Real Estate Roundtable

February 16, 2017

TARGETED CAPITAL ACCOUNTS - THE NEW TREND IN OPERATING AGREEMENTS | Kim Palmer

NEW PARTNERSHIP IRS AUDIT RULES | Donna Weaver

TAX UPDATE AND A LOOK AHEAD IN 2017 | Adam Hill

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SPEAKERS

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Kim's attention to detail, organizational skills and proactive approach to tax planning leaves her clients confident that opportunities are addressed when they should be — well in advance of tax season.

Kim focuses on tax issues primarily relating to the real estate industry, including commercial, industrial, self-storage and multi-family, as well as real estate funds; clients renting telecommunications equipment; and clients structured as partnerships that fall into many other industries. Kim assists clients with complex restructuring transactions, including the purchase/sale of assets and ownership interests, buyouts between owners, issuance of ownership interests and debt restructuring transactions. Other areas of expertise include like-kind exchanges, partnership transactions, exit strategies, disguised sale transactions, waterfall allocations and transactions, and UPREIT and REIT transactions.

- Cohen & Company team leader; leads the firm's Partnership Tax Group
- Summit County Habitat for Humanity (President)
- Commercial Real Estate Women (CREW) of Akron (Past President)
- Kent State University Accounting Advisory Council
- Ohio Society of CPAs
- American Institute of CPAs
- Leadership Akron (Class of 2012)
- Greater Akron Chamber 30 for the Future award

Donna Weaver, CPA, MT

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As a small business owner herself, Donna understands the angst and decision processes owners of closely held businesses go through. Donna builds instant rapport, owner-to-owner, allowing her to help clients through their challenges.

Donna's technical expertise lies in tax compliance and planning for partnerships, limited liability corporations (LLCs) and S Corporations. She conducts year-end analyses of clients' tax situations to identify opportunities to reduce tax liabilities, taking into account business and personal tax planning goals. She also focuses on 1031 exchanges, flow-through entity transactions, and state and local tax planning. Many of her clients are in the real estate, manufacturing and service industries.

- Cohen & Company team leader
- Commercial Real Estate Women (CREW) of Greater Akron (Vice President & President-Elect)
- Ohio Society of CPAs
- American Institute of CPAs

Adam Hill, CPA

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Adam approaches each engagement in a straightforward and efficient way that keeps clients informed of progress and issues as they arise. Business owners value his honest advice and perseverance to get things done.

Adam focuses on business, attest and tax issues for the real estate, construction and energy industries. Primarily working with commercial and residential developers and property management companies whose projects range from $5 million to $500 million in scope, Adam assists with daily business issues as well as tax planning and structuring; deal and financing assistance; investment analysis; forecast and projections; cash flow and common area maintenance (CAM) analysis; general business planning; conservation easements; cost certifications; and historic, new markets, and energy tax credits and incentives. Adam assists clients across the country.

- Partner-in-Charge of firm's Real Estate & Construction Group; Cohen & Company team leader
- Boys and Girls Club of Lorain County (Treasurer)
- Urban Land Institute – Cleveland (Sponsorship Chair, Treasurer)
- International Council of Shopping Centers
- Advisory board member for a national title company
- North Ridgeville Soccer League (Treasurer)
- North Ridgeville Home Owners Association (Treasurer)
- Ohio Society of CPAs
- American Institute of CPAs

1 **Targeted Capital Accounts**

the new trend in operating agreements

KIM PALMER, CPA, MT

2 **Overview**

› Becoming the new standard in operating agreements

› Historical operating agreements:

- Income/loss allocations based on the safe harbor provided under IRC Regulation 1.704-1(b)(2)
- A "cash follows tax" approach – calculation for the allocation of taxable income/loss and distributions were then made based on the balance of the partners' capital accounts

›

3 **Historical Language**

› Safe harbor for economic effect if:

- Capital accounts of partners maintained under 704(b),
- Upon liquidation of partnership, liquidating distributions made in accordance with positive capital account balances, and
- If such partner has a deficit balance in capital account following the liquidation of interest in the partnership, he/she is unconditionally obligated to restore the amount of such deficit balance or the agreement provides for a "qualified income offset"

› Does it meet requirements of IRC Section 704?

4 **Targeted Capital Account Language**

› "Tax follows cash" approach

- Distributions based on the liquidation provisions (waterfall) of the operating agreement
- Taxable income/loss allocated so that after the income/loss allocation has been made, the balance in each partner's capital account shall to the extent possible, be equal to an amount that would be distributed to the partner based on a hypothetical liquidation of the partnership and distributions are made based on the waterfall calculation

7 **Capital Account as Defined in Operating Agreement**

› IRC Section 704(b) – referred to as "book" capital accounts

› This is NOT GAAP or books and records but a tax concept

› Tax and book capital accounts may not be equal

› Fair market value concept

› Intention of targeted capital account allocations is that each partner's book capital account is reflective of the amount that partner would receive upon liquidation

›

8 **704(b) Book Capital Account and Fair Market Value Differences**

› Income/loss is not typically reflective of appreciation/depreciation of the partnership's value

› Differences between book and tax capital accounts:

- Contributions of appreciated/depreciated assets
- A book-up or book-down has occurred due to:
  - New partner was admitted to partnership

- Property (other than money) is contributed to or distributed by the partnership
- A grant of an interest (profits or capital interest)
- Issuance of a noncompensatory option

9 **Allocation of Taxable Income/Loss**

› Because of differences noted on previous slide, the allocations of both book and taxable income need to be reviewed on an annual basis and a standard formula will not work under the targeted capital allocations approach.

10 **Factors to Consider**

› Waterfall distribution calc (preferred returns to preferred members, how is capital returned and in what order, profits partner and distributions)
› Is taxable income/loss reflective of an economic appreciation/depreciation
› Historic allocations of income/loss and any true-ups
› Special allocations under IRC Section 704(c)
› Book and tax equal (is there book income but tax loss)?
›

11 **Summary**

› Modeling and projection based on factors listed
› An annual calculation factoring in all items – will not necessarily be pro rata
› When amending agreements, consider changing to this language

12 **Questions?**

Information presented is not meant to constitute legal, accounting or other professional advice. Any action taken based on information in this presentation should be taken only after a detailed review of the specific facts and circumstances. Information is current as of the date presented.

1 **New Partnership**
IRS Audit Rules

DONNA M. WEAVER, CPA, MT

2 **Background – Previous Law**

› Partnerships audited under three regimes
  • Unified Audit Rules (TEFRA)
  • Small Partnership Rules
  • Electing Large Partnership Rules

3 **Unified Audit Rules (TEFRA)**

› TEFRA partnership - has >10 partners (can have <10 partners – i.e., one partner is a partnership) and is audited under the consolidated audit procedures
› Tax treatment of partnership items is determined at the partnership level rather than the partner level
› A partner's allocation of items cannot be examined by the IRS in the process of auditing an individual partner's return, but can be examined in a partnership-level audit
› After an audit of the partnership, any assessment must be made against and collected from the partners. Partners, not the partnership, are responsible for tax liability
› Assessment made against taxpayers who were partners in the year in which the misstatement of tax liability arose - the year under audit

4 **Small Partnership Rules**

› Unified audit rules do not apply to partnerships having 10 or fewer partners
› Partners can only be
  • Individuals (other than nonresident alien)
  • C Corporations
  • Estates of deceased partner
› IRS applies the audit procedures for individual taxpayers
  • Each partner is audited separately; each partner controls their own audit
  • Partnership is audited separately, in conjunction with partner audits
› Small partnerships can elect to have the unified audit rules apply

5 **Electing Large Partnership Rules**

› Electing Large Partnership Rules (ELP)
  • Partnerships with 100 or more partners who elect to be treated as electing large partnership (ELP) for reporting and audit purposes
  • IRS uses unified audit procedures for ELP and any adjustments or assessments occur at the partnership level
  • Adjustments flow through to partners for year in which adjustment takes effect, rather than the audited year partners
  • The adjustments generally do not affect prior year returns of any partner
  • Partners cannot take an inconsistent position with the partnership regarding partnership items, have no right of notice from the IRS and have no right to participate in the audit proceedings

6 **Why New Rules?**

› Use of LLCs and partnerships has increased over the years, but IRS audits of these types of entities have not kept up with this increase

- Audits of large partnerships and tiered partnerships generally are more time consuming and complex, result in multiple audits and have difficulty identifying all partners
- The IRS did not have capacity or the resources for these types of audits
- Few large partnerships elected to be subject to the ELP rules
- IRS wanted a way to streamline partnership audits

7 **New IRS Audit Rules - Effective Dates and Definitions**

- Effective for partnership tax years beginning after 12/31/2017
- Partnership may elect early application of these rules – tax years beginning after 11/2/15 and pre 1/1/2018
- Reviewed year – year under audit (year to which the item being adjusted relates)
- Adjustment year – year audit or judicial review is completed (court decision, notice of final partnership adjustment mailed)
- Imputed underpayment (the tax due) – Net non-favorable adjustment to the partnership tax year multiplied by the applicable tax rate

8 **New IRS Audit Rules - Overview**

- All notices sent to the partnership and partnership representative (not to individual partners), including:
  - Audit notices
  - Proposed partnership adjustments
  - Final partnership adjustments
- Partnership level determination
  - Allows the IRS to assess and collect taxes, penalties and interest associated with audit adjustments at the partnership level rather than flowing adjustments through to the individual partners
  - Partners pay tax in adjustment year, not reviewed year, thus may be paying tax for a year for which they were not even a partner
  - IRS will assess partnership for "imputed underpayments," which are taxed at the highest individual or corporate rate in the code during the tax year at issue
  - Imputed underpayment treated as nondeductible expense by the partnership

9 **New IRS Audit Rules - Overview**

- Example - IRS will assess in tax year of the adjustment not the year the adjustment relates to – i.e., audit of 2018 tax year completed in tax year 2020 – tax imposed on 2020 return
  - "Reviewed year" means taxable year being audited/adjusted - 2018
  - "Adjustment year" means taxable year in which the final adjustment is determined. The tax, penalty and interest is paid in this year (tax year 2020)
  - Tax year 2020 partners liable even if not a partner in the year under audit (tax year 2018), former partners not liable if not partners in adjustment year (yr. 2020)
- Requires a partner treat each item of income, gain, loss, deduction or credit attributable to a partnership consistently with how those items are treated on the partnership return
- Any adjustment not resulting in an imputed underpayment shall be taken into account by the partnership in the adjustment year
- If partnership ceases to exist, the partnership adjustment is taken into account by the former partners
- Push out election – partners pay tax, penalties and interest

10 **Notices of Proceedings and Adjustments**

- Secretary mails to partnership and partnership representative
  - Notice of administrative proceeding initiated at the partnership level with respect to an adjustment of any items of income, gain, loss, deduction, or credit of a partnership, or any partners distributive share thereof
  - Notice of proposed partnership adjustment resulting from such proceeding
  - Notice of final partnership adjustment resulting from such proceeding
- If Secretary mails a notice of final partnership adjustment and the partnership files a petition for readjustment (see judicial review slide), the Secretary shall not mail another notice
- Secretary may, with the consent of the partnership, rescind any notice of partnership adjustment, thus will not be considered a notice of partnership adjustment and taxpayer will have no right to bring judicial proceeding

11 **Partnerships Affected**

- Impacts all partnerships regardless of size
- Includes all partnerships and entities that should be classified as partnerships (non-filing partnerships)
- Some partnerships may be able to elect out if they meet certain criteria

12 **Can a Partnership Elect Out of these Rules?**
The Opt Out Election

- Certain partnerships may opt out if
  - Have 100 partners or fewer
  - Partners must be individuals, C Corps., foreign entities (that would be treated as C Corps. if they were domestic entities), S Corps. or estates of deceased partners
    - S Corps – look through and count each shareholder (for purposes of counting partners)
      - e.g., – Partnership with 50 partners – 49 individuals and one S Corp., but S Corp. has 75 shareholders, thus partnership deemed to have greater than 100 partners, thus opt out election is not available
      - Election is not available to partnerships in which another partnership is a partner
- Each partner handles own audit, makes own decisions and pays own professional fees (not bound by decisions of partnership representative)

13 **How to Elect Out (Opt Out Election)**

- Must be done on a timely filed return - annual election
- Partnership must notify all partners that election has been made
- Must disclose to IRS name and taxpayer ID numbers of all partners, including information for each S Corp. shareholder, as each S Corp. shareholder is counted as a partner
- If elect out – tax treatment of adjustment to partnership's items of income, gain, loss, deduction or credit will be determined at the partner level
- Item to note - if IRS deems an arrangement is a partnership that should be filing a return, there is no opportunity to elect out if no partnership return was filed

14 **Elect Out Under PROPOSED Regulations**

- Election to opt out is not valid unless all of the requirements are met
- Partner count is based on number of statements (K-1s) partnership is required to furnish to its partners
- Special rule for S Corp. partners – must take into account each statement (K-1) required to be

furnished by the S Corp. to each of its shareholders

- e.g., – Partnership with 51 partners – 50 individuals and one S Corp., but S corp. has 50 shareholders, thus partnership deemed to have 101 partners (50+1+50). Due to 101 statements required to be issued opt out election is not available

› Partners who are husband and wife count as two separate partners

› Cannot make election if partnership has partners that are NOT eligible, such as partnerships, trusts, foreign entity, disregarded entity, nominee, estate of individual other than a deceased partner

15 ☐ **Elect Out Under PROPOSED Regulations**

› Election required to disclose the following to the IRS, for each person that was a partner at anytime during the tax year to which the election applies

- Partner name
- Taxpayer ID
- Federal tax classification
- Affirmative statement that the partner is eligible
- This info is required for each shareholder of a partner that is a S Corp.

› Partnership must notify each partner that the election was made within 30 days of making election

› IRS will open deficiency proceedings at the partner level

› IRS will review elections carefully to ensure that such election is not being used solely to frustrate IRS compliance efforts

16 ☐ **Consistency Under PROPOSED Regulations**

› Partner treatment of items must be consistent with the partnership treatment even if partnership elects out of these audit rules

› Partner may file notice of inconsistent treatment; if no notice filed by partner, then IRS can assess partner, not partnership, for tax and penalties (treated as a clerical error on the partner's return)

› A partner may not request abatement of an assessment for inconsistency

- However, if the partner received the inconsistent information from the partnership, there is penalty relief available for the partner

› Partnership-partner – e.g., E is a partnership-partner of T and E files a valid election to opt out of rule; E still must treat items attributable to E's interest in partnership T in a manner that is consistent with T's partnership return

17 ☐ **Partnership Representative**

› Each partnership must designate a partnership representative

› Designated partner or person must have a substantial presence in the U.S.

› Does NOT have to be a partner of the partnership

› Has "sole authority to act on behalf of the partnership" and to bind the partnership and all partners with respect to IRS audits - individual partners have no right to participate in such proceedings

› No explicit obligation to act in the best interest of the partnership

› If none designated by the partnership, IRS may designate the partnership representative

18 ☐ **Partnership Representative Under PROPOSED Regulations**

› Person who is not an individual (an entity partnership representative) may be a partnership representative only if an individual (a designated individual) who meets all criteria is appointed by the partnership as the sole individual through whom the partnership representative will act

› Designation of partnership representative must be made on a partnership return for the taxable

year to which the designation applies

› Partnership representative designation may not be changed either by resignation or revocation until
  - The partnership files an administrative adjustment request (AAR)
  - Upon receipt of a notice of administrative proceeding from IRS

19 **Partnership Representative Under PROPOSED Regulations**

› Example from the proposed regulations –
  - Partnership Representative "has sole authority to act on behalf of the partnership and bind the partnership."

›
  - Partnership designates P as partnership representative. The partnership agreement includes a clause that requires P to consult with an identified management group of the partnership before taking any action with respect to an IRS administrative proceeding. P consents to an extension of time for the IRS to mail final notice of partnership adjustment and does NOT consult with the management group before doing so. P's consent provided to the IRS is valid.

20 **General Rules – Partnership Adjustments**

› Imputed underpayment determined by
  - Netting all adjustments of items of income, gain, loss or deduction and multiplying by the highest tax rate in effect for the reviewed year (currently 39.6%)
  - Treating net increase or decrease in loss as a decrease or increase in income, respectively
  - Taking adjustments to credits as an increase or decrease in the amount determined under the netting process

› Imputed underpayments are assessed and collected at the partnership level in the adjustment year
  - If partnership ceases to exist before adjustment takes effect, the adjustment will be taken into account by the former partners of the partnership
  - If technical termination of partnership, the successor partnership will be responsible for adjustment/imputed underpayment
  - Payments are not deductible by the partnership

› Adjustment not an imputed underpayment – taken into account by the partnership in the adjustment year as a reduction in non-separately stated income or increase in non-separately stated loss or, if a credit, as a separately stated item

21 **Partnership Adjustment Under PROPOSED Regulations**

› Imputed underpayments will be determined by a grouping and netting process
  - i.e. - Items of same character are netted separately and then totaled
    - Net ord. Inc. adj. $40 + $20 net cap. Inc. adj. = $60 x highest rate
  - After netting groups/subgroups, any net non-positive adjustments are disregarded in the calculation of the imputed underpayment

› Adjustments between taxable years cannot be netted

› Imputed underpayment is calculated by multiplying the total positive netted partnership adjustment by the highest federal tax rate for the reviewed year, then increased or decreased by any adjustment to the partnership's credits

› Can be multiple imputed underpayments – only one general, but other specific

22 **Partnership Adjustment Under PROPOSED Regulations**

› Reallocation grouping - adjustment that reallocates items from one or more partners to one or more other partners

- Treated as two separate adjustments to prevent the two adjustments from netting to zero
- May result in income being taxed twice
  - e.g., Partnership has two partners A and B - $30k ordinary income and $70k depreciation are specially allocated to B. IRS audit determines $30k ordinary income and $70k depreciation should be reallocated from B to A
  - Partnership adjustment allocated to B is $40 = 70-30
  - Partnership adjustment allocated to A is $(40) = 30-70
  - Imputed underpayment determined with net positive adjustments only, net non-positive adjustment is disregarded (A and B adjustments treated separately because they are distributive share items)
  - Partnership liable for payment of adjustment (unless modification/exclusion is obtained)

23 ☐ **Modifying Imputed Adjustments – Reducing Tax Due**

› Partnership can modify imputed adjustment under procedures established by the Secretary of Treasury – proposed regulations provide guidance

› Generally partnerships must pay tax equal to the "imputed underpayment" unless Partnership can demonstrate that the adjustment would be lower if it were based on certain partner-level information from the reviewed year

› Partnership submits this info to the IRS - must be submitted no later than 270 days after the date the notice of proposed partnership adjustment is mailed – IRS can extend this time period

- IRS cannot issue a notice of final partnership adjustment until the end of the 270 day period

› e.g., – partnership has tax-exempt partner, partners taxed at lower rates (C Corps.), income items taxed at lower rates (capital gains), and/or partners already file amended return which includes their share of the adjustments, etc.

24 ☐ **Modifying Imputed Adjustments Under PROPOSED Regulations**

› Partnership representative must submit for any request for modification all relevant information

- Information to be furnished to the IRS must include a detailed description of the partnership structure, allocations, ownership, ownership changes, its partners, the partnership agreement, etc. for each taxable year relevant to the request for modification

› Types of modifications defined and examples are included in proposed regs.

- Amended return by partner for all taxable years and partner had made full payment of taxes penalties and interest
- Tax-exempt partner modification
- Modification based on tax rate that is lower than highest rate (cap. gain rate)

› Modification shall be made only upon approval by Secretary

25 ☐ **Partner Level Adjustment Alternative (Push Out Election)**

› Election must be made within 45 days after the date of the notice of final partnership adjustment – only revocable with IRS consent

› Partnership provides to each partner of the partnership for the reviewed year, and to the IRS, a statement of the partner's share of any adjustment to income, gain, loss, deduction or credit as determined in the notice of final partnership adjustment

- For the partner's tax year that includes the end of the reviewed year, the amount by which the partner's income tax would increase if the partner's share of the adjustments were taken into account for that tax year, plus
- For any of the partners' tax years after the tax year that includes the end of the reviewed year and before the tax year that includes the date the statement was furnished, the amount by which

the partners income tax would increase by reason of adjustment to tax attributes

- › Reviewed year partners are liable for their share of the tax imposed, plus penalties and interest
  - Tax and penalties are determined at the partnership level and the partners of the partnership for the reviewed year will be liable for such tax and penalties
  - Interest computed at partner level
  - Interest charged at higher rate than if partnership was liable – 2% higher (5% instead of 3%)

26 **Push Out Election – Items to Note**

- › Each partner in the reviewed year picks up his share of the audit adjustment (as determined by the partnership) by including the adjustment in his taxable income for the reviewed year and recomputing his tax for such year, and then paying the tax with his return for the taxable year in which the partnership furnished the required statement
- › Each partner is not only required to recompute income for reviewed year, but also to recompute taxable income for each tax year succeeding the reviewed year to the extent that a change in tax attributes, as a result of the audit adjustment, would increase the tax due for such succeeding year

27 **Push Out Election Under PROPOSED Regulations**

- › 45-day time period for making the election cannot be extended
- › Election must be signed by the partnership representative, contain required info
  - Name, address and TIN of partnership
  - Taxable year to which election relates
  - Copy of the notice of final partnership adjustment
  - Identify which imputed adjustment to which the election applies
  - Each reviewed year partner's name, address and TIN
  - Other info as prescribed by the IRS
- › Statements (not K-1s) must be furnished to the reviewed year partners and the IRS no later than 60 days after the date all partnership adjustments are finally determined

28 **Push Out Election Under PROPOSED Regulations**

- › Statements must include:
  - Name and TIN of reviewed year partner
  - Current address of reviewed year partner
  - Reviewed year partners share of items as originally reported for the review year
  - The reviewed year partner's share of partnership adjustments
  - Modifications with respect to reviewed year partner
  - Reviewed year partner's share of any amount attributable to adjustments to the partnerships tax attributes for any intervening year resulting from the partnership adjustments in the reviewed year
  - Reviewed year partner's share of penalties, additions to tax
  - Reviewed year partner's safe harbor interest amount, if applicable
  - Date the statement is furnished to the reviewed year partner
  - Partnership taxable year to which the adjustments relate
  - Other info required as prescribed by the IRS

29 **Alternatives to General Rule – Administrative Adjustment Alternative**

- › Partnership files an administrative adjustment request (AAR), i.e., an amended return
  - When partnership files AAR - Adjustment taken into account for the partnership tax year in which the AAR is filed (the year of filing, not the year being amended)

- Partner cannot file AAR and partnership cannot file AAR solely to change the partnership representative
- For adjustments that result in underpayments, either
  - Tax will be due at the partnership level at the time the AAR is filed, or
  - Tax will be passed through to the partners under the alternative procedures (push out election procedures)
- Adjustments not resulting in underpayments are passed through to the reviewed year partners as additional deductions in the current year

30 ☐ **Interest and Penalties**

- General Rule – penalties and interest determined at the partnership level as if the partnership had been an individual subject to income tax for the reviewed year and the imputed underpayment were an actual underpayment for the year
- Computed for both reviewed year (based on the adjustment) and adjustment year (if the partnership fails to pay the imputed underpayments)
- Interest on reviewed year adjustments is computed for period beginning on the day after the return due date for the reviewed year and ending on the earlier of the return due date for the adjustment year or the date payment is made
- Failure to pay, fraud and accuracy-related penalties will be imposed in the adjustment year, as applicable

31 ☐ **Statute of Limitations on Making Adjustments**

- No adjustment may be made the later of the date that is three years after the latest date for which the partnership return was filed
  - The return due date
  - The date on which the partnership files an administrative adjustment request
  - In no event may a partnership file a request for adjustment after a notice of administrative proceeding with respect to the taxable year is mailed
- For modification of an imputed underpayment – 270 days, plus extensions, after all information required to be submitted to the IRS under those rules has been submitted
- For a notice of proposed adjustment – 330 days after the date of the notice
- The partnership and IRS can extend the limitation period by agreement
- Fraud or no return filed – an adjustment may be made at any time
- Substantial omission from partnership gross income (25%) – six year limitation period applies

32 ☐ **Judicial Review of Partnership Adjustment**

- Partnership has 90 days, after the date on which a notice of final partnership adjustment is mailed, to file a petition for readjustment with the tax court, district court, or US Court of Federal Claims
- Partnership must deposit with the IRS the amount of the imputed underpayment in order to file a readjustment petition in district court or U.S. Court of Federal Claims

33 ☐ **Planning and Other Considerations**

- Incorporate new language into new and existing partnership agreements
- Include opt out election required or allow language for applicable partnerships
  - Require partners to provide applicable information needed for opt out election (S Corps.)
  - Partner count - keep under 100
  - Consider not admitting partnerships or other ineligible partners to the partnership

› Push out election - mandatory or optional

34 **Planning and Other Considerations**

› Mandatory capital contribution to cover professional fees related to an audit
› Distribution provisions that include the impact of a partnership level tax payment – who should bear the impact of the tax liability
› Provisions added to the partnership agreement should survive the termination of a partner's interest
› Require partners to treat tax items consistently with the partnership's tax return

35 **Planning and Other Considerations**

› Partnership Representative
- Replace "Tax Matters Partner" language with partnership representative
- Impose fiduciary duties on partnership representative to act in best interest of all partners
- Consider limiting powers or obtain approval from partners before making decisions - Major issue – partnership representative can bind all partners and the partnership
- Specify if the partnership representative must also be a partner
- Detail how the partnership representative should address the following:
  - Extension of the statute of limitations
  - Audit decisions and elections
  - Hiring of outside advisors to aid with IRS audit
- Indemnifying partnership representative

36 **Planning and Other Considerations**

› Partner items
- Exiting partners do not benefit from future favorable adjustments
- New partners liable for prior-year adjustments
- Assess former partners for future partnership adjustments
- Indemnification for new partners
- Purchase and sale issues
- Partner privacy issues – partner info going to IRS when elect to opt out of rules

37 **Questions?**

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1 **Tax Update and a Look Ahead**

1 *ADAM HILL, PARTNER*

2 **Overview**

› Tax update for 2016 taxes
- Bonus Depreciation
- Qualified Improvement Property
- Section 179 Expense
- New Due Dates
- Update on Repair Regulations
-

› Tax proposals under the new administration
- Business
- Individual

3 **PATH Act**

› On December 18, 2015 President Obama signed the Protecting Americans from Tax Hikes Act (PATH Act)
- Some extenders were made permanent while others were extended for 2-5 years
- For the first time in several years we knew the tax rules to plan without speculating!

4 **PATH Act – Bonus Depreciation**

› Extended but not made permanent
- Deduction will be phased out and eliminated by 2020
  - 2016-2017 will allow for a 50% deduction
  - 2018 will allow for a 40% deduction
  - 2019 will allow for a 30% deduction as the final year
- Introduces qualified improvement property and qualified property definitions

5 **PATH Act – Bonus Depreciation**

› Qualified Improvement Property – new category of property eligible for bonus depreciation beginning in 2016
- Expands on previous Qualified Leasehold Improvement Property
- Does not need to be placed in service pursuant to the terms of a lease
- Any improvement to an interior portion of a building that is nonresidential real property if the improvement is placed in service after the date the building was first placed in service

6 **PATH Act – Bonus Depreciation**

- Items not included under the Qualified Improvement Property criteria:
  - Enlargement of a building,
  - Any elevator or escalator, and
  - The internal structural framework of the building
- New definition to improvement property is less restrictive than the leasehold property category – property will now be eligible for bonus depreciation regardless of leasing issues

- and when the building was placed into service
- Related party rules do not apply as qualified improvement property does not consider lease terms and definitions

7 ☐ **PATH Act – Bonus Depreciation**

› Qualified Improvement Property does not qualify for Section 179 depreciation unless it meets the definition of:
- Leasehold Improvement
- Retail Improvement, or
- Restaurant Improvement

8 ☐ **PATH Act – Section 179 Expensing**

› Permanently sets limit at $500,000 and phasing out at $2,000,000 of additions

› Made permanent 179 expensing of qualified real property and removed $250,000 cap
- Pre PATH Act, limit for 179 expensing was $25,000 and started to phase out at $200,000 of additions

› Ability to revoke election on amended return made permanent

› Remember the limits are tested at the entity and the individual level and also limits to active trade or business

9 ☐ **Surface Transportation Act of 2015**

› Tax return due dates for return years beginning after 12/31/15:
- Partnerships 2 ½ months after year end (3/15 for calendar year partnerships, automatic 6 month extension)
- Corporations (except for 6/30 year ends) 3 ½ months after year end (4/15 for calendar year C corps.), automatic 6 month extension)

10 ☐ **Repair Regulations: Recap of 2014**

› Filed Form 3115s to adopt TPR:
- DCN 184/186/187 – Repairs and maintenance, unit of property
- DCN 196 – Late partial disposition
- DCN 21 – Removal costs

› Used 3115 templates, filed if had 481(a) adjustment or not

› De minimis safe harbor – annual election made for taxpayers with tangible property
- $500 for small taxpayer initially; notice 2015-82 raised to $2,500 beginning 1/1/2016
- $5,000 if applicable financial statement

11 ☐ **Repair Regulations: 2016 Opportunity**

› Notice 2017-6 extended ability to adopt TPR under certain eligibility rules for taxpayers not in compliance

› Eligible taxpayers: not in liquidation, no overall accounting method change, not under IRS audit or notice of audit, not in final year of trade or business

› If taxpayer filed to comply with TPRs under Rev. Proc. 2015-20 (small taxpayer safe harbor)
- Elected to adopt TPRs by not filing the 3115s, therefore cannot go back and file the 3115s now
- Gave up tax deductions for PYs and audit protection

(risk IRS disallowance of repair deductions that were capitalized)

12 ☐ **Repair Regulations: 2016 Opportunity**

› Eligible taxpayers can adopt and file TPRs in 2016 under certain automatic method changes

› What opportunities are available?

13 ☐ **Repair Regulations:**
Did Nothing in Past – What to Do in 2016

1. Implement TPRs – file 3115s even if zero 481(a) adjustment:
   - Automatic method changes available
     - DCN 184 – prior capitalization to expense, R&M
     - DCN 7 – Depreciation method changes/corrections
     - DNC 21 – Removal costs that were previously capitalized
     - DCN 205/206 – separately stated assets
   - Not available
     - DCN 196 –Late partial asset dispositions
     - DCN 197 – Late GAA elections
2. Employ the RABI criteria to determine if 2016 tangible property should be capitalized or expensed
   - Be sure to document process, methodology, conversations with client and analysis. IRS is looking for this in audits.
3. Check depreciation schedules for improper class lives, bonus issues, etc. (DCN #7)

14 ☐ **Repair Regulations:**
Filed Form 3115s but Made a Mistake

› A Form 3115 cannot be amended
   - If a return has been filed and prior to the extended due date we realize an adjustment was left off, a superseding Form 3115 can be submitted under administrative relief procedures 301.9100-2(b) via an amended tax return filing
   - Once the extended due date of the tax year has passed, a Form 3115 that was filed cannot be amended
     - IRS does allow *submission of additional information* related to a Form 3115 that was filed in a previous year via Rev. Proc. 2015-13 Section 6

15 ☐ **Repair Regulations:**
Filed Form 3115s but Made a Mistake

› For filing of 2016 tax returns, taxpayers will have 2 different options:
   1. Provide additional info on a prior Form 3115 (following the procedures in Rev. Proc. 2015-13 Section 6) that was filed and amend the prior year tax return, taking into account the 481(a) adjustment that was missed for that tax year

16 ☐ **Repair Regulations:**
Filed Form 3115s but Made a Mistake

› For filing of 2016 tax returns, taxpayers will have 2 different options:
   2. Forget about prior year Form 3115s that were filed and submit another Form 3115 for the 2016 tax year, taking the adjustment into account in the current tax year
      - Only permitted because eligibility rules have been waived

- Note: this normally would not be permitted as one of the eligibility rules is that the taxpayer has not made or requested a change for the same item during any of the 5 taxable years ending with the year of the change

17 **Ohio Update**

- Invest Ohio: small business credit; 10% credit for investing in qualifying small business
- Refundable job retention credit for larger employers
- Historic building credit extension
- Ohio USE tax
- Ohio Small Business deduction increased to 75% of qualifying income for 2015, 100% for 2016 and special 3% business income rate (2015)

18 **Tax Proposals Under the New Administration**

19 **Tax Proposals Under the New Administration**

20 **Tax Proposals Under the New Administration**

- House Republican Tax Reform Blueprint "A Better Way"
- Marginal Rate Reductions:
  - 20% corporate, 25% pass-through, 33% Individual
- Replace depreciation of capital assets with immediate expensing – applies to structures, but not land
- Eliminate the deductibility of interest expense
- Eliminate Section 1031 Like Kind Exchange
- Repeal all itemized deductions except mortgage interest and charitable donations
- Repeal AMT and Estate Tax

21 **Tax Proposals Under the New Administration**

- President Trump has outlined a number of tax initiatives he would like to address in first 100 days
- Goal is to:
  - Grow the economy 4% per year
  - Create 25 million new jobs
  - Through massive tax reduction and simplification
- Different from House:
  - Carried interest
  - Interest deductibility
  - Section 1031 – Like Kind Exchanges

22 **Business Tax Proposals**

- Proposed corporate tax rate:
  - Trump 15%
  - House GOP Plan 20%
- Proposed top rate for business income from pass-through entities (generally business conducted through an S corporation or a partnership)
  - Trump 15%
  - House GOP Plan 25%

› Reduced rates would be "available to all businesses, both small and large, that want to retain the profits within the business"

23 **Business Tax Proposals**

› Some sort of deduction may be made available to pass-through entities to be taxed as corporations

- (at the new lower rate of 15%)

› Will there be a second layer of tax on distributions from pass-through entities?

› Expensing of assets up front – could elect to deduct full cost of their capital investments (excluding land) in the first year; House GOP Plan does not limit the deduction to a particular industry

24 **Business Tax Proposals**

› Potential restrictions on interest deductions

› Repeal corporate AMT

› Carried interest could be taxed as ordinary income rather than capital gain

› One-time repatriation of accumulated foreign earnings at a 10% tax rate

› Section 179 increased from $500K to $1M

25 **Business Tax Proposals**

Tax Credits

› Has slowed the market down considerably

› Tax Credit Investors:

- Most are on the sidelines waiting for final rules
- Some are adding language to the OA to allow for an adjustment once the rules get finalized

› Will any of these programs stay in place?

› If not, how long of a transition period will there be?

26 **Individual Tax Proposals**

› Currently seven federal tax brackets with a top rate of 39.6%, proposal will consolidate these into three brackets with a top rate of 33% (12%, 25% and 33%)

› Repeal the AMT

› Capital gains and investment income would be taxed at a maximum rate of:

- House GOP Plan 16.5%
- Trump 20%

27 **Individual Tax Proposals**

› Medicare surcharge of 3.8% on investment income would be repealed

› The current 0.9% Medical Hospital Insurance tax would be repealed

› Limit on itemized deductions

- House GOP Plan: eliminate all except mortgage interest and charitable contributions
- Trump Plan: retain all but have overall cap of $200,000 for joint filers and $100,000 for single filers

› Substantial increase in standard deduction

- $30,000 for joint filers and $15,000 for single filers

28 **Individual Tax Proposals**

- "Above the line" deduction for child care expenses
- Estate tax would be repealed
- Gift tax would be preserved
- Capital gains on appreciated assets held at the time of death may be taxed to the extent they exceed $10 million
- 754 step-up – would it remain in place?

29 **Questions?**

Information presented is not meant to constitute legal, accounting or other professional advice. Any action taken based on information in this presentation should be taken only after a detailed review of the specific facts and circumstances. Information is current as of the date presented.