CORPORATE TAX - USA

IRS seeks comments for new tax examination and collection regime

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Introduction

Late last year Congress overhauled the rules by which the Internal Revenue Service (IRS) examines partnerships and limited liability companies (for further information please see "Congress enacts new tax examination and collection regime for partnerships"). With the stroke of a pen, Congress repealed over three decades of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) rules relating to the tax examination of partnerships, the so-called unified audit and litigation procedures. Instead, the Bipartisan Budget Act of 2015 installed a set of rules to simplify for the IRS the examination of partnerships and limited liability companies and the collection of any tax resulting from such examination.

New rules

The new rules:

- create a powerful partnership representative to replace the tax matters partner;
- strip partners of notice and participation rights regarding partnership-level examination and litigation; and
- default to a collection procedure of any additional tax and penalties at the partnership level (instead of at the partner level).

In light of the new legislation, partnerships and partners should evaluate the provisions of their partnership and limited liability company agreements and make fundamental changes to the tax representation and procedure provisions.

While the concepts and policy goals for the new rules had been planned for some time, the drafting of the law was done fairly quickly. Accordingly, Congress had to enact technical corrections 45 days later in the Protecting Americans from Tax Hikes (PATH) Act of 2015. However, the PATH Act did not tackle many of the technical problems and certainly did not solve any of the statutory ambiguities.

For example, a partnership with 100 or fewer partners can elect out of the Bipartisan Budget Act tax examination and collection regime. However, those 100 or fewer partners must be comprised of:

- only individuals;
- C corporations;
- foreign entities that would be treated as C corporations;
- estates of deceased partners; or
- S corporations.

Although certain entities, like grantor trusts and single member limited liability companies, are

treated as individuals for tax purposes, the plain language of the statute appears to place a partnership with a grantor trust or single member limited liability company partner in the Bipartisan Budget Act regime, without any ability to elect out. It appears that the IRS would prefer to adopt this hardline, exclusive interpretation of the statutory provision. Regulations could fix that.

In public forums, IRS executives have stated that they will move quickly to promulgate regulations to "fill in the gaps" in the legislation. On March 4 2016 the IRS issued Notice 2016-23 to solicit comments regarding implementation of the Bipartisan Budget Act regime. This is the first chance to provide comments directly to the Treasury Department and the IRS's regulation-writing staff, and is an important part of the regulatory process under the Administrative Procedures Act. There will be few opportunities to participate in the process involving these complex and high-stakes statutory provisions.

The IRS's specific requests for comment include the following:

- For the partnership representative:
  - any limitations on who may be designated as a partnership representative;
  - the definition of 'substantial presence' in the United States; and
  - the 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.
- For calculating the partnership level tax:
  - how character changes, restrictions and limitations under the Internal Revenue Code are taken into account;
  - the effect of unrelated business taxable income of a tax-exempt entity on the modification procedure relating to tax-exempt partners; and
  - any other issues and factors that should be considered when formulating the modification procedures.
- Regarding the revised K-1 or push-out procedures:
  - 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 partners and the IRS; and
  - how tax attributes should be taken into account for intervening years between the reviewed year and the adjustment years.
- Regarding a partnership level administrative adjustment request:
  - what steps the IRS should take upon receipt of an administrative adjustment request; and
  - what opportunities the partnership has for review of IRS actions taken regarding an administrative adjustment request.
- Regarding general procedural rules:
  - what information will the notices of proceedings and adjustment contain;
  - what rules apply regarding assessment, collection and payment of the imputed underpayment;
  - how penalties and interest are computed; and
  - what judicial review of partnership adjustments is available.

Comment

The new partnership tax audit and collection regime under the Bipartisan Budget Act will create a good deal of confusion and uncertainty in the marketplace. Partnerships and limited liability companies have been favoured as business and investment vehicles due to their flexible structures and pass-through nature for the purposes of federal and state income taxes. The Bipartisan Budget Act has weakened those favourable attributes. Providing comments to the Treasury Department and IRS as part of the regulation process may ameliorate some of the concerns.

For further information on this topic please contact Charles M Ruchelman at Caplin & Drysdale, Chartered by telephone (+1 202 862 5000) or email (cruchelman@capdale.com). The Caplin & Drysdale, Chartered website can be accessed at www.caplindrysdale.com.

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