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Two-year budget deal – with streamlined audit rules for large partnerships – heads to White House

The House and Senate this week approved a two-year budget deal forged between the White House and congressional leaders that would, among other things, partially lift statutory caps on discretionary spending for fiscal years 2016 and 2017, suspend the federal debt ceiling into March of 2017, and offset the cost of the spending increases with a mix of tax and nontax provisions – including new rules that would make it easier for the Internal Revenue Service to audit certain large partnerships.

The Bipartisan Budget Act of 2015, which was made public in the early hours of October 27, is the product of several weeks of quiet negotiations between President Obama and then-House Speaker John Boehner, R-Ohio, House Minority Leader Nancy Pelosi, D-Calif., Senate Majority Leader Mitch McConnell, R-Ky., and Senate Minority Leader Harry Reid, D-Nev.

The bill cleared the House on October 29 by a vote of 266-167, with relatively low levels of Republican support. Only 79 GOP lawmakers voted in favor of the measure and 167 voted against it; in contrast, all 187 Democrats casting a vote were in the “aye” column.

The measure cleared the Senate at 3:00 a.m. on October 30 by a vote of 64-35. As was the case in the House, the vote tally revealed a split within the GOP. All told, Republicans accounted for 18 votes in favor of passage and all 35 votes against. Across the aisle, the chamber’s 44 Democrats and 2 Independents (who normally caucus with the Democrats) all voted “aye.”

The budget deal now goes to the White House, where it is expected that President Obama will promptly sign it into law.

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The agreement defuses two politically contentious fiscal issues – federal spending limits and the debt ceiling – until after the 2016 elections and marks the culmination of efforts by John Boehner, who resigned as House speaker on October 29 and from Congress on October 30, to "clean up the barn" for his successor, Rep. Paul D. Ryan, W-Wis. (House members officially elected Ryan as their new speaker on October 29. See related coverage in this issue for details.)

Budget agreement overview

The agreement would lift the statutory caps on discretionary spending (known as the "sequester") by $50 billion for the remainder of fiscal year 2016 (which began on October 1) and $30 billion in fiscal year 2017, with those increases equally divided between defense and domestic accounts – a precondition of any deal according to President Obama and congressional Democrats. The increases would be offset with a mix of unrelated measures, including increasing premiums paid by single-employer defined benefit plans to the Pension Benefit Guaranty Corporation, deferring required deductible pension contributions by certain employers, selling oil from the Strategic Petroleum Reserve, and implementing certain tax compliance measures (discussed in further detail below).

Lawmakers will still have to agree upon and enact appropriations legislation that conforms to the new fiscal 2016 spending caps prior to December 12 when the current stop-gap funding measure, or "continuing resolution," is scheduled to expire.

Debt ceiling: The deal also would suspend the statutory limit on the government's borrowing authority through March 15, 2017, extend the solvency of the Social Security Disability Insurance program until 2022 primarily by reallocating certain payroll tax revenues from the program's retirement fund to its disability fund, and prevent a major increase in Medicare premiums set to impact millions of beneficiaries beginning next year.

Extenders left out: Notably, the deal is silent on the future of the so-called tax extenders (such as the research and experimentation credit, bonus depreciation, the subpart F exemption for active financing income, and the lookthrough rule for certain payments between related controlled foreign corporations) which most recently lapsed at the end of 2014. Many observers believe these provisions may be addressed in conjunction with either a long-term Highway Trust Fund reauthorization or the aforementioned appropriations legislation – both of which are slated to move through Congress prior to year-end.

Changes to audits for large partnerships

On the revenue side of the budget agreement, one of the more significant tax provisions is a proposal to modify the audit rules for large partnerships.

Current rules: In 1982, Congress passed the Tax Equity and Fiscal Responsibility Act (TEFRA), which established unified audit rules for large partnerships (those with more than 10 partners) and required that the tax treatment of all partnership items be determined at the entity level for these partnerships. In 1997, Congress added rules to allow large partnerships with more than 100 partners (an electing large partnership or ELP) to elect into a simplified reporting regime, which included streamlined audit and adjustment procedures.

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President Obama included proposals in some of the administration's previous budget packages to mandate the ELP system of streamlined audit and adjustment procedures for partnerships with 1,000 or more partners, but these proposals were never taken up in Congress. In February 2014, Rep. Dave Camp, R-Mich., who was then chairman of the House Ways and Means Committee, released the draft of a comprehensive tax reform plan that included a proposal to streamline the audit process in a manner similar to the ELP rules but applicable to partnerships with more than 100 partners. The Obama administration subsequently incorporated Camp's proposal into its fiscal 2015 and 2016 budget blueprints.

Proposed changes: The provision in the new budget deal is modeled largely on the Camp and White House proposals. Specifically, the legislation would repeal the current TEFRA and ELP rules (including the simplified reporting procedures) and replace them with one set of entity-level audit rules that would apply to all partnerships (subject to an opt-out by certain partnerships with 100 or fewer partners). Under these streamlined audit rules, the IRS would examine partnership items for a particular year (the "reviewed year"), and any adjustments would be taken into account by the partnership at the entity level in the year the audit or judicial review is completed (the "adjustment year").

- **Entity-level tax:** Generally, the partnership would pay the tax, interest, and penalties on underpayments. Any adjustments not causing underpayments would generally flow through to the partners in the year of the adjustment. The amount of the underpayment at the partnership level could be reduced by (1) the tax reported on the underpayment by partners filing amended returns, (2) the tax attributable to tax-exempt partners, and (3) the tax rate differential due to a lower corporate tax rate or lower capital gain/dividend rate.
- **Election for partners to pay tax:** Alternatively, partnerships may elect to issue adjusted information returns to reviewed-year partners, who would then take the adjustments into account on their individual returns in the adjustment year through a simplified amended return process. Those partners would calculate what the extra tax would have been in the reviewed year and then pay the tax (and interest and penalties) from that prior year with the tax return for the year when they receive the statement of adjustments. Once this election is made, it may only be revoked with the consent of the Secretary.
- **Partnership-requested adjustments:** A partnership could request adjustments, which, if approved, would be treated similar to the rules that would apply if the IRS made the adjustments.
- **Designated partnership representative:** Audits would be handled by a designated partnership representative, who could be a partner or other person with a substantial presence in the US, and that person would have the sole authority to act on behalf of the partnership with respect to partnership audits.
- **Joint and several liability:** In a change from prior iterations, the budget deal proposal states that partners would not be subject to joint and several liability for those liabilities determined at the partnership level.
- **Opt-out for small partnerships:** Small partnerships with 100 or fewer qualifying partners would be allowed to opt out of the new rules, and those partnerships and partners would be subject to the general rules that apply to auditing individual taxpayers. To qualify to elect out, the partners must all be individuals, C corporations,

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foreign entities that would be treated as C corporations if domestic, S corporations, estates of deceased partners, or others if the Secretary prescribes in guidance. Thus, partnerships with partners that are partnerships or trusts would be unable to elect out without further guidance. The proposal also contains several consent and election rules with special rules for certain partners such as S corporations. The election to opt out is made for a particular year with a timely filed return for that taxable year.

Effective date: The provision would be effective for returns filed for partnership tax years beginning after 2017. According to estimates from the Joint Committee on Taxation (JCT) staff, the audit proposal would increase federal receipts by just over $9.3 billion between 2016 and 2015.
URL: https://www.jct.gov/publications.html?func=startdown&id=4846

Partnership interests created by gift

An unrelated provision in the budget agreement that would clarify the rules for partnership interests created by gift would be effective for taxable years beginning after December 31, 2015, and would increase federal receipts by nearly $1.9 billion over 10 years, according to the JCT staff.

Pension smoothing

The agreement also would increase federal receipts by an estimated $6.53 billion over 10 years through a so-called “pension smoothing” provision that would modify the interest rate that employers must use to calculate their pension plan liabilities for purposes of determining their annual minimum funding obligations for 2018, 2019, and 2020.

The change would generate revenue by lowering an employer’s plan funding payments, thereby reducing the value of its deductions for those payments.

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Ryan takes gavel as House speaker

Rep. Paul D. Ryan, R-Wis., was elected as the new speaker of the House October 29, ending a month of leadership turmoil within that chamber’s Republican Conference.

Ryan, who House Republicans formally nominated one day earlier as their candidate to succeed outgoing Speaker John Boehner, R-Ohio, had entered the race for the top spot reluctantly. He was drafted to run for the position by many in the party following Boehner’s sudden decision last month to retire from Congress and the unexpected decision by House Majority Leader Kevin McCarthy, R-Calif., to pull out of the contest. Ryan received 236 votes on the House floor, essentially securing the consensus among the 247 GOP conference members that he asked for when he agreed to run. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 36, Oct. 23, 2015.)

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Rule changes ahead

Boehner, who addressed the House for the last time as speaker shortly before the floor vote, officially retired from his 24-year career in the House, effective at the end of the day on October 30. He leaves in mid-term, at odds with an increasingly vocal bloc of conservative GOP members that have sought significant changes in leadership's approach to legislating and in the House rules.

In recognition of this dynamic, Ryan told his Republican colleagues on October 28 that he plans to empower all members to be part of the legislative process and that by the end of the year he intends to revamp the internal House rules, in collaboration with all of the party's members. Rep. Cathy McMorris-Rogers, R-Wash., chair of the House Republican Conference, has begun collecting proposed rule changes from members.

Choosing the next Ways and Means leader

Ryan, who resigned his position as chairman of the Ways and Means Committee upon his election to the speakership, also said that before Thanksgiving he will restructure the Republican Steering Committee, which recommends committee assignments – and whose next task will be to determine his replacement as the House's top taxwriter. There is word that the group may meet the week of November 2, so the current Steering Committee members may be the ones that will recommend the next Ways and Means chairman to the full Republican Conference.

Currently, the Steering Committee comprises 33 party members, including the speaker and other members of leadership; the chairmen of five of the 20 standing committees (including Ways and Means); representatives elected by members from different regions, made up of roughly equal numbers of members; and representatives from each of the past three classes elected. Because the speaker gets five votes and the majority leader gets three, a total of 38 votes are cast on the panel. A member needs 20 votes to win the Steering Committee's nomination.

Given the speaker's direct control of five votes and the fact that Ryan's view will likely carry even greater weight when it comes to naming the next leader of the taxwriting panel, the decision may come down to who Ryan wants to succeed him.

Ways and Means members Kevin Brady of Texas and Pat Tiberi of Ohio are vying for the post. Brady is the more senior of the two, but Texans already chair six of the 20 House committees. While Brady and Tiberi are seen to have some political and stylistic differences, both come from the mainstream conservative, business-friendly wing of the party and are likely to stay on a course similar to the one Ryan charted during the 10 months of his chairmanship.

Tiberi outlined his "vision" for the committee on October 28, saying he believes it should take a leading role in fixing the federal transportation infrastructure system, advancing free trade, and pushing for comprehensive tax reform. Brady, who officially announced his candidacy earlier

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this week, has emphasized his support for a “pro-growth agenda” and his previous experience chairing Congress’ Joint Economic Committee.

House taxwriter Devin Nunes, R-Calif., who had recently expressed interest in seeking the chairman’s post, announced October 29 that he would not be a candidate.

Johnson tapped as interim Ways and Means chair

The Ways and Means Committee announced on October 29 that Rep. Sam Johnson, R-Texas, will serve as interim chairman until the Steering Committee names Ryan’s permanent successor. Johnson is the most senior member of Ways and Means and chairs that panel’s Social Security Subcommittee.

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Short-term highway spending patch becomes law

The House and Senate this week approved legislation that extends spending authority for the Highway Trust Fund through November 20. The Surface Transportation Extension Act of 2015 (H.R. 3819) was approved in the House of Representatives by voice vote on October 27 and cleared the Senate by unanimous consent a day later. President Obama signed the measure into law on October 29 – the same day that a previous short-term extension of highway spending had been set to lapse.

H.R. 3819 includes no revenue offsets. The just-expired three-month highway patch that was enacted in July extended the Highway Trust Fund’s spending authority through October 29, but transferred enough money from the government’s general fund to keep the highway fund solvent for a longer period, possibly until well into 2016, according to a recent release from the Department of Transportation. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 30, Sep. 11, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150911_1.html

Buying time for multi-year highway bill

Passage of this latest short-term extension of highway spending authority is intended to give the House time to complete work on a long-term infrastructure package that it can then conference with the six-year measure – the Developing a Reliable and Innovative Vision for the Economy (DRIVE) Act – approved by the Senate in July.

Former House Ways and Means Committee Chairman – now House Speaker – Paul D. Ryan, R-Wis., had hoped to advance a plan this fall that would overhaul US international tax rules and use certain one-time revenues from deemed repatriation to help pay for a multi-year highway spending bill. But that effort stalled earlier this month and Ryan subsequently told the House Transportation and Infrastructure Committee to move forward on highway legislation without the assumption of funding from international tax reform. (For prior coverage, see *Tax*

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News & Views, Vol. 16, No. 33, Oct. 2, 2015.) The transportation panel recently approved the spending component for a six-year, $325 billion highway bill and ranking Democrat Peter DeFazio, D-Ore., told reporters this week that a completed bill – including a revenue package – could reach the House floor by November 3.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/151002_1.html

DRIVE Act in the driver's seat?

Although specific details on potential revenue raisers for a long-term House highway measure have not yet been released, Ryan has hinted in recent weeks that the House could opt for offsets resembling those in the Senate-approved DRIVE Act. That measure would extend highway programs for six years, while financing about three years of the shortfall between Highway Trust Fund spending and dedicated revenues – or roughly $50 billion – with an assortment of tax compliance provisions as well as budget offsets ranging from selling oil in the Strategic Petroleum Reserve to reducing the dividend rate paid by the Federal Reserve on stock held by certain member banks. (For additional details, see *Tax News & Views*, Vol. 16, No. 25, July 24, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150724_1.html

But recent developments have left some holes in the Senate bill's revenue package. Several tax compliance and enforcement provisions from the DRIVE Act – worth nearly $5 billion in increased revenue over 10 years, according to estimates from the Joint Committee on Taxation staff – were enacted in the just-expired three-month highway patch and are no longer available as offsets for a long-term infrastructure bill.

In addition, a scaled-down version of the DRIVE Act's provision to sell oil in the Strategic Petroleum Reserve now appears in the two-year budget deal that cleared the House and Senate this week and currently awaits President Obama's signature. (See related coverage in this issue for details.) As a result, even more revenue could be siphoned off from the Senate highway plan.

Other Senate-approved offsets for highway spending, such as reducing the dividend rate paid by the Federal Reserve, have proved to be controversial for some House Republicans. Moreover, some House GOP members have criticized the DRIVE Act for providing only three years' worth of offsets for a six-year spending plan.

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