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Spending Bill Passes, Including Technical Corrections to Partnership Audit Rules

President Trump signed the Consolidated Appropriations Act, 2018 (https://www.congress.gov/115/bills/hr1625/BILLS-115hr1625enr.pdf) (the Bill) on Friday, March 23. The Bill funds the government through September and includes technical corrections to numerous past laws, including the Bipartisan Budget Act of 2015, the Protecting Americans from Tax Hikes Act of 2015 and the American Taxpayer Relief Act of 2012. The Joint Committee on Taxation (JCT) estimates (https://www.jct.gov/publications.html?func=startdown&id=5065) that the revenue provisions will cost $2.7 billion over 10 years. The JCT's technical explanation is available here (https://www.jct.gov/publications.html?func=startdown&id=5064). The Bill also includes $320 million for the IRS to implement the Tax Cuts and Jobs Act (TCJA). The technical corrections in the Bill related to the partnership audit rules include the following:

- The Bill clarifies the scope of the partnership audit rules. It eliminates references to adjustments to partnership income, gain, loss, deduction or credit, and instead refers to partnership-related items, defined as any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person, without regard to whether the item or amount appears on the partnership's return and including an imputed underpayment, and an item or amount relating to any transaction with, basis in or liability of the partnership.

- The Bill clarifies that the partnership audit rules do not apply to taxes imposed, or to amounts required to be deducted or withheld, under Chapters 2 (tax on self-employment income) or 2A (tax on net investment income), 3 (withholding tax on nonresident alien individuals or foreign corporations), or 4 (withholding tax for certain foreign accounts) of the Internal Revenue Code of 1986, as amended (Code), except as otherwise specifically provided.

- The Bill applies a specific timing rule in the case of any tax imposed, including any amount that is required to be deducted or withheld, under Chapters 3 (withholding tax on nonresident alien individuals or foreign corporations) or 4 (withholding tax for certain foreign accounts). In these cases, the tax is determined with respect to the reviewed year. The tax is imposed with respect to the adjustment year; similarly, the amount required to be deducted or withheld is deducted or withheld with respect to the adjustment year. The reviewed year and the adjustment year are defined in Section 6225(d). (Section references are to the Code.)

- The Bill clarifies the manner of netting items to determine the amount of an imputed underpayment of a partnership. Items of different character (capital or ordinary), for example, are not netted together in determining the amount of an imputed underpayment. Rather, an imputed underpayment of a partnership with respect to a reviewed year is determined by the Secretary by appropriately netting partnership adjustments for that year and by applying the highest rate of tax in effect for the reviewed year under Section 1 or 11.

- The Bill clarifies the requirements for reviewed-year partners filing amended returns with payment of any tax due.

- The Bill sets forth an alternative procedure to filing amended returns, referred to as the pull-in procedure. Under the pull-in procedure, the Secretary determines the partnership's imputed underpayment as reduced by the portion of the adjustments to partnership-related items that direct and indirect reviewed-year partners take into account and with respect to which those partners pay the tax due, provided the requirements of the pull-in procedure are met.

- The Bill clarifies the rules applicable in the case of partnerships and S corporations in tiered structures when a partner files an amended return and pays, or provides information to the Secretary and pays in a pull-in. The Bill addresses the situation of a partnership (or an S corporation, which is treated similarly to a partnership under this rule) that is a direct or indirect partner of an audited partnership which has elected to push out adjustments of partnership-related items to partners (or S corporation shareholders, which are treated similarly to partners under this rule) under Section 6226. The provision sets forth requirements applicable to such partners and the time frame for satisfying these requirements.

ABA Tax Section Submits Comments on Fractions Rule and TCJA Partnership Interest Provisions

The ABA submitted comments (https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/031518comments.authcheckdam.pdf) on proposed regulations issued under Section 514 (the Fractions Rule), addressing the extent to which a tax-exempt organization's income with respect to "debt-financed property" is treated as unrelated business taxable income in the case of real property held by certain tax-exempt organizations. The ABA also submitted comments (https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/031918comments.authcheckdam.pdf) regarding the need for published guidance with respect to Sections 864(c)(8) and 1446(f), which were added by the TCJA. Section 864(c)(8)(A) provides that gain or loss of a nonresident alien individual or foreign corporation from the sale, exchange or other disposition of a directly or indirectly held partnership interest shall be treated as effectively connected to the extent that such gain or loss does not exceed the gain or loss such person would have recognized as effectively connected gain or loss had the partnership sold all of its assets at their fair market value as of the date of the transfer. Section 1446(f) provides that if any portion of the gain (if any) on a disposition of an interest in a partnership would be treated under Section 864(c)(8) as income effectively connected with the conduct of a trade or business within the U.S., the transferee of the partnership interest must withhold tax equal to 10 percent of the amount realized on the disposition.

New Jersey Releases Notice Regarding Treatment of Deemed Repatriation Dividends Under TCJA

The New Jersey Department of Revenue released a notice (http://www.state.nj.us/treasury/taxation/section965.shtml) regarding New Jersey's treatment of deemed repatriation dividends reported pursuant to Section 965 (added to the Code by the TCJA). For New Jersey corporation business tax purposes, the deemed repatriation dividends will be excluded from entire net income, as provided in the Corporation Business Tax Act (N.J.S.A. 54:10A-4(k)(5)) (Act). If a corporation does not meet the ownership thresholds, the deemed repatriation dividends will be included in entire net income to the extent provided in the Act. For New Jersey gross income tax purposes, dividends are an enumerated category of income. Thus, deemed repatriation dividends reported under Section 965 must be included in New Jersey gross income in the same tax year and in the same amount as reported for federal purposes.

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