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# Regulations: Early elections into new partnership audit regime

The U.S. Treasury Department and IRS today released for publication in the Federal Register temporary regulations (T.D. 9780) and, by cross-reference, proposed regulations (REG-105005-16) concerning the election to apply the new partnership audit regime to partnership returns filed for tax years beginning after November 2, 2015 (the date the new regime was enacted) and before January 1, 2018. Absent such an "early election," the new regime generally applies only to returns for partnership tax years beginning after December 31, 2017.

The regulations provide the time, form, and manner for making the early election into the regime. The regulations are effective August 5, 2016.

Read the **temporary regulations** [PDF 204 KB] and the **proposed regulations** [PDF 198 KB]

Comments and requests for a hearing are due 60 days from the date of the regulations' publication in the Federal Register—scheduled for August 5, 2016.

## Background

The *Bipartisan Budget Act of 2015* (Pub. L. 114-74), enacted in November 2015, repeals the TEFRA rules (as well as the electing large partnership rules) and provides a new system for the centralized audit, adjustment, and collection of tax that generally applies to all entities classified as partnerships that are required to file federal income tax returns.

The new rules are extremely complex and address a host of issues including:

- Partnership adjustments and assessments
- Consistency between the partnership return and its partners' returns

- Designation of a “partnership representative”

- Administrative adjustment requests (AARs), amending Schedules K-1, and statutes of limitations on assessment and refunds.

Very generally, under the new rules, the IRS can impose liability at the partnership level if it determines, on audit, that a partnership understated its income or made incorrect allocations for the audited year—unless the partnership makes certain elections or those who were partners in the audited year take certain actions (such as filing amended returns and paying any tax due with respect to their shares of the adjustment). However, a partnership can elect to “push out” to each audited-year partner such partner’s share of any adjustment to partnership items, instead of paying a partnership-level tax. If this election is properly made, each audited-year partner takes its share of the adjustment into account on its **current-year** tax return (using a formula to determine the amount by which to increase its current-year tax).

Some partnerships with relatively simple structures may be able to elect out of the new rules (the “election out”).

The new rules generally apply to returns for partnership tax years beginning after December 31, 2017. However, a provision of the Budget Act (section 1101(g)(4)) allows partnerships to elect to apply the new rules earlier, at such time and in such form and manner as prescribed by the Treasury.

**KPMG observation**

There currently are many questions about the new rules, including questions regarding how the “push out” method applies in tiered partnership structures. Additional administrative guidance (or legislative clarification) is needed to address these questions.

In light of the many uncertainties associated with the new rules, partnerships may want to exercise caution before electing to apply the rules earlier than the general effective date. However, there may be limited situations in which an audited partnership may want to apply the new rules early. This could be the case, for example, if too much income—or too few deductions—were reported for a tax year, and the new rules with respect to “overstatements” of income would allow the resulting adjustment to be taken into account as a current year loss by the appropriate partners.

**Temporary regulations**

**Overview**

Today’s temporary regulations (set forth in Reg. section 301.9100-22T) provide the time, form, and manner for a partnership to make an “early election” to apply the new partnership audit regime to any of its partnership returns filed for an eligible tax year.

The preamble explains that Reg. section 301.9100-22T(a) generally provides that the early election does not apply to "elections out" of the new regime. Reg. section 301.9100-22T(a) further provides that:

- An early election is not valid if it is not made in accordance with the temporary regulations.
- An early election, once made, may only be revoked with consent of the IRS.
- An early election is not valid if it frustrates the purposes of the Budget Act amendments.
- Partnerships may not request an extension of time (a "9100 request") for making an early election under Reg. section 301.9100-3.

**KPMG observation**

The regulations do not expand upon the meaning of the rule providing that an early election is not valid if it frustrates the purposes of the new audit regime. The preamble explains that an early election is not valid if it frustrates the collection of any imputed underpayment that may be due by the partnership under section 6225(a), but does not otherwise elaborate on the meaning of this rule. It is possible that this rule is intended to address bankrupt partnerships from making the early election in an attempt to shift liability from the partners to a bankrupt entity. In this regard, note that the temporary regulations' procedures for making an early election (described below) require a representation that the partnership is not insolvent; does not reasonably anticipate becoming insolvent; is not currently bankrupt; does not reasonably anticipate becoming bankrupt; and has, and reasonably anticipates having, sufficient assets to pay a potential imputed underpayment.

**Eligible tax year**

An "eligible taxable year" generally is any partnership tax year beginning after November 2, 2015 and before January 1, 2018.

The preamble explains, however, that exceptions are provided to avoid proceedings under both the TEFRA partnership procedures and the new partnership audit regime for the same partnership tax year. Thus, an early election does not apply if the partnership has taken "the affirmative step" to apply the TEFRA partnership procedures with respect to the partnership return for that tax year. This occurs when the tax matters partner has filed an AAR for the partnership tax year under section 6227(c) of the TEFRA partnership procedures with respect to a partnership tax year. Similarly, an early election does not apply if a partnership that is not subject to the TEFRA partnership procedures has filed an amended return of partnership income for the partnership tax year.

**Making the early election**

Reg. section 301.9100-22T(b) generally provides that an early election must be made within 30 days of when the IRS first notifies the partnership, in writing, that a

partnership return for an eligible tax year has been selected for examination (a "notice of selection for examination"). The "notice of selection for examination" is a notice that precedes the notice of an administrative proceeding required under section 6231(a) (as amended by the Budget Act).

The following general procedures apply in making the early election:

- The early election must be in writing and must include a statement that the partnership is electing to have the partnership audit regime enacted by the Budget Act apply to the partnership return identified in the notification of selection for examination.
- The partnership must write "Election under Section 1101(g)(4)" at the top of the statement.
- The statement must be provided to the individual identified in the notice of selection for examination as the IRS contact for the examination.
- The statement must be dated and signed by the tax matters partner, or by an individual who has the authority to sign the partnership return for the tax year under examination under section 6063, the applicable regulations, and applicable forms and instructions.
- The statement must include the name, taxpayer identification number, address, and telephone number of the individual who signs the statement, as well as the partnership's name, taxpayer identification number, and tax year to which the statement applies.
- The statement must include representations that the partnership is not insolvent; does not reasonably anticipate becoming insolvent; is not currently and does not reasonably anticipate becoming subject to a 11 U.S.C. bankruptcy petition; and has sufficient assets, and reasonably anticipates having sufficient assets, to pay the potential imputed underpayment that may be determined during the partnership examination.
- The statement must include a representation, signed under penalties of perjury, that the individual signing the statement is duly authorized to make the election and that, to the best of the individual's knowledge and belief, the statement is true, correct, and complete.

A partnership making the early election also will be required to designate the "partnership representative" described in the new rules, and to provide the partnership representative's name, taxpayer identification number, address and daytime telephone number, and any other information as required in future guidance regarding the partnership representative. The preamble states that the IRS and Treasury Department expect to issue additional guidance regarding designation of a partnership representative, including who is eligible to be a partnership representative.

## Special rules for AARs

Reg. section 301.9100-22T(b) generally provides that the IRS will not issue a notice of an administrative proceeding (which cuts off the partnership's time for filing an AAR under the new rules) for at least 30 days after it receives a valid early election. During the period of at least 30 days after the IRS receives a valid early election and before the IRS mails the notice of an administrative proceeding, the partnership may file an AAR under the new rules.

In addition, the preamble explains that Reg. Section 301.9100-22T(c) provides an exception to the general rule that a partnership may only elect into the new audit regime after first receiving a notice of selection for examination. This exception provides that a partnership that has not received a notice of selection for examination may make an election to have the new partnership audit regime apply to a partnership return for an eligible tax year if the partnership wishes to file an AAR under the new regime's rules. Once such an election is made, all aspects of the new partnership audit regime, except the election out, apply to the return filed for the eligible tax year subject to the election.

The preamble, however, states that in no case may an election under Reg. section 301.9100-22T(c) be made earlier than January 1, 2018. Consequently, an AAR intended to be filed under section 6227, as amended by the Budget Act, may not be filed before January 1, 2018 (except by partnerships that have been issued a notice of selection for examination). An AAR filed before that date (other than an AAR filed by a partnership that made a valid election under Reg. section 301.9100-22T(b)) will be treated as an AAR by the partnership under section 6227 of the TEFRA partnership procedures, or as an amended return of partnership income for partnerships not subject to the TEFRA partnership procedures, and will prevent the partnership tax year for which the request, or return, is filed from being an eligible tax year.

According to today's release, the IRS and Treasury Department intend to issue guidance regarding AARs under the new rules before January 1, 2018.

For more information, contact a tax professional in KPMG's Washington National Tax office:


### Passthroughs group

Debbie Fields | +1 (202) 533-4580 | dafields@kpmg.com
Sarah Staudenraus | +1 (202) 533-4574 | sarahstaudenraus@kpmg.com

### Practice, Procedure and Administration group

Harve Lewis | +1 (202) 533-6024 | harvelewis@kpmg.com
Larry Mack | +1 (202) 533-3381 | lawrencemack@kpmg.com

## Federal Legislative and Regulatory Services group

John Gimigliano | +1 (202) 533-4022 | jgimigliano@kpmg.com
Carol Kulish | +1 (202) 533-5829 | ckulish@kpmg.com