Bipartisan Budget Act of 2015
Proposed Regulations addressing Partnership Audit Rules

February 10, 2017
**Legislation**

- H.R. 1, Chairman Camp’s tax reform bill (December 2014)—not enacted
  - Tax imposed at the partnership level at highest individual or corporate rate
  - No option to flow-through tax to partners
  - Joint and several liability
- Bipartisan Budget Act of 2015 (P.L. 114-74)—signed into law November 2, 2015
- Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113)—signed into law December 18, 2015
  - Included provision for MLP passive losses
- The Tax Technical Corrections Act of 2016 (H.R. 6439, S. 3506), introduced in the House and the Senate on December 6, 2016 (the “Technical Correction”)—not yet enacted
Basic Provisions of BBA Partnership Audit and Adjustment Rules

For returns filed for partnership taxable years beginning after December 31, 2017:

- TEFRA and ELP audit and adjustment rules are repealed
- Tax on “imputed underpayments” is assessed and collected at the partnership level unless partnership elects to push out adjusted items.
- Under default rule, partnership pays tax in the adjustment year and adjustment-year partners bear economic burden.
- Partnership must designate one representative (the “partnership representative”) to deal with IRS in audit proceedings.
- Partners have no statutory right to participate in tax audits or litigation, no right to opt out, and no partner-level defenses.
What’s Clear Now

It will be easier for the IRS to audit large partnerships

• Easier to locate the Partnership Representative than the Tax Matters Partner
• No right to notice/participation by other partners
• Statutory mechanism to assess and collect tax at the partnership level
• Burden of passing adjustment through to the partners has shifted from the IRS to the partnerships
The Current State of Play

Congress:
• Tax Technical Corrections Act of 2016
• Agreed to by Chairman and Ranking Member of W&M and SFC

Treasury and IRS:
• Temporary Regulations for electing into BBA Regime issued Aug. 5, 2016
• Proposed Regulations on the implementation of the BBA rules issued Jan. 18, 2017
  - Subsequently withdrawn in response to White House regulatory freeze
  - Disregarded Technical Correction in key respects
Digging Deeper

Key BBA Audit and Adjustment Provisions
Section 6221

Scope of the BBA Rules
New Section 6221 – Scope of the BBA Audit and Adjustment Rules

• Section 6221: In general, any adjustment to items of income, gain, loss, deduction, or credit of a partnership shall be determined at the partnership level.

• Technical Correction provides that “any partnership-related item” shall be determined at the partnership level.

• Proposed regulations take an expansive view of the scope of rules:
  • Preamble cites issues under TEFRA and notes that Congress intentionally avoided limiting terms in the BBA.
    • The rules cover all items and information related to or derived from a partnership, including items at the partner level.
    • The rules will apply to adjustments with respect to disguised sales, guaranteed payments, section 704(c) allocations, and transactions to which section 707 applies.
New Section 6221 – Election Out for Partnerships With 100 or Fewer Partners

Partnerships furnishing 100 or fewer statements under section 6031(b) (i.e., schedules K-1) may elect out of new provisions.

Each partner must be:

• Individual
• C corporation
• S corporation
• Estate of deceased partner
Proposed Regulations – Election Out

- Proposed regulations clarify that eligible partners include tax exempt entities.
- Eligible partners do not include partners that are partnerships, disregarded entities, trusts, or nominees.
- A partnership must file the election with the partnership’s return and must disclose partners’ names, partner tax identification numbers, tax classification, and an affirmative statement that the partner is an eligible partner.
- A partnership must notify partners of the election within 30 days.
Section 6222

Partnership-Partner Consistency
New Section 6222 – Partnership-Partner consistency

Inconsistencies between a partner’s return and a partnership return that result in an underpayment of tax by a partner are treated as a math error on the partner’s return unless that partner files a notice of inconsistent treatment.

Proposed regulations clarify that the same treatment will apply in the case of a partner that is itself a partnership. Items of consistent treatment include:

- An item on a partnership return, and any amendment or supplement, including an administrative adjustment request (AAR)
- Items included on a Section 6226 push-out statement

A partner may file an election to notify the IRS that the reason for the inconsistency was because a partner received incorrect information from the partnership.
Section 6223

Partners Bound by Actions of the Partnership
New Section 6223 – Designation of a partner representative

Each partnership shall designate a partnership representative that will have the sole authority to act on behalf of the partnership with respect to an IRS examination.

The partnership representative can be any person, regardless of whether that person is a partner of the partnership, so long as the person has “substantial presence in the United States”.

Proposed regulations define “substantial presence in the United States”:

- Available to meet with IRS “as is necessary and appropriate”
- Has street address in United States and U.S. phone number
- Has a U.S. TIN

If the partnership representative is an entity, the partnership must also designate an individual with substantial presence in the United States to act on behalf of the entity.

The designation is made annually, on the partnership return for the partnership taxable year to which the designation applies.
New Section 6223 – Resignation and revocation of a partner representative under proposed regulations

A partnership representative may resign as partnership representative for a certain tax year by providing notice to the IRS and the partnership.

- The resigning partnership representative may designate a successor partnership representative.
- If the resigning partnership representative does not designate a replacement, the partnership will have the opportunity to name a successor.
- If the partnership does not designate a succeeding representative, the IRS will designate a representative on behalf of the partnership.

At the option of the partnership, a partnership representative designation may be revoked through notification to the IRS in writing of such revocation.
New Section 6223 – Binding nature of actions of the partnership representative

A partnership and all partners are bound by actions taken by the partnership representative and any final decision in an audit proceeding.

Under the proposed regulations actions include:

• Settlement agreements entered into by the partnership representative on behalf of the partnership

• Notices of final partnership adjustment that were uncontested by the partnership representative

• Final decisions in court with respect to a contested notice of final partnership adjustment are binding on the partnership and the partners.
Section 6225

The Default Rule - Payment of Imputed Underpayment at the Partnership Level
Section 6225 – Imputed Underpayment

All adjustment items are netted and the net underpayment is multiplied by highest rate under Sec. 1 or 11 (as modified by 6225(c)). Adjustments that reallocate the distributive share of an item from one partner to another generally only increase underpayment.

Technical Correction provides that adjustments are separately netted within the categories of items that the partnership is required to account for separately under section 702.

Proposed regulations take a similar approach, providing that items should be grouped and sub-grouped to account for character and preferences.
Section 6225 – Imputed Underpayment

Proposed Regulations break adjustments into four groupings:

1. Reallocation grouping—disregard net decreases to items of income or gain and increases to deductions, losses, or credits

2. Credit grouping

3. Creditable expenditures

4. Residual grouping—any adjustment not described in 1-3 is further divided into subgroupings according to any limitations or restrictions such as character or holding period.

Only net positive adjustments taken into account. Adjustments that do not result in an imputed underpayment are taken into account by a partnership in the adjustment year.
Section 6225 – General and Specific Underpayment

The regulations provide two types of underpayments:

**General imputed underpayment** – all adjustments that are not taken into account to determine a specific imputed underpayment.

**Specific imputed underpayment** – adjustments to an item or items that were allocated to one partner or group of partners that had similar characteristics or participated in a similar transaction.
Section 6225 – Modification of the Imputed Underpayment

Modification of an imputed underpayment may be requested and taken into account at the approval of the IRS.

The proposed regulations provide that only the partnership representative may request such modification and provides procedures for requesting specific types of modifications.

- The partnership representative must submit the request for modification within 270 days of the date the notice of proposed partnership adjustment (NOPPA) is mailed.
- Subject to the consent of the IRS, an extension of the 270-day period may be requested.
Section 6225 – Modification of the Imputed Underpayment

A partnership must substantiate a request for modification by providing documents and other necessary information including, but not limited to: (1) tax returns; (2) partnership operating documents; and (3) certifications in the form and manner required.

The IRS will deny a request for modification if support for such modification is not timely provided.

With any request for modification, a partnership representative must provide the IRS details of: (1) the structure; (2) allocations; (3) ownership; (4) ownership changes; (5) partners, including indirect partners, for each taxable year relevant to the modification; and, (6) the partnership agreement that was effective for each relevant year.
Section 6225 – Modification of the Imputed Underpayment

The statute allows certain modifications of imputed underpayments:

- Amended returns of partners
- Amounts allocable to tax-exempt partners
- Amounts allocable to partners of an MLP with losses subject to section 469(k)
- Rate modification for amounts allocable to a C corporation
- Rate modification for qualified dividends and capital gains allocable to an individual

The proposed regulations offer three additional modifications:

- Modification of the number and composition of imputed underpayments
- Partners that are qualified investment entities (QIE) under Section 860 (REITs and RICs)
- Partner closing adjustments
Amended returns to reduce imputed underpayment

Statute—

• The “imputed underpayment amount may be modified” if “one or more partners file returns (not withstanding 6511) for the taxable year of the partners” which includes the end of the reviewed year of the partnership.

• Payment of any tax due is included with such return

Technical Correction—

• More returns: an amended return also must be filed “for any taxable year with respect to which any tax attribute is affected by reason of any adjustment” that is allocable to the partner.

• Adds “pull-in” procedure: allows partners to pay tax with respect to their adjustments and reduce the partnership’s imputed underpayment without actually filing amended returns.
Certain passive losses of publicly traded partnerships

Proposed regulations define a specified partner as a person that meets the requirements for the reviewed year through the adjustment year:

- The person is a partner of a publicly traded partnership
- The person is an individual, estate, trust, closely held C corporation, or personal service corporation
- The person had a specified passive activity loss

A partnership must report to each specified partner the amount of reduction of its suspended passive loss carryovers at the end of the adjustment year.
Section 6225 – Tax paid by partnership – Nondeductible expense

How is tax paid by the partnership treated?

Section 6241(4) provides that no deduction is allowed under subtitle A for any payment required to be made by a partnership pursuant to the BBA audit and adjustment rules.

- Proposed regulations clarify that payment by a partnership of any amount required to be paid is treated as an expenditure described in section 705(a)(2)(B) including: any imputed underpayment, amounts taken into account by partners under section 6226, interest, penalties, or additions to tax.
Section 6226

The “Push-Out” Election
New Section 6226 – Election to pass tax through to partners

Partnership may elect not later than 45 days after date of the “notice of final partnership adjustment” to pass the adjustment through to its partners.

Partnership provides a “statement” to each person that was a partner in the reviewed year (i.e., the year under audit) showing that person’s share of adjusted items.

Recipient of statement must increase its tax for the year the statement is received by the additional tax that would have been due if the adjustment were taken into account in the reviewed year plus any additional amount that would have been due in intervening years.
Proposed Regulations – Election to pass tax through to partners

The proposed regulations provide that a push-out election must be signed by the partnership representative and include:

1. Name, address, and TIN of the partnership
2. Tax year to which the election relates
3. Copy of the FPA
4. In the event an FPA relates to more than one imputed underpayment, identification of which imputed underpayment(s) the election relates
5. Each reviewed year partner’s name, address, and TIN

A partnership that makes a valid push-out election under Section 6226 is no longer liable for an imputed underpayment.
Proposed Regulations—Statements furnished to partners and filed with the IRS

Proposed regulations provide no later than 60 days after all partnership adjustments are finally determined, a partnership that makes the push-out election must furnish to each reviewed year partner and file with the IRS a statement that includes:

1. Name and TIN of reviewed year partner
2. Current or last address of the reviewed year partner
3. Reviewed year partner’s share of items as originally reported in the reviewed year;
4. The reviewed year partner’s share of partnership adjustments
5. Modifications with respect to the reviewed year partner related to amended return filings
6. Reviewed year partner’s share of adjustments to the partnership’s tax attributes
7. Reviewed year partner’s share of any penalties and additions to tax
8. The reviewed year partner’s safe harbor amount
9. Date the statement is furnished
10. Tax year to which the adjustments relate
Proposed Regulations – Safe harbor amount

- Partnership making a push-out election must calculate a “safe harbor” amount (and in certain cases a safe harbor interest amount) for each partner.
- The safe harbor amount is calculated by applying the rules applicable to the imputed underpayment calculation by using the adjustment allocated to the partner (without taking into account the modifications that would reduce the underpayment at the partnership level other than an amended return filed by the partner).
- A partner that receives a push-out statement may elect to pay the safe harbor amount rather than the additional reporting year tax that would be calculated by the partner.
Proposed regulations clarify that a partnership must undertake “reasonable diligence” to identify a correct address for a reviewed year partner if a statement is returned to the partnership as undeliverable.
New Section 6226 – Invalid election

Proposed regulations provide that if a 6226 push-out election is determined to be invalid the IRS will notify the partnership and the partnership representative within 30 days of such determination. If the IRS makes a final determination that the election is invalid, section 6225 will apply and the partnership will be liable for any imputed underpayment.

An election is valid only if all provisions are satisfied including: time, form, and manner for making the election and requirements for furnishing statements to reviewed year partners and filing statements with the IRS.
New Section 6226 – Tiered Partnerships

Can an upper-tier partnership elect to pass through adjusted items reported to it by a lower tier? (Greenbook Proposal and JCT Bluebook language)

- Potential for entity-level tax that cannot be pushed out
- Accounting considerations
New Section 6226 – Tiered Partnerships – Technical Correction

In order to facilitate the “push-out” in tiered-partnership structures, the Technical Correction adds new rules requiring an upper-tier partnership that receives a push-out statement (i.e., the statement described in new section 6226(a)(2)) to:

- file a “partnership adjustment tracking report” with the IRS and
- either (i) pay the imputed underpayment (determined under rules similar to those in new section 6225) or (ii) furnish push-out statements to its partners.

- Due date: upper-tier partnership receiving a push-out statement must file the partnership adjustment tracking report with the IRS and pay the imputed underpayment or furnish push-out statements to its partners “not later than the due date for the return for the taxable year of the audited partnership which includes the date the final determination was made with respect to such partnership.”
New Section 6226 – Tiered Partnerships – Proposed Regulations

• IRS reserved on the tiered-partnership issue.
• Preamble makes the IRS’s case against allowing the push-out election, noting that the approach in the Technical Correction poses “significant administrative concerns” and seeks further comment.
Section 6241

Treatment where partnership ceases to exist
New Section 6241 – Treatment of a partnership that ceases to exist

If a partnership ceases to exist before a partnership adjustment takes effect, the former partners, rather than the reviewed year partners, shall take into account the adjustment.

- The regulations define “cease to exist” if the partnership terminates within the meaning of 708(b)(1)(A), or does not have the ability to pay in full the amount due.
  - The partnership does not have the ability to pay if the IRS determines the partnership’s account is not collectible
- A partnership does not cease to exist because
  - Technical termination under 708(b)(1)(B)
  - A 6226 push-out election is made
  - The partnership has not paid any amount required
New Section 6241 – Treatment of a partnership that ceases to exist

If a partnership ceased to exist, the partnership must furnish each former partner a 6226 push-out statement reflecting the former partner’s share of the partnership adjustment and file such statement with the IRS.

If the statements are not timely furnished to former partners and filed with the IRS, the IRS has the authority to notify the former partner in writing of such partner’s share of the partnership adjustment.
New Section 6241 – Treatment of a partnership that ceases to exist

The regulations define “former partners” as the partners that are partners in the partnership in the adjustment year – the year in which the partnership receives the final partnership adjustment.

- Former partner takes adjustments into account as if the partnership that ceased to exist had elected to push out the partnership adjustments under section 6226.

- If a former partner is a partnership-partner that also ceased to exist, that partnership-partner’s former partners are liable.

If there are no adjustment year partners, the partners of the partnership during the last taxable year for which the partnership return was filed are considered the former partners.
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