**STRADLEY RONON**

# Tax Insights

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## IRS Issues Final Partnership Representative Regulations Under Centralized Partnership Audit Regime

The IRS has issued final regulations (https://www.federalregister.gov/documents/2018/08/09/2018-17002/partnership-representative-under-the-centralized-partnership-audit-regime-and-election-to-apply-the) on the centralized partnership audit regime in effect for tax years beginning after Dec. 31, 2017. See our prior coverage, here (https://www.stradley.com/insights/publications/2017/12/tax-insights-december-27-2017), here (https://www.stradley.com/insights/publications/2018/02/tax-insights-february-7-2018) and here (https://www.stradley.com/insights/publications/2017/06/tax-insights-june-14-2017). The regulations finalize temporary regulations issued in 2016 that apply to taxpayers who elected to apply the centralized partnership regime to tax years beginning before Jan. 1, 2018. The final regulations also make significant modifications to the proposed regulations issued in early 2017 regarding partnership representatives.

Highlights of the final regulations include:

- **Designation of a partnership representative.** A disregarded entity may be designated as a partnership representative, but the partnership also must appoint a designated individual to act on behalf of such entity. Additionally, the partnership itself may be designated as its own representative if it meets the substantial presence requirement. The final regulations keep the requirement that the individual, and/or entity, must have a substantial presence in the United States, but have removed the capacity to act requirement.

- **Changing a partnership representative.** The proposed regulations permitted a change in the partnership representative only after a notice of administrative proceeding was mailed or in conjunction with an administrative adjustment request. However, the final regulations allow a partnership to change its representative when it is notified that it was selected for examination, so that the partnership has the opportunity to make adjustments prior to the beginning of the administrative proceeding. The final regulations also set forth guidelines for the resignation or revocation of the representative and notification requirements when there is a change.

- **IRS designation of a partnership representative.** If the IRS determines that a designation is not in effect, it must consider the following factors when designating an individual as the partnership's representative: (a) the views of the partners having a majority interest in the partnership regarding the designation; (b) the general knowledge of the person in tax matters and the administrative operation of the partnership; (c) the person's access to the books and records of the partnership; (iv) whether the person is a United States person; and (d) in the case of a partner of the partnership, the profits interest of such partner.

## IRS Issues Proposed Regulations Regarding the Qualified Business Income Deduction Enacted by the 2017 Tax Cuts and Jobs Act

The IRS has issued proposed regulations (https://www.irs.gov/pub/irs-drop/reg-107892-18.pdf) under Section 199A enacted by 2017 legislation commonly known as the Tax Cuts and Jobs Act (TCJA). (Section references are to the Internal Revenue Code of 1986, as amended.) For taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2026, an individual taxpayer generally may deduct 20 percent of qualified business income from a sole proprietorship and a pass-through entity, e.g., a partnership or an S corporation, as well as 20 percent of aggregate qualified REIT dividends, qualified cooperative dividends and qualified publicly traded partnership income. (See our summary of the TCJA here (https://www.stradley.com/insights/publications/2017/12/tax-insights-december-20-2017).)

Under the proposed regulations, the IRS provides:

- In determining qualified business income (QBI): (a) any disallowed losses that were suspended in a tax year that began before Jan. 1, 2018, are not taken into account; (b) a net operating loss deduction is not taken into account for QBI, unless part of the loss was disallowed under Section 461(l) (Section 461(l) limits the ability of noncorporate taxpayers to use trade or business losses against other sources of income. The practical result is that the business losses of a noncorporate taxpayer for a tax year can offset no more than $500,000 (for married taxpayers filing jointly), or $250,000 (for other individuals), of a taxpayer's nonbusiness income for that year); (c) gain or loss that is not treated as capital gain or loss under Section 1231 may be included in QBI, provided all other requirements are met; (d) interest income is not included in QBI – the regulations clarify that "interest income" includes income received on working capital, reserves and similar accounts, but interest income received on accounts or notes receivable for services or goods provided by the trade or business may be included in QBI; (e) QBI does not include guaranteed payments, payments to a partner for services rendered (Section 707(a) payments) or reasonable compensation (even if not paid by the S corporation); and (f) items of income of QBI that are properly attributable to more than one trade or business must be allocated using a reasonable method, which must be consistently applied over the tax years.

- Aggregation rules for individuals that allow those who qualify to treat multiple trades or businesses as a single trade or business.

- An anti-abuse rule to prevent taxpayers from capturing REIT dividends without having economic exposure to the REIT stock.

- Special rules that apply in determining what types of income qualify as QBI (e.g., effectively connected income, guaranteed payments and net operating losses), also apply to the determination of a taxpayer's allocable share of income, gain, deduction and loss from a publicly traded partnership.

- W-2 wages must be determined separately for each trade or business by the individual or pass-through entity. If wages are attributable to more than one trade or business, the wages should be allocated the same way deductions are allocated among each trade or business.

- If a business is a specified service trade or business, then none of the related income can be taken into account for QBI.

- A de minimis rule for determining whether a business is a specified service trade or business.

## IRS Issues Proposed Regulations on Additional Depreciation Deduction Enacted by the TCJA

The IRS has issued proposed regulations (https://www.pwc.com/us/en/tax-services/publications/insights/assets/Bonus%20depreciation%20regs.pdf) clarifying the requirements for taking the additional first-year depreciation deduction under Section 168(k). Generally, Section 168(k) allows a 100 percent additional first-year depreciation deduction for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023. The regulations provide four requirements in order for the depreciable property to qualify for the deduction: (a) the property must be of a specified type (e.g., water utility property, computer software, qualified film property, etc.); (b) the original use of the property must start with the taxpayer, or property that is acquired by the taxpayer must meet certain acquisition requirements; (c) the property must be placed into service within a specified time frame; and (d) the property must be acquired after Sept. 27, 2017.

## Ninth Circuit Withdraws Its Opinion in *Altera*

The U.S. Court of Appeals for the Ninth Circuit withdrew (http://cdn.ca9.uscourts.gov/datastore/opinions/2018/08/07/16-70496.pdf) its opinions, both majority and dissenting, issued in *Altera Corp. v. Comm'r* (http://cdn.ca9.uscourts.gov/datastore/opinions/2018/07/24/16-70496.pdf). The majority opinion of the Ninth Circuit had reversed the Tax Court's holding that had invalidated the cost-sharing regulations applicable to stock-based compensation. The opinions were withdrawn "to allow time for the reconstituted panel to confer on this appeal," because a judge on the original panel that reviewed the case died before the opinion was issued.

## IRS Provides Procedures for Automatic Consent to Accounting Method Changes

The IRS, in Rev. Proc. 2018-40 (https://www.irs.gov/pub/irs-drop/rp-18-40.pdf), instructs taxpayers to use the automatic change procedures to switch to the new permitted accounting methods enacted under the TCJA.

## Pennsylvania and Philadelphia Decouple From Bonus Depreciation Change Under the TCJA

Pennsylvania, and by law Philadelphia, decoupled (https://www.phila.gov/2018-08-01-philly-to-follow-pennsylvania-on-bonus-depreciation/) from the federal changes enacted under the TCJA that allowed for bonus depreciation deductions under Section 168(k). Therefore, taxpayers must add back any bonus depreciation taken on their federal income tax returns to their state and city returns. Taxpayers are still permitted, for both Pennsylvania and Philadelphia purposes, to take the normal depreciation deduction under Section 167.

## New York Issues Guidance on Repatriation Income

The New York Department of Taxation and Finance has issued notices 18-7 (https://www.tax.ny.gov/pdf/notices/n18-7.pdf) and 18-8 (https://www.tax.ny.gov/pdf/notices/n18-8.pdf), regarding instructions for reporting repatriation amounts under Section 965 on the taxpayer's 2017 state return. Taxpayers that have already filed their returns will need to file amended returns in compliance with these new instructions.


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