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Bipartisan Budget Act of 2015

October 30, 2015

Special Report

HIGHLIGHTS

- Repeal Of TEFRA/ELP Partnership Rules
- New Streamlined Audit Process
- Delayed Effective Date For TEFRA/ELP Repeal
- ACA Automatic Enrollment Repeal
- Extension Of Funding Stabilization Rules For DB Plans

INSIDE

Budget Agreement Repeals TEFRA/ELP Partnership Audit Rules, ACA Automatic Enrollment

Legislation that eliminates the so-called TEFRA unified partnership audit rules (as first introduced in the Tax Equity and Fiscal Responsibility Act of 1982), along with the electing large partnership (ELP) rules, in favor of a more streamlined audit regime has been approved by Congress and is on its way to the White House for President Obama's expected signature. Repeal of the existing partnership audit rules is part of a two-year federal budget agreement intended to avert the threat of a government default. The Bipartisan Budget Act of 2015 also repeals automatic enrollment in certain employer-sponsored health plans under the Affordable Care Act (ACA) and revises and expands some existing pension provisions, among other changes.

IMPACT. *TEFRA partnership repeal has been debated before, but this time its attractiveness as a revenue raiser brought it to the forefront as lawmakers looked for ways to offset the budget bill, without "increasing" taxes. Instead, TEFRA repeal is also being promoted as a compliance enhancement that is a win-win for both the IRS and taxpayers.*

The revenue offsets won quick approval in Congress as part of the overall package, with the House voting 266 to 167 to approve the bill on October 28 and the Senate passing the bill by a vote of 64 to 35 in the early morning hours of October 30. President Obama immediately issued a statement applauding passage of the agreement.

IMPACT. *Partnerships have time to adjust, with the new streamlined partnership rules applicable to returns filed for partnership tax years beginning after 2017. However, subject to certain exceptions, partnerships may choose to apply the new regime to any partnership tax year beginning after the date of enactment (when the President signs the budget bill). Other provisions, including repeal of the ACA's automatic enrollment requirement for affected employers, are effective on enactment.*

COMMENT. *Before TEFRA's introduction in 1982, partnership returns generally were audited as adjuncts to the audits of partners' returns. Since the returns of the individual partners were separately audited, any given partnership item could be subject to separate administrative procedures and possibly inconsistent treatment. TEFRA introduced procedures where the partnership itself would be audited and adjustments made at the partnership level would flow through to the returns of the individual partners.*

Those procedures worked when targeted partnerships had relatively few partners. Now, because many partnerships subject to TEFRA have hundreds and even thousands of partners, both compliance and auditing have become unwieldy to the point of being tremendously inefficient and prone to missed deadlines and other compliance nightmares.

IMPACT. *Repeal of automatic enrollment is the second significant revision to the ACA in recent weeks. Previously, Congress passed and President Obama signed the Protecting Affordable Coverage for Employees (PACE) Act, which amended the*

Public Health Service Act to redefine small employer as one with 50 or fewer employees for purposes of the small group health market. The PACE Act gives states the option to expand the definition to include employers with up to 100 employees for purposes of the small group health market.

NEW PARTNERSHIP AUDIT RULES

The new partnership rules are intended to streamline partnership audits into a single set of rules for auditing partnerships and their partners at the partnership level. Partnerships with 100 or fewer qualifying partners would be permitted to opt out of the new rules, electing instead to be subject to audits on the level of each individual partner.

Currently, there are three different regimes for auditing partnerships:

- Partnerships with more than 10 partners are audited under unified TEFRA procedures that are then binding on the partners;
- Partnerships with 100 or more partners that elect to be treated as Electing Large Partnerships (ELPs) are subject to a unified audit under which any adjustments are generally reflected on the partners' current year return rather than on an amended prior-year return; and
- Partnerships with 10 or fewer partners are audited as part of each partner's individual audit.

COMMENT. *If any partner is not an individual, C corporation or the estate of an individual, or if any partner is a nonresident alien, the TEFRA unified procedure applies without regard for the number of partners. However, TEFRA does not apply to a partnership that qualifies as a small partnership (10 or fewer partners) unless the small partnership elects to apply those provisions.*

COMMENT. *Every TEFRA partnership must designate a tax matters partner to act as a liaison with the IRS during an audit or in litigation.*

COMMENT. *Partnerships are among the fastest growing type of business entity. According to the IRS, the number of partnerships has grown at an average annual rate of 3.9 percent since 2003. Partnerships with 100 or more partners accounted for almost half (47.3 percent) of all partners in 2012. For 2012, partnerships passed through $1,400.8 billion in total income minus total deductions available for allocation to their partners. This amount represents a 43.4-percent increase from 2011 when partnerships passed through $976.9 billion. The finance and insurance sector also accounted for the largest portion of the growth in total assets, reporting an increase of $802.5 billion (from $11,349.3 billion to $12,151.9 billion), followed by the real estate and rental and leasing sector with an increase of $330.9 billion (from $4,621.90 billion to $4,952.8 billion).*

"The Bipartisan Budget Act repeals the TEFRA and ELP rules and creates a streamlined structure for auditing partnerships and their partners at the partnership level."

COMMENT. *The ELP rules were put in place to make audits of large partnerships and any subsequent adjustments less burdensome on both the partnership and the IRS. Adjustments made at the partnership level flow through to the partners for the year in which the adjustment takes effect, rather than the audit year. Prior-year returns of partners would generally be unaffected. The ELP rules, however, appear to be underutilized. The IRS reported that just 103 partnerships elected to file Form 1065-B, U.S. Return of Income for Electing Large Partnerships, in 2012, a decrease from 105 in 2011.*

Streamlined Audit Structure

The Bipartisan Budget Agreement repeals the TEFRA and ELP rules and creates a streamlined structure for auditing partnerships and their partners at the partnership level. Generally, the IRS would examine the partnership's items of income, gain, loss, deduction, credit and partners' distributive shares for a particular year of the partnership (the so-called "reviewed year"). Any adjustments would be taken into account by the partnership, not the individual partners, in the year that the audit or any judicial review is completed (the so-called "adjustment year") and would be collected from the partnership.

IMPACT. *Unlike prior proposals, the Bipartisan Budget Act does not subject partners to joint and several liability for any liability determined at the partnership level.*

A Congressional Summary of the new provision explains that partnerships "would have the option of demonstrating that the adjustment would be lower if it were based on certain partner-level information from the reviewed year, rather than imputed amounts determined solely on the partnership's information in such year." A partnership would also have the option of initiating an adjustment for a reviewed year, such as when it believes additional payment is due or an overpayment was made, with the adjustment taken into account in the adjustment year.

IMPACT. *The IRS will now need to develop regulations to reflect repeal of the TEFRA and ELP rules. Lawmakers provided for a delayed effective date. The Bipartisan Budget Act applies to returns filed for partnership tax years beginning after 2017. The delayed effective date also may provide an opportunity for stakeholders to amend the new partnership rules. The provisions were essentially taken from H.R. 2821, sponsored by Rep. James Renacci, (R-Ohio), who had planned to hold several additional hearings on refine the* *bill before any floor action. Among the additional tweaks suggested by certain parties have been application of the rules for multi-tiered partnerships and consideration of foreign and tax-exempt partners, as well as changes in partnership allocations and membership from year to year.*

COMMENT. *President Obama previously proposed to overhaul the TEFRA and ELP rules and replace them with "simplified partnership procedures." President Obama called the existing TEFRA and ELP rules "inefficient and more complex than those applicable to other large entities." President Obama and other proponents of repealing TEFRA have often linked proposals to overhaul the taxation of private equity firms with TEFRA repeal. The budget agreement enacts the TEFRA repeal but to what extent the repeal will impact private equity firms remains to be seen.*

Opt-out. Partnerships with 100 or fewer qualifying partners may opt out of the new audit regime. Partnerships that opt-out will be audited under the general rules applicable to individual taxpayers. The opt-out is available provided that each partner is an individual, C corporation, foreign entity that would be a C corporation under U.S. law, an S corporation, or the estate of a deceased partner.

COMMENT. *Repeal is treated as a revenue raiser based on the assumption of increased compliance activities by the IRS, bringing in $9.3 billion in net revenues over the next 10 years. In FY 2012, the IRS audit coverage rate for large partnerships was 0.8 percent. In comparison, the audit coverage rate for large C corporations was 27.1 percent.*

PARTNERSHIP INTERESTS CREATED BY GIFT

The Bipartisan Budget Act clarifies that Congress did not intend for the family partnership rules to provide an alternative test for whether a person is a partner in a partnership. The determination of whether the owner of a capital interest is a partner would be made under the generally applicable rules defining a partnership and a partner. Further, the agreement clarifies that a person is treated as a partner in a partnership in which capital is a material income-producing factor whether the interest was obtained by purchase or gift and regardless of whether the interest was acquired from a family member.

IMPACT. *The Joint Committee on Taxation estimates that this "clarification" will bring in $1.9 billion over the next 10 years.*

ACA AUTOMATIC ENROLLMENT

The ACA requires employers with more than 200 full-time employees to automatically enroll new full-time employees in one of the employer's health benefits plans (subject to any authorized waiting period), and to continue the enrollment of current employees in a health benefits plan offered through the employer. Employees may opt out of automatic enrollment. The ACA also imposes notice requirements for automatic enrollment. The IRS and the U.S. Departments of Health and Human Services (HHS) and Labor (DOL) announced after passage of the ACA that affected employers would not be required to comply with the automatic enrollment provision until regulations are issued. The agencies have not yet issued regulations.

The budget agreement repeals the ACA's automatic enrollment requirement for affected qualified employers. Repeal is effective on enactment.

IMPACT. *Automatic enrollment was apparently never a high priority for the agencies, as they worked to develop guidance for more far-reaching ACA provisions, such as the employer shared responsibility requirement and the Code Sec. 36B premium assistance tax credit.*

IMPACT. *Employers may still choose to set up an automatic enrollment regime if they wish. The Bipartisan Budget Act merely repeals the requirement under the ACA that employers with more than 200 full-time employees automatically enroll new employees in their health plan.*

COMMENT. *The budget agreement treats repeal of automatic enrollment as a revenue raiser because it takes the position that employees as a group will receive more taxable income as opposed to nontaxable health benefits.*

COMMENT. *Before year-end, the Senate could take up partial repeal of the ACA under a House-approved reconciliation bill. The House bill would repeal the employer and individual shared responsibility provisions and the excise tax on so-called "Cadillac" health plans. However, passage of the Bipartisan Budget Act and its spending cuts and easing of sequestration, especially for defense spending, may slow consideration of the House's ACA bill in the Senate. Lawmakers have a short window before year-end to address, among other things, the tax*

SELECTED REVENUE RAISERS IN THE BIPARTISAN BUDGET ACT OF 2015*

Partnership Audits and Adjustments:	$9.324 billion
Funding Stabilization Extension:	$6.534 billion
Partnership Interests Created by Gift:	$1.894 billion

Source: *Joint Committee on Taxation*
*Over 10 years

extenders and the federal appropriations for fiscal year (FY) 2016, a fact that could further push the House's ACA repeal bill to the backburner in the Senate.

DEFINED BENEFIT (DB) PLANS FUNDING STABILIZATION

Code Sec. 430 provides minimum funding requirements for single-employer DB plans. Interest rates are specified for purposes of calculating the minimum required contribution. The rates used for these purposes are a set of three segment rates or, alternatively, a full yield curve. The Moving Ahead For Progress Act (MAP-2) adjusted the three segment rates to fall within a specified range determined based on a percentage of the average of the corresponding segment rates for a 25-year period ending on September 30 preceding the calendar year that includes the first day of that plan year. The Bipartisan Budget Act extends the funding stabilization rules for DB plans through 2019.

Mortality Tables. The Treasury Department prescribes mortality tables used by calculate pension liabilities. DB pension plans may apply to use plan-specific substitute mortality tables. The Bipartisan Budget Act expands the availability of private sector DB plans to use separate mortality tables for plan years beginning after December 31, 2015.

PENSION BENEFIT GUARANTY CORPORATION

The Pension Benefit Guaranty Corporation (PBGC) insures single employer DB plans and multiemployer plans. The PBGC is financed by insurance premiums set by Congress.

COMMENT. *The PBGC does not insure, among other arrangements, 401(k) plans, federal, state and local government plans, military pensions, and Employee Stock Ownership Plans.*

Premiums. The Bipartisan Budget Act increases the single-employer fixed premium to $68 for 2017, $73 for 2018, and $78 for 2019, and subsequently re-indexed for inflation. The variable rate premium would continue to be indexed for inflation, but would be increased by an additional $2 in 2017, an additional $3 in 2018, and an additional $3 in 2019.

Pension Payment Acceleration. The Bipartisan Budget Act accelerates the premium payment due date in future years. For plan years beginning in 2025, the due date for premiums will be the 15th day of the ninth calendar month beginning on or after the first day of the premium payment year.

COMMENT. *Under current law, the due date is generally the 15th day of the tenth full calendar month of the premium payment year.*

PAYROLL TAXES

The Disability Insurance Trust Fund, which pays benefits to disabled workers and their spouses and children, is funded by a proportion of taxes under FICA and SECA. The Bipartisan Budget Act reallocates from the Old-Age and Survivors Insurance Trust Fund to the Disability Insurance Trust Fund an additional 0.57 percentage points (for a total of 2.37 percentage points of the total combined 12.4 percent payroll tax) in 2016, 2017 and 2018.

DEBT COLLECTION

The Bipartisan Budget Act authorizes the use of automated calls to cell phones to collect debts owed to the U.S. government. Regulations are to be promulgated within nine months of enactment.

SEQUESTRATION

The Budget Control Act of 2011 set in place sequestration (across the board spending cuts). The Bipartisan Budget Act eases sequestration in 2016 and 2017 for defense and non-defense spending.

COMMENT. *Congress has yet to approve a FY 2016 budget for the IRS. The IRS, along with other federal agencies, is operating under a stop-gap spending bill scheduled to expire in mid-December. Passage of the Bipartisan Budget Act is expected to spur passage of an omnibus spending bill before expiration of the stop-gap spending bill.*

TAX EXTENDERS – NEXT UP?

Lawmakers did not address the so-called "tax extenders" in the budget agreement. Under current law, more than 50 popular, but temporary, tax incentives known as extenders expired for tax years after 2014. For individuals, the extenders include the state and local sales tax deduction, the teachers' classroom expense deduction, the Code Sec. 25C residential energy property credit, and the tuition and fees deduction. For businesses, the extenders include the research tax credit, enhanced Code Sec. 179 expensing, bonus depreciation, and a host of other industry-specific incentives. The House has approved a number of stand-alone extenders bill. The Senate is expected to take up a package of extenders. As 2015 draws to a close, the IRS has cautioned that late passage of the extenders may delay the start of the 2016 filing season. As in past years, Congress appears on course to pass a one or two-year extension of "extenders" in December. A two-year extension (retroactive to the start of 2015 and through 2016) would take the extenders through the end of the Obama administration.

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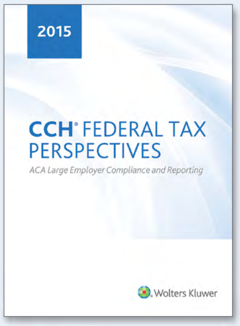

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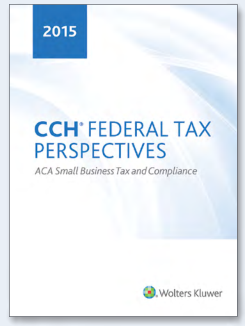

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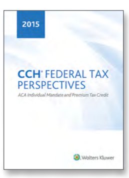

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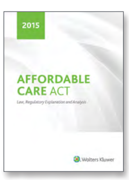

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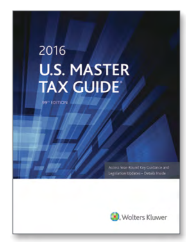

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