

August 2016

HWH Tax Alert

TREASURY DEPARTMENT ISSUES REGULATIONS FOR EARLY ELECTIONS INTO NEW PARTNERSHIP AUDIT REGIME

On August 4th, the Treasury Department and IRS released temporary and proposed regulations addressing the manner in which partnerships may make an early election to apply the new partnership audit rules created by the Bipartisan Budget Act of 2015 (“BBA”) to partnership tax years beginning after November 2, 2015 (the date the BBA was enacted) and before January 1, 2018. For partnerships not making the early election, the new audit regime will generally apply only to tax returns for partnership tax years beginning after December 31, 2017.

As noted in our earlier **HWH Tax Alert**, the BBA replaced the existing TEFRA rules and electing large partnership rules with a single unified audit standard. Under the new standard, partnerships are subject to a default regime pursuant to which tax liability from partnership audit adjustments will generally be assessed and collected at the partnership level. This is in contrast to the prior rules which provided for a centralized partnership audit procedure, but with the IRS collecting any required adjustments from the partners of the audited partnership. Although the BBA rules contain a procedure for electing to “push out” partnership adjustments to the partners, the IRS has yet to issue guidance regarding these procedures or other aspects of the BBA rules. Because there remain many unanswered questions with respect to application of the new audit procedures (particularly in the case of tiered partnership structures), as well as their interaction with the partnership provisions of Subchapter K, partnerships should exercise considerable caution before deciding to make an early election into the new audit regime under the recently issued regulations.

The regulations, which are effective August 5, 2016, provide detailed rules regarding the time, form and manner for making the early election. See Temp. Reg. §301.9100-22T. In general, the regulations provide that partnerships may make an election into the new partnership audit regime within 30 days of receiving a notice of selection of examination. The notice of selection of examination precedes the issuance of a notice of administrative proceeding. An election once made may only be revoked with the consent of the IRS. Under the new regulations, a partnership may also file an administrative adjustment request (AAR) after receiving a notice of selection for examination.

The temporary regulations make clear that an early election is valid only if made in accordance with the regulations. Furthermore, the regulations provide that an election is not valid “if it frustrates the purposes of Section 1101 of the BBA.” The preamble to the regulations suggests that the “purposes” of Section 1101 of the BBA include collection of the tax due from the partnership under the default rule of the new audit regime. The Treasury is apparently concerned that partnerships with insufficient assets may attempt to use the early election as a means of shifting tax liability from partners (who would otherwise be liable for the tax under TEFRA) to the partnership (which may not have the financial resources to make the required payment).

The procedures for making the early election include numerous requirements, including:

- the early election must be in writing and include a statement that the partnership is electing to have the partnership regime enacted by the BBA apply to the partnership return identified in the notice of selection for examination.
- the partnership must write “Election Under Section 1101(g)(4)” at the top of the statement.
- the statement must include the partnership’s name, taxpayer identification number and the partnership taxable year for which the election is being made (and the name, taxpayer identification number, address and telephone number of the individual who signs the statement under penalties of perjury).
- the statement must include information required to properly designate the partnership representative as defined by section 6223 as amended by the BBA (which must include the name, taxpayer identification number, address and daytime telephone number of the partnership representative and any other information required by forms and guidance issued by the IRS).

Additionally, consistent with the Treasury’s concern about the improper use of the early election by partnerships lacking the financial ability to pay the imputed underpayment at the partnership level, the regulations require that a statement of early election must include the following representations:

- the partnership is not insolvent nor reasonably anticipates becoming insolvent before resolution of any adjustment with respect to partnership taxable years for which the early election applies.
- the partnership has not filed and does not reasonably anticipate filing a voluntary petition for relief under title 11 of the United States Code.

- the partnership is not subject to, and does not reasonably anticipate becoming subject to, an involuntary petition under title 11 of the United States Code.
- the partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay a potential imputed underpayment with respect to the partnership taxable year at issue.

The Temporary Regulations do not address the consequences that follow if any of the foregoing representations are breached (although it may be that the IRS will then determine that the early election is not valid thereby providing the IRS with the right to collect any tax liability resulting from the partnership adjustments directly from the partners.).

Although the BBA provides that certain eligible partnerships with 100 or fewer partners may elect out of the new partnership audit regime (the “small partnership exception”), the Temporary Regulations clarify that a partnership that makes an early election to apply the new partnership audit regime may not then elect out of the new rules under the small partnership exception with respect to that return. Absent this rule, certain partnerships might make the early election to remove themselves from the existing TEFRA rules (i.e. essentially electing into and then electing out of the new audit regime).

The foregoing is intended only as a brief summary of certain aspects of the recently issued Treasury Department temporary regulations. As noted above, because many aspects of the new partnership audit rules have yet to be addressed by IRS guidance, advisors and their partnership clients should exercise considerable caution before deciding to make an early election to apply the new audit rules.

* * * * *

Contacts

If you have any questions about this HWH Tax Alert, please feel free to directly contact Ken Harris at (312) 662-4620 (kharris@hwhlegal.com) or Bob Bedore at (312) 662-4625 (rbedore@hwhlegal.com).

This Legal Alert is provided by Harris Winick Harris LLP for educational and informational purposes only and is not intended, and should not be construed, as legal advice.