates to the taxable year of the partner that includes the end of the reviewed year of the partnership. The amended return is to take into account all adjustments in the amount of any item of income, gain, loss, deduction, or credit of the partnership (or any partner's distributive share) properly allocable to each partner, along with changes for any other taxable year with respect to which any tax attribute is affected by reason of the adjustments. Payment of any tax due is to be included with the amended return. In the case of an adjustment that reallocates the distributive share of any item from one partner to another, this modification procedure is only available if amended returns for the reviewed year are filed by all partners affected by the adjustment.

Modification procedures: tax-exempt partners

Procedures for modification provide for determining the amount of the imputed underpayment without regard to the portion of it that the partnership demonstrates is allocable to a partner that would not owe tax by reason of its status as a tax-exempt entity for the reviewed year.²⁰⁹ For this purpose, a tax-exempt entity means (1) the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of these, (2) an organization (other than a cooperative) that is exempt from Federal income tax, (3) any foreign person or entity, and (4) any Indian tribal government determined by the Secretary in consultation with the Secretary of the Interior to exercise governmental functions. Under this procedure for modification, the partnership demonstrates the amounts of adjustments that are allocable to the tax-exempt partner and the resulting portion of the imputed underpayment allocable to that partner.²¹⁰

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Section 6226 Election

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liable for its share of the penalty, addition to tax, and additional amount.²¹⁶

Interest at partner level from reviewed year, with adjustments

In the case of an imputed underpayment for which the election under this provision is made, interest is determined at the partner level.²¹⁷ Interest is determined from the due date of the partner's return for the taxable year to which the increase is attributable. Interest is determined taking into account any increases attributable to a change in tax attributes for an intervening tax year. The rate of interest determined at the partner level is the underpayment rate as modified under the provision, that is, the rate is the sum of the Federal short-term rate (determined monthly) plus 5 percentage points.

Time and manner of making election

The partnership may make this election not later than 45 days after the notice of final partnership adjustment.²¹⁸ The election is revocable only with the consent of the Secretary. The election may be made whether or not the partnership files a petition for judicial review of the notice of final partnership adjustment.²¹⁹

The partnership may make the election within 45 days from the notice of final partnership adjustment, and within 90 days from the notice of final partnership adjustment may file a petition for readjustment with the Tax Court, district court, or Court of Federal Claims.²²⁰ Upon the final court decision, dismissal of the case, or settlement, the partnership is to implement the election by furnishing statements (at the time and manner prescribed by the Secretary) to the reviewed year partners showing each partner's share of the adjustments as finally determined. As part of any settlement, for example, it is contemplated that the Secretary may permit revocation of a previously made election, and the partnership may pay at the partnership level.

Time and manner of furnishing statement

The statement is to be furnished to the Secretary and to partners within such time and in such manner as is prescribed by the Secretary. In the absence of such guidance, the statements are to be furnished to the Secretary and to all partners within a reasonable period following the last day on which to make the election under this provision. The date the statement is furnished (as well as the date of the statement) is the date the statement is mailed, for this purpose.

Information furnished on statement to the Secretary and to partners

The statement furnished to the Secretary and to partners is to include the amounts of and tax attributes of the adjustments allocable to the recipient partner. Under regulatory authority, the Sec-

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Treatment of Tiered Partnerships

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retary may require the statement to show the amount of the imputed underpayment allocable to the recipient partner. In addition, the statement is to include the name and taxpayer identification number of the recipient partner. The Secretary may require that the statement include such additional information as is necessary or appropriate to carry out the purposes of the provision, such as the address of the recipient partner and the date the statement is mailed.

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.

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AARs

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

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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.

Procedural Rules

*In general*²²⁶

The new centralized system provides rules governing notices, time limitations, restrictions on assessment and the imposition of interest and penalties in the context of a partnership adjustment.²²⁷ The provisions include specific grants of regulatory authority to address the identification of foreign partners, the manner of notifying partners of an election out of centralized procedures, the manner in which a partnership representative is selected, and the extent to which the new centralized system may be applied before the generally applicable effective date.

Notice of proceedings and adjustments

The centralized system contemplates three types of principal notifications by the Secretary to the partnership and the partnership representative in the course of an administrative proceeding with respect to that partnership. The notifications also apply to any proceeding with respect to an administrative adjustment request filed

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Where Partnership Ceases to Exist

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payment, is suspended during the period the Secretary is prohibited by reason of the Title 11 case from making the adjustment, assessment, or collection. For adjustment or assessment, the relevant statute of limitations is extended for 60 days thereafter. For collection, the relevant statute of limitations is extended for six months thereafter.

In a case under Title 11, the 90-day period to petition for judicial review after the mailing of the notice of final partnership adjustment²⁵¹ is suspended during the period the partnership is prohibited by reason of the Title 11 case from filing such a petition for judicial review, and for 60 days thereafter.

Treatment where partnership ceases to exist

If a partnership ceases to exist before a partnership adjustment under the centralized system is made, the adjustment is taken into account by the former partners of the partnership, under regulations provided by the Secretary. Whether a partnership ceases to exist for this purpose is determined without regard to whether there is a technical termination of the partnership within the meaning of section 708(b)(1)(B). The successor partnership in a technical termination succeeds to the adjustment or imputed underpayment, absent regulations to the contrary. A partnership that terminates within the meaning of section 708(b)(1)(A) is treated as ceasing to exist. In addition, a partnership also may be treated as ceasing to exist in other circumstances or based on other factors, under regulations provided by the Secretary. For example, for the purpose of whether a partnership ceases to exist under new section 6241(7), a partnership that has no significant income, revenue, assets, or activities at the time the partnership adjustment takes effect may be treated as having ceased to exist.

Extension to entities filing partnership return

If a partnership return (Form 1065) is filed by an entity for a taxable year but it is determined that the entity is not a partnership (or that there is no entity) for the year, then, to the extent provided in regulations, the provisions of this subchapter are extended in respect of that year to the entity and its items of income, gain, loss, deduction, and credit, and to persons holding an interest in the entity.

For example, assume two taxpayers purport to create a partnership for taxable year 2018, and a Form 1065 is filed for that year. The partnership is the subject of an audit under the centralized system for 2018, and pursuant to the provisions for judicial review, the partnership is determined by a court not to exist as partnership. Nevertheless, the rules of the centralized system apply to the items of income, gain, loss, deduction and credit, and to the two taxpayers, in respect of 2018. An imputed underpayment may be collected from the purported partnership in the adjustment year pursuant to new section 6225. Alternatively, the purported partnership representative may elect (at the time and in the manner prescribed by the Secretary) under new section 6226 to issue statements to the two taxpayers, which purported to hold partnership

Benefits of Paying at Partnership Level

- Total tax due for reviewed year may be less than under section 6226
 - No section 1411 tax and no “affected items” tax effects
- Interest rate lower by 2% (but, for a corporate partner, the section 6226 interest would be deductible and the section 6225 interest is not)
- Penalties may be less (may be no “substantial understatement” at partnership level whereas may be a “substantial understatement” at partner level)
- Total tax due for years between reviewed year and adjustment year may be higher under section 6226 (section 6226 requires correlative adjustments to other years BUT only the years in which taxes would increase)
 - i.e., years in which taxes would decrease are ignored

Benefits of Paying at Partnership Level

- Section 6226 might come with obligations a partnership does not want to perform or cannot perform
 - Statute obligates source partnership to provide to IRS the amount of FPA allocable to each partner
 - Statute obligates source partnership to tell each partner that more tax is owed and precisely what the adjustments are

Specific Questions For Practitioners

- Who should serve as the partnership representative and what rights will the partners/partnership give to the partnership representative?
 - Will it make sense to have a more-or-less "permanent" partnership rep -- possibly a bank or trust company or professional service firm
- What notice provisions will you incorporate in agreements since the law no longer requires IRS to provide notices
- What rights do partners want with respect to the ability to participate in proceedings?
- Any appetite to limiting the number and types of partners to allow the small partnership election?
- Are you drafting provisions that lock-in or exclude election out of the new regime (for partnerships with 100 or fewer qualifying partners)
- What are you advising to people that are acquiring an interest in a partnership?
- How will you deal with a partnership that “ceases to exist”?

Specific Questions For Practitioners

- After an imputed adjustment is determined, and the partnership wants to use the revised K-1 “push out” procedures, how does the partnership “furnish” the K-1 to each reviewed year partner.

IRS Enforcement Issues



Questions





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