Current Federal Tax Developments

Week of December 9, 2019

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ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF DECEMBER 9, 2019

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Current Federal Tax Developments

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SECTION: 3402
IRS RELEASES FINAL VERSION OF FORM W-4 FOR 2020

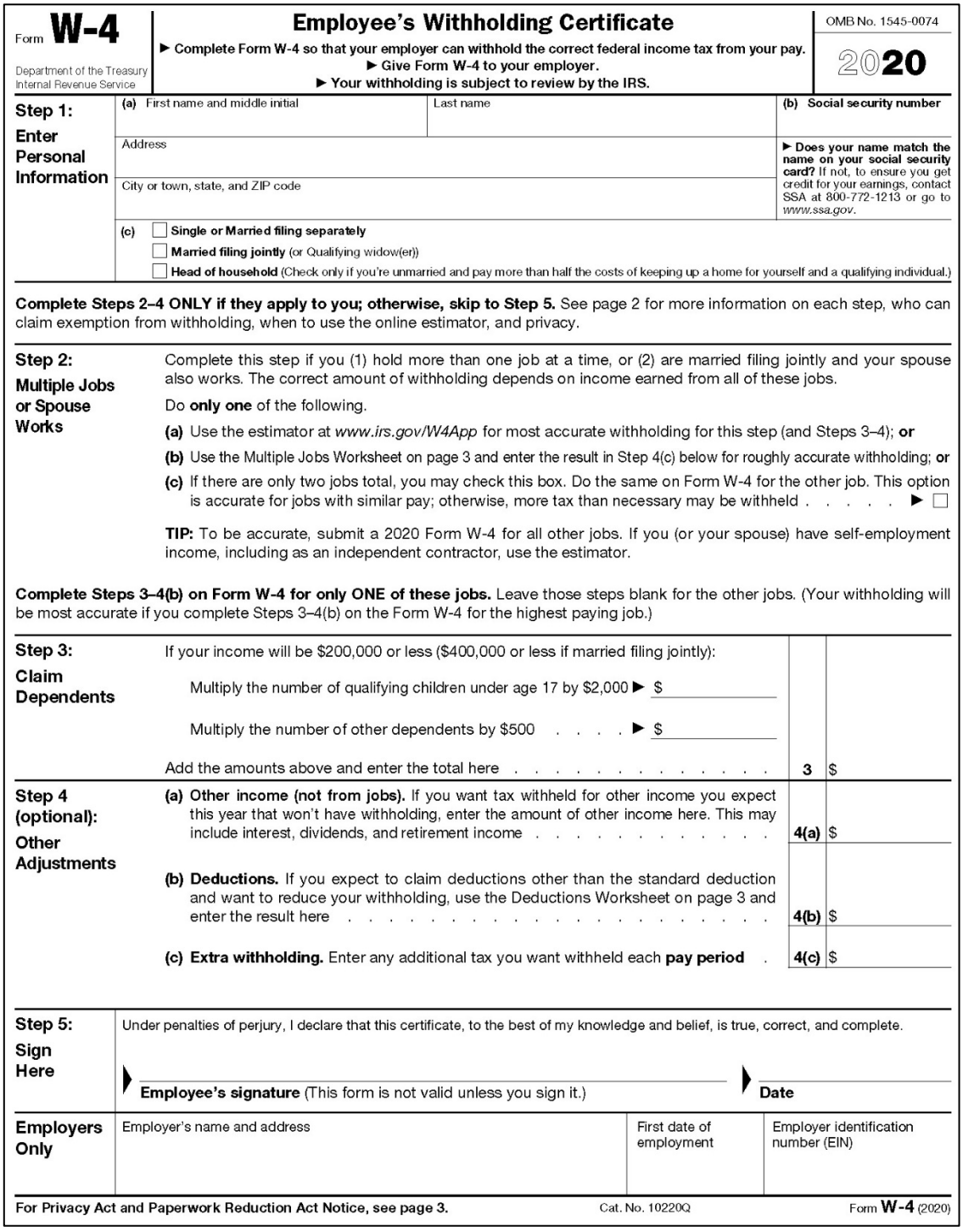
Citation: Form W-4, 12/4/19

The IRS has issued the final version of the revised Form W-4 for 2020.[1] The new Form W-4 is meant to more accurately estimate the proper amount of withholdings from an employee's paycheck following the changes made by 2017's Tax Cuts and Jobs Act.

Note that the form is significantly different from its predecessor, which will likely lead to some confusion on the part of employees regarding how they should fill out the form. The new form eliminates the concept of withholding allowances.

[1] Form W-4, December 4, 2019, https://www.irs.gov/pub/irs-pdf/fw4.pdf (retrieved December 6, 2019)

The first page of the form is reproduced below:



Form **W-4**

Department of the Treasury
Internal Revenue Service

Employee's Withholding Certificate

► **Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.**
► **Give Form W-4 to your employer.**
► **Your withholding is subject to review by the IRS.**

OMB No. 1545-0074

2020

Step 1: Enter Personal Information

(a) First name and middle initial | Last name | **(b) Social security number**

Address

City or town, state, and ZIP code

► **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

(c) ☐ **Single or Married filing separately**
☐ **Married filing jointly** (or Qualifying widow(er))
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2–4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the online estimator, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

(a) Use the estimator at *www.irs.gov/W4App* for most accurate withholding for this step (and Steps 3–4); **or**

(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . ► ☐

TIP: To be accurate, submit a 2020 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

Complete Steps 3–4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3–4(b) on the Form W-4 for the highest paying job.)

Step 3: Claim Dependents

If your income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ► $

Multiply the number of other dependents by $500 . . . . ► $

Add the amounts above and enter the total here . . . . . **3** $

Step 4 (optional): Other Adjustments

(a) Other income (not from jobs). If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income . . . . . **4(a)** $

(b) Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . . **4(b)** $

(c) Extra withholding. Enter any additional tax you want withheld each **pay period** . **4(c)** $

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

Employee's signature (This form is not valid unless you sign it.) | **Date**

Employers Only

Employer's name and address | First date of employment | Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 3. Cat. No. 10220Q Form **W-4** (2020)

The form encourages employees to skip to Step 5, which is the signature block, and have withholdings based solely on their filing status expected to be used on their tax return unless the following situations apply to the employee:

- The employee has multiple jobs or the employee's spouse works (which obviously is a fairly common situation);
- The employee has dependents (and expects income to be below the level at which the dependent credits phase out); or
- The employee:
  - Has other income that is from other than jobs;
  - Expects to itemize deductions rather than claim the standard deduction; or
  - The employee simply wants to have an additional amount withheld from his/her paycheck beyond what is calculated based on the withholding schedules/tables.

Taxpayers with multiple jobs are offered three options to deal with their withholding adjustments. The taxpayer can use the IRS's withholding estimator at https://www.irs.gov/W4App for the most accurate withholding in this situation.

Alternatively, the taxpayer can complete the Multiple Jobs Worksheet found on page 3 of Form W-4, consulting tables found on page 4 of Form W-4.

Form W-4 (2020) Page 3

Step 2(b)—Multiple Jobs Worksheet *(Keep for your records.)*

If you choose the option in Step 2(b) on Form W-4, complete this worksheet (which calculates the total extra tax for all jobs) on **only ONE** Form W-4. Withholding will be most accurate if you complete the worksheet and enter the result on the Form W-4 for the highest paying job.

Note: If more than one job has annual wages of more than $120,000 or there are more than three jobs, see Pub. 505 for additional tables; or, you can use the online withholding estimator at *www.irs.gov/W4App*.

1	**Two jobs.** If you have two jobs or you're married filing jointly and you and your spouse each have one job, find the amount from the appropriate table on page 4. Using the "Higher Paying Job" row and the "Lower Paying Job" column, find the value at the intersection of the two household salaries and enter that value on line 1. Then, **skip** to line 3	1	$
2	**Three jobs.** If you and/or your spouse have three jobs at the same time, complete lines 2a, 2b, and 2c below. Otherwise, skip to line 3.		
	a Find the amount from the appropriate table on page 4 using the annual wages from the highest paying job in the "Higher Paying Job" row and the annual wages for your next highest paying job in the "Lower Paying Job" column. Find the value at the intersection of the two household salaries and enter that value on line 2a	2a	$
	b Add the annual wages of the two highest paying jobs from line 2a together and use the total as the wages in the "Higher Paying Job" row and use the annual wages for your third job in the "Lower Paying Job" column to find the amount from the appropriate table on page 4 and enter this amount on line 2b	2b	$
	c Add the amounts from lines 2a and 2b and enter the result on line 2c	2c	$
3	Enter the number of pay periods per year for the highest paying job. For example, if that job pays weekly, enter 52; if it pays every other week, enter 26; if it pays monthly, enter 12, etc.	3	
4	**Divide** the annual amount on line 1 or line 2c by the number of pay periods on line 3. Enter this amount here and in **Step 4(c)** of Form W-4 for the highest paying job (along with any other additional amount you want withheld)	4	$

The final option to deal with multiple jobs is to check a box on Form W-4 if there are only two jobs. The IRS notes that this will only arrive at the proper result if the income from the two jobs are about the same. If that is not true, this option will result in excess withholding.

Those with dependents who expect to have income below the level at which the credits begin to phase-out simply compute the expected dependent credits for the year.

Those that expect to claim itemized deductions rather than the standard deduction use the deductions worksheet:

Step 4(b)—Deductions Worksheet *(Keep for your records.)*

1	Enter an estimate of your 2020 itemized deductions (from Schedule A (Form 1040 or 1040-SR)). Such deductions may include qualifying home mortgage interest, charitable contributions, state and local taxes (up to $10,000), and medical expenses in excess of 10% of your income	1	$
2	Enter: • $24,800 if you're married filing jointly or qualifying widow(er) • $18,650 if you're head of household • $12,400 if you're single or married filing separately	2	$
3	If line 1 is greater than line 2, subtract line 2 from line 1. If line 2 is greater than line 1, enter "-0-"	3	$
4	Enter an estimate of your student loan interest, deductible IRA contributions, and certain other adjustments (from Schedule 1 (Form 1040 or 1040-SR)). See Pub. 505 for more information	4	$
5	**Add** lines 3 and 4. Enter the result here and in **Step 4(b)** of Form W-4	5	$

While employees who are not changing jobs do not have to fill in a new Form W-4 for 2020, doing so will lead to a more accurate level of withholding. Of course, if an employee had intentionally been overwithholding in the past to obtain a large refund the following April, achieving the same result will require a different approach than simply leaving off allowances.

Without getting into whether having a large refund due is a good idea, the reality is that such a result is strongly preferred by a large portion of the population, including those using professional tax advisers.

SECTION: 6011
IRS RELEASES FINAL VERSIONS OF FORMS 1040 AND TWO OF THREE SUPPORTING SCHEDULES

Citation: Final Forms 1040, 1040-SR, Schedules 2 and Schedule 3, 11/29/19

The IRS has released the final versions of Form 1040 and Form 1040-SR just before Thanksgiving 2019, along with final versions of two of the three schedules that go along with the two forms.

Form 1040 is the first update of the Form 1040 since the postcard version debuted in 2018. This version no longer meets what Treasury had apparently used to define a postcard, as the 2019 version takes up more than half of each page. Good news for most CPAs is that the form now is mathematically complete—the adjustments now actually flow from Schedule 1 to a line on the front of the return.

Final version Form 1040 (2019)

The IRS also released the final version of the new version of Form 1040 designed for those over 65 (Form 1040-SR) who decide to use this form in lieu of the standard Form

1040. The form was mandated by Congress as part of the Bipartisan Budget Act of 2018 (not to be confused with the 2015 bill with the same name that gave us the revised partnership audit regime).

In the end, given the changes Treasury was making to the Form 1040 to get to the postcard and the return to a slightly larger form for 2019, the Form 1040-SR no longer seems to serve an obvious purpose. While it was meant to be a Form 1040-EZ for seniors, the IRS got rid of the Form 1040-EZ and generally reduced the lines on the Form 1040.

This resulted in the first Form 1040-SR, which Congress mandated be released for 2019 returns, has lines that are identical to those on the Form 1040. In fact, the form uses the same supporting schedules (Schedules 1, 2 and 3) as the standard Form 1040 and, despite some press reports to the contrary when the original draft was issued, allows the use of itemized deductions with the form.

So what purpose does it serve now? Honestly, the answer is not much—it exists because it legally has to exist by order of the United States Congress. But the only real differences are that it has slightly larger print and has a "cheat sheet" of standard deduction amounts at the bottom of the first page.

If a senior is preparing his/her own return by hand the larger print may make it easier to fill in the return and the cheat sheet is handy for quickly coming up with the proper standard deduction. However, even among seniors most returns are filed electronically where the big print provides no real advantage.

Note that the form can *only* be used by those who are 65 or over (so hopefully your bad eyesight waited until you became Medicare eligible). Most CPAs will likely only force their software to use this form for clients that might insist on it being used. Certainly, the use of this form will not simplify the preparation of a senior's return by a tax adviser.

Final version Form 1040-SR (2019)

After taking a break for Thanksgiving, the IRS on Black Friday 2019 released two of the three schedules that go along with Forms 1040 and 1040-SR.

The 2019 version of Schedule 2 has additional taxes, including the alternative minimum tax and self-employment taxes.

Final version Form 1040/1040-SR Schedule 2

The 2019 version of Schedule 3 contains additional credits and payments, such as the foreign tax credit, dependent care credit and estimated tax payments.

Final version Form 1040/1040-SR Schedule 3

The schedule that has not yet been released is Schedule 1, which contains additional income and adjustments to income. A second draft version of this form was issued by the IRS on October 10, 2019. The IRS added a question related to virtual currency transactions on the revised Schedule 1. Presumably the IRS has to take additional time for comments on the draft Schedule 1 before it can be released in final form.

SECTION: 6011
VIRTUAL CURRENCY QUESTION REMAINS ON FINAL VERSION OF 2019 SCHEDULE 1

Citation: Final Schedule 1 (Forms 1040 and 1040-SR), 12/5/19

A question regarding virtual currencies will be part of the Form 1040 package for 2019, as the IRS has now released the final version of Schedule 1 (Form 1040 and Form 1040-SR)[2] and the question added in the second draft version about virtual currencies remains on the final form.

Taxpayers who otherwise have to file Schedule 1 and those who would answer the following question "Yes" are required to provide an answer to the following question:

> At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?

Advisers will need to obtain an answer to this question from all clients in order to properly complete Schedule 1 of Form 1040. CPAs in particular are generally required to obtain information from clients to answer questions on tax filings under the provisions of *Statements on Standards for Tax Services No. 2*:

> A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.[3]

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[2] Schedule 1 (Form 1040 and Form 1040-SR), December 5, 2019, https://www.irs.gov/pub/irs-pdf/f1040s1.pdf retrieved December 7, 2019

[3] *AICPA Statement on Standards for Tax Services No. 2*, ¶2, https://www.aicpa.org/content/dam/aicpa/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices/downloadabledocuments/ssts-no.2-answers-to-questions-on-returns.pdf retrieved December 7, 2019

While the standard does provide there are some cases where it would be appropriate to omit an answer[4] the standard notes:

> A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.[5]

The standard also reminds CPAs that there may be consequences to omitting an answer that would always have to be considered even if the CPA believes the question meets the criteria to avoid providing an answer:

> A member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete or result in penalties.[6]

Conceivably the IRS could prevail in taking the position a return was never filed if it is incomplete and the IRS has had success in using the fact that the taxpayer's return did not indicate they had an FBAR filing obligation on Schedule B to prove willful failure to file an FBAR. Presumably the IRS will look to take similar positions if taxpayers are found to have unreported virtual currency transactions when the question has not been answered yes on Schedule 1.

The final version of the Schedule, like its predecessor from 2018, contains additional income items not found on the main Form 1040, as well as all adjustments to income.

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[4] *AICPA Statement on Standards for Tax Services No. 2*, ¶4

[5] *AICPA Statement on Standards for Tax Services No. 2*, ¶5

[6] *AICPA Statement on Standards for Tax Services No. 2*, ¶6

The final version of the form is reproduced below:

SCHEDULE 1 (Form 1040 or 1040-SR)
Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

► Attach to Form 1040 or 1040-SR.
► Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. 01

Name(s) shown on Form 1040 or 1040-SR | Your social security number

At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ Yes ☐ No

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions) ►		
3	Business income or (loss). Attach Schedule C	3	
4	Other gains or (losses). Attach Form 4797	4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	5	
6	Farm income or (loss). Attach Schedule F	6	
7	Unemployment compensation	7	
8	Other income. List type and amount ►	8	
9	Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a	9	

Part II Adjustments to Income

10	Educator expenses	10	
11	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	11	
12	Health savings account deduction. Attach Form 8889	12	
13	Moving expenses for members of the Armed Forces. Attach Form 3903	13	
14	Deductible part of self-employment tax. Attach Schedule SE	14	
15	Self-employed SEP, SIMPLE, and qualified plans	15	
16	Self-employed health insurance deduction	16	
17	Penalty on early withdrawal of savings	17	
18a	Alimony paid	18a	
b	Recipient's SSN ►		
c	Date of original divorce or separation agreement (see instructions) ►		
19	IRA deduction	19	
20	Student loan interest deduction	20	
21	Reserved for future use	21	
22	Add lines 10 through 21. These are your **adjustments to income.** Enter here and on Form 1040 or 1040-SR, line 8a	22	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F Schedule 1 (Form 1040 or 1040-SR) 2019

SECTION: 6055
RELIEF GRANTED FOR DATE FOR PROVIDING FORMS 1095-B AND C, AS WELL AS ADDITIONAL RELIEF FOR FORM 1095-B PROVISION DUE TO REDUCTION OF INDIVIDUAL SHARED RESPONSIBILITY PAYMENT TO ZERO

Citation: Notice 2019-63, 12/2/19

In Notice 2019-63[7] the IRS has granted an extension of time until March 2, 2020 for employers and insurers to furnish 2019 Forms 1095-B and 1095-C to employees and insured individuals.

The IRS provided the following reason for the extension of time, which is similar to the extensions granted in each of the prior four years:

> The Department of the Treasury (Treasury Department) and the Service have determined that a substantial number of employers, insurers, and other providers of minimum essential coverage need additional time beyond the January 31, 2020, due date to gather and analyze the information and prepare the 2019 Forms 1095-B and 1095-C to be furnished to individuals.[8]

Although the regulations allow for issuers to request the IRS grant an extension of time to provide these documents, this broad grant of an extension of time means such additional requests will not be processed:

> In view of this automatic extension to March 2, 2020, the provisions under §§ 1.6055-1(g)(4)(i)(B)(1) and 301.6056-1(g)(1)(ii)(A) allowing the Service to grant an extension of time of up to 30 days to furnish Forms 1095-B and 1095-C will not apply to the extended due date. Because the extension of the due date to furnish information statements to individuals granted in this notice applies automatically and is as generous as the permissive 30-day extension of time to furnish 2019 information statements under sections 6055 and 6056 that may be requested by some reporting entities in submissions to the Service, the Service will not formally respond to such requests.[9]

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[7] Notice 2019-63, December 2, 2019, https://www.irs.gov/pub/irs-drop/n-19-63.pdf retrieved December 2, 2019

[8] Notice 2019-63, p. 6

[9] Notice 2019-63, p. 6

The IRS reminds those providing these forms that this extension does not impact the time for filing these documents with the IRS:

> This notice does not extend the due date for filing with the Service the 2019 Forms 1094-B, 1095-B, 1094-C, or 1095-C. However, this notice does not affect the provisions regarding an automatic extension of time for filing information returns; the automatic extension remains available under the normal rules for employers and other coverage providers who submit a Form 8809 on or before the due date. See §§ 1.6081- 1 and 1.6081-8. This notice also does not affect the provisions regarding additional extensions of time to file[10]

The Notice also provides that the IRS is considering the impact of the reduction of the *individual* shared responsibility payment to zero on the filing of Form 1095-B. The law still requires such a form to be filed, but taxpayers do not generally need this form in order to prepare their individual returns.

The Notice provides that the penalty for failing to furnish the Form 1095-B to an insured party will be waived for 2019 if two conditions are met:

- The reporting entity posts a notice prominently on its website stating that responsible individuals may receive a copy of their 2019 Form 1095-B upon request, accompanied by an email address and a physical address to which a request may be sent, as well as a telephone number that responsible individuals can use to contact the reporting entity with any questions; and

- The reporting entity furnishes a 2019 Form 1095-B to any responsible individual upon request within 30 days of the date the request is received[11]

The IRS refers to this program as "2019 section 6055 furnishing relief."[12]

The Notice goes on to warn that this relief does not extend to Forms 1095-C issued for self-insured plans by an employer:

> As noted earlier in this notice, ALE members that offer self-insured health plans are generally required to use Form 1095-C, Part III to meet the section 6055 reporting requirements, instead of Form 1095-B. However, because of the combined reporting under sections 6056 and 6055 on the Form 1095-C for full-time employees of ALE members enrolled in self-insured health plans, the 2019 section 6055

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[10] Notice 2019-63, pp. 6-7

[11] Notice 2019-63, pp. 7-8

[12] Notice 2019-63, pp. 7-8

> furnishing relief does not extend to the requirement to furnish Forms 1095-C to full-time employees. Accordingly, for full-time employees enrolled in self-insured health plans, penalties will continue to be assessed consistent with prior enforcement policies for any failure by ALE members to furnish Form 1095-C, including Part III, according to the applicable instructions. However, the 2019 section 6055 furnishing relief does extend to penalty assessments in connection with the requirement to furnish the Form 1095-C to any employee enrolled in an ALE member's self-insured health plan who is not a full-time employee for any month of 2019, subject to the requirements of the 2019 section 6055 furnishing relief.[13]

Finally, the Notice extends the program for the IRS granting good faith relief for certain errors:

> This notice also extends relief from penalties under sections 6721 and 6722 to reporting entities that report incorrect or incomplete information on the return or statement when these entities can show that they made good-faith efforts to comply with the information-reporting requirements under sections 6055 and 6056 for 2019 (both for furnishing to individuals and for filing with the Service). This relief applies to missing and inaccurate taxpayer identification numbers and dates of birth, as well as other information required on the return or statement. Reporting entities must make a good-faith effort to comply with the regulations under sections 6055 and 6056 to be eligible for this relief. In determining good faith, the Service will take into account whether an employer or other coverage provider made reasonable efforts to prepare for reporting the required information to the Service and furnishing it to employees and covered individuals, such as gathering and transmitting the necessary data to an agent to prepare the data for submission to the Service or testing its ability to transmit information to the Service. Reporting entities that fail to file an information return or furnish a statement by the extended due dates, except as otherwise provided in this notice, are not eligible for relief.[14]

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[13] Notice 2019-63, pp. 8-9

[14] Notice 2019-63, pp. 9-10

SECTION: 6221
DETAILED GUIDANCE ISSUED FOR BBA REGIME EXAMS PENDING REVISION OF INTERNAL REVENUE MANUAL

Citation: LB&I-04-1019-010, 10/31/19

The IRS Large Business and International Division and Small Business/Self-Employed Division issued an Internal Guidance Memorandum to IRS personnel regarding interim field examination procedures under the partnership audit rules that were enacted as part of the Bipartisan Budget Act of 2015 (the BBA rules).[15]

The memorandum, the PDF of which is 66 pages long, contains provisions that are to be used until the Internal Revenue Manual is formally updated for the program. The memorandum contains the following sections:

- Delinquent Return and Substitute for Return (SFR)
- Compliance Assurance Process (CAP)
- Partnerships in Bankruptcy and Cease to Exist
- BBA Scope — Adjustments at the Partnership Level
- Planning the Examination
- Executing the Examination
- Resolving the Examination
- Report Writing
- Case Disposition Procedures

While the document outlines procedures agents are to use in exams, it does contain some interesting reminders about the BBA regime and some of the IRS's views of how the law operates.

[15] LB&I-04-1019-010, October 31, 2019, released to public November 28, 2019, https://www.irs.gov/pub/foia/ig/spder/lbi-04-1019-010.pdf

Overview Section

The memorandum, in the Overview Section, reminds IRS employees that the partnership representative is the sole party authorized to act on behalf of the partnership:

> A partnership must designate a partnership representative. The partnership representative has sole authority to act on behalf of the partnership. Partners are bound by the decisions made by the partnership representative. *Direct and indirect partners have no participation rights during the examination.* (emphasis added)[16]

The overview also indicates how the IRS will approach partnership level math errors:

> The BBA regime also provides that if an adjustment is identified on account of a mathematical or clerical error appearing on the partnership return, the IRS may make an adjustment to correct the error and may assess the partnership an imputed underpayment resulting from that adjustment. The notice to the partnership of the adjustment on the basis of correcting the error is not considered a notice of final partnership adjustment under section 6231(a)(3). [17]

For large taxpayers involved in the Compliance Assurance Process[18] the memo notes that since the process takes place *before* a return is filed, the CAP process is not subject to the BBA regime rules.[19]

Bankrupt Partnerships and Partnerships No Longer in Existence

If a partnership is currently involved in a Title 11 bankruptcy case the IRS cannot make the adjustment assessment or make collections during the case. But the IRS can take the following actions while the case is before the Bankruptcy Court:

- A BBA examination,
- The mailing of any notice with respect to a BBA examination,

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[16] LB&I-04-1019-010, p. 7

[17] LB&I-04-1019-010, p. 7

[18] https://www.irs.gov/businesses/corporations/compliance-assurance-process-cap-frequently-asked-questions-faqs

[19] LB&I-04-1019-010, p. 8

- The issuance of a Notice of Administrative Proceeding (NAP), Notice of Partnership Proposed Adjustment Package (NOPPA), and Notice of Final Partnership Adjustment (FPA),
- A demand for tax returns,
- The assessment of any tax and imputed underpayment, or
- The issuance of notice and demand for payment.[20]

The final regulations indicated that if a partnership no longer exists, the IRS would look to the partners to pay any assessment. The memo indicates the IRS will deem the partnership to cease to exist in the following cases:

> A partnership ceases to exist if the IRS makes a determination that such partnership (including partnership-partner):
>
> A. Terminates within the meaning of § 708(b)(1), or
>
> B. Does not have the ability to pay, in full, any amount due (not collectible).[21]

Partnership Related Items (PRIs) and Partner Only Items

The memo notes that the BBA regime applies to any partnership-related item (PRI), and not to items shown on another party's return that results after the application of the IRC to a PRI based on a specific taxpayer's facts and circumstances.[22] Of course, figuring out the dividing line between those "in the partnership" and "outside the partnership" items was a troubling issue in the prior TEFRA regime, and it is reasonable to expect the same will be true in the BBA regime.

The memo does provide a list of items the IRS deems to be examples of PRIs:

- The character, timing, source, and amount of the partnership's income, gain, loss, deductions, and credits;
- The character, timing, and source of the partnership's activities;
- The character, timing, source, value, and amount of any contributions to, and distributions from, the partnership;

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[20] LB&I-04-1019-010, p. 8

[21] LB&I-04-1019-010, p. 9

[22] LB&I-04-1019-010, p. 9

- The partnership's basis in its assets, the character and type of the assets, and the value (or revaluation) of the assets;
- The amount and character of partnership liabilities and any changes to those liabilities from the preceding tax year;
- The category, timing, and amount of the partnership's creditable expenditures;
- Any item or amount resulting from a partnership termination;
- Any item or amount relating to an election under section 754; and
- Partnership allocations and any special allocations.[23]

As well, the IRS provides a shorter list of items it deems not PRIs:

- A deduction shown on the return of a partner that results after applying (correctly or incorrectly) a limitation under the Code (such as section 170(b)) at the partner level to a partnership-related item based on the partner's facts and circumstances, and
- A partner's adjusted basis in his/her partnership interest (outside basis).[24]

The memo also notes that components of a partner's basis may be PRI.[25]

The BBA regime only applies to taxes imposed under Chapter 1 of Subtitle A of the IRC—that is, Income Taxes. The memo notes that specifically this means the BBA exam does not cover the following partnership related taxes:

- Chapter 2 (Tax on Self-Employment Income — "SECA")
- Chapter 2A (Unearned Income Medicare Contribution — "NIIT")
- Chapter 3 (Withholding of Tax on Nonresident Aliens and Foreign Corporations)
- Chapter 4 (Taxes to Enforce Reporting on Certain Foreign Accounts)[26]

The memo notes that a special quirk applies to Chapter 2 (Self-Employment) and Chapter 2A (Net Investment Income Tax) with regard to the statute of limitations on assessments. IRC §6501(c)(12) provides the following special rule that extends the

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[23] LB&I-04-1019-010, pp. 9-10

[24] LB&I-04-1019-010, p. 10

[25] LB&I-04-1019-010, p. 10

[26] LB&I-04-1019-010, p. 10

statute in certain cases for these taxes that are impacted by partnership level adjustments:

> **(12) Certain taxes attributable to partnership adjustments**
>
> In the case of any partnership adjustment determined under subchapter C of chapter 63, the period for assessment of any tax imposed under chapter 2 or 2A which is attributable to such adjustment shall not expire before the date that is 1 year after—
>
> (A) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under section 6234, such decision becomes final, or
>
> (B) in any other case, 90 days after the date on which the notice of the final partnership adjustment is mailed under section 6231.[27]

The IRS warns its employees that this rule may not apply if the partnership did not report any self-employment income or income subject to net investment income tax on the original return:

> If a partnership improperly classifies income, or does not classify income at all, as subject to SECA or NIIT on its originally filed return, there is a risk that section 6501(c)(12) will not apply to the assessment of any tax imposed under chapter 2 or 2A which is attributable to partnership adjustments determined under the BBA regime. In this case, you must protect partners' section 6501(a) statutes to assess SECA or NIIT related to both their originally reported distributive share and/or to their distributive share of adjustments to PRIs you make at the BBA partnership level. Example — your sole adjustment is to increase net earnings from self-employment on line 14 of Schedule K-1 from zero to equal to ordinary income on line 1 of Schedule K-1.[28]

The memo goes on to provide details of how the agent is to handle the complexities of this situation,[29] concluding with a series of examples of both partner-level audits and partnership-level audits on these issues.

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[27] IRC §6501(c)(12)

[28] LB&I-04-1019-010, p. 11

[29] LB&I-04-1019-010, pp. 11-14

EXAMPLE 1 - PARTNER-LEVEL AUDIT[30]

An examiner is auditing the Form 1040 of an individual taxpayer. Taxpayer is a partner in a partnership that is subject to the BBA regime. The partnership issued a Schedule K-1 to the partner reporting $100,000 of ordinary income on line 1 and $100,000 of income subject to SECA on line 14 of Schedule K. The partner did not report the income as subject to SECA. The examiner determines, as part of the individual's audit, a chapter 2 deficiency of $3,800 ($100,000 X 3.8% maximum Medicare rate). BBA doesn't apply to taxes under chapter 2 and the inconsistent reporting rules under section 6222 can't be used to assess non-chapter 1 taxes. The examiner is not required to open an audit of the BBA partnership because there's no adjustments to PRI.

EXAMPLE 2 - PARTNER-LEVEL AUDIT[31]

An examiner is auditing the Form 1040 of an individual taxpayer. That taxpayer is a partner in a partnership that is subject to the BBA. The partnership issued a Schedule K-1 to the partner reporting $100,000 of section 1231 gain on line 10 of schedule K from the sale of assets used in one of its trade or business activities. The partner did not report the income as subject to NIIT. The examiner determines, as part of the individual's audit, that the partner was a passive investor in the BBA partnership and its activities. As such the examiner determines a chapter 2A deficiency of $3,800. This adjustment and assessment is made in a proceeding outside of the BBA regime; the examiner is not required to open an audit of the partnership under the BBA regime because the partner's failure to include this income as NIIT is exclusively a partner level issue.

EXAMPLE 3 - PARTNER-LEVEL AUDIT[32]

An examiner is auditing the Form 1040 of an individual taxpayer. That taxpayer is a partner in a partnership that is subject to the BBA. The partnership issued a Schedule K-1 to the partner reporting $100,000 of ordinary income on line 1 and $0 of income subject to SECA on line 14 of Schedule K. The partner did not report the income as subject to SECA. Examiner reviews the partnership's other partners and notes that all its partners took similar positions with respect to SECA that they, as partners, were not subject to SECA. The examiner may open the partnership for examination and follow dual procedures. Primarily the examiner will make a $100,000 PRI adjustment to line 14 of Schedule K-1 and compute an IU[33] of $37,000. The examiner is required to utilize BBA PCS linking procedures to have the CPF issue substantially similar SNDs for SECA tax to all the partnerships' partners and protect the partners' 6501(a) statutes; these SNDs will state that the partner is subject to SECA on their distributive share of income from the BBA partnership because (state reason; i.e., The IRS has determined that your interest in the BBA partnership is not a limited partnership interest for purposes of

[30] LB&I-04-1019-010, p. 14

[31] LB&I-04-1019-010, p. 14

[32] LB&I-04-1019-010, pp. 14-15

[33] Imputed underpayment

Chapter 2 SECA) and this $3,800 ($100,000 X 3.8% maximum Medicare rate) assessment of SECA will be made at the partner level.

EXAMPLE 1 - PARTNERSHIP-LEVEL AUDIT[34]

An examiner is auditing the Form 1065 of a partnership subject to the BBA. The partnership has 10 equal individual partners. The partnership reported $1,000,000 of ordinary income on schedule K, line 1 and reported that $0 of that income as subject to SECA on schedule K, line 14. The examiner determines that the partnership should have reported the entire $1,000,000 on line 14 of Schedule K as subject to SECA. There is no other adjustments to a PRI. Under dual procedures, primarily, this PRI adjustment will result in an IU. Secondarily, the $1,000,000 adjustment to line 14 must be taken into account for purposes of determining the partners' SECA tax obligations. The IRS may adjust and assess each partners' SECA tax liabilities on their individual returns. Since each partner is an equal partner, each partners' income subject to SECA will be increased by $100,000 or 10% of the increase to line 14 of Schedule K-1. The IRS will issue a SND stating that the partner is subject to SECA on their distributive share of income from the BBA partnership and assess $3,800 ($100,000 X 3.8% maximum Medicare rate) to each partner for their SECA tax related to an adjustment made to the BBA partnership. The examiner must follow the BBA linkage procedures and protect the partners' section 6501(a) statutes.

The memo also discusses the interaction with Chapter 3 and 4 withholding taxes and procedures to deal with such taxes which generally are outside of the BBA regime.[35] As with the SEC and NII issues, the memo contains examples of such situations arising in a Chapter 3 or 4 audit.

EXAMPLE A – CHAPTER 3 OR 4 AUDITS[36]

An examiner is auditing Form 1042 filed by a partnership subject to the BBA regime. The partnership has 2 equal partners, one is a US citizen and one is a non-resident alien who is a resident of another country. The partnership earned $200 of US source royalty income and reported $100 on each partner's Schedule K-1. The partnership withheld $15 from the foreign partner. The examiner proposes a rate adjustment and determines that the partnership should have withheld $30 from the foreign partner. As such the examiner determines a chapter 3 deficiency of $15. This adjustment and assessment is made in a proceeding outside of the BBA because the tax imposed on the partnership for its failure to withhold on that income, however, is not a tax imposed by chapter 1. Rather, it is a tax imposed by chapter 3, which is not covered by the BBA. Even though the examiner is auditing the

[34] LB&I-04-1019-010, p. 15

[35] LB&I-04-1019-010, pp. 15-16

[36] LB&I-04-1019-010, p. 16

partnership's Form 1042, the examiner is not required to open an audit of the BBA partnership's Form 1065.

EXAMPLE B – CHAPTER 3 OR 4 AUDITS[37]

An examiner is auditing Form 1065 filed by a partnership subject to the BBA. The partnership has 2 equal partners, one is a US citizen and one is a nonresident alien who is a resident of another country. The partnership earned $200,000 of US source royalty income and reported $100,000 on each partner's Schedule K-1. The examiner notes that the partnership properly withheld $30,000 from the foreign partner. The examiner determines, as part of the Form 1065 audit, that the partnership should have reported $400,000 of US source royalty income and proposes a base adjustment. The imputed underpayment is $74,000, calculated as the $200,000 adjustment to royalty income subject to chapter 1 income tax times the maximum individual rate of 37%. The examiner notes that the partnership should have withheld an additional $30,000 from the foreign partner. In this instance, the $37,000 imputed underpayment attributable to the foreign partner's $100,000 allocable share of the adjustment satisfies the partnership's requirement to withhold chapter 3 tax; if the partnership elects to push out the partnership adjustment, the partnership must remit $30,000 of chapter 3 withholding on behalf of the foreign partner's $100,000 allocable share of the adjustment.

EXAMPLE C – CHAPTER 3 OR 4 AUDITS[38]

Similar facts in example B except that the examiner is auditing Form 1042 (instead of Form 1065) and discovers the under-reported royalty. The examiner may determine, assess, and collect chapter 3 tax attributable to an adjustment to a partnership-related item (increase the partnership's royalty income) without conducting a BBA examination. The examiner's assessment will be limited to $30,000 (not the $74,000 imputed underpayment), the chapter 3 withholding attributable to the foreign partner. This adjustment and assessment is made in a proceeding outside of the BBA because the tax imposed on the partnership for its failure to withhold on that income, however, is not a tax imposed by chapter 1. Rather, it is a tax imposed by chapter 3, which is not covered by the BBA. Even though the examiner is auditing the partnership's Form 1042, the examiner is not required to open an audit of the BBA partnership's Form 1065.

Electing Out of the BBA Regime

The memo has provisions that examining agents will use when facing a partnership that made an election out of the BBA regime for one or more years under exam. First, the memorandum directs the agent to see if a timely election was made. The memo notes the following:

> A. Non-filers can't elect out because there was no return filed. The election can't be made on a substitute for return (SFR). The SFR will be subject to the centralized partnership audit regime.

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[37] LB&I-04-1019-010, pp. 16-17

[38] LB&I-04-1019-010, p. 17

> B. Similarly, a constructive or de facto partnership would be subject to the centralized partnership audit regime because it would not have made a timely election.[39]

Assuming the election was timely, the memo next goes on to direct the examining agent to determine if the partnership was eligible to make the election. The memo provides:

> 1. There are two criteria that a partnership must meet to be eligible to elect out of the BBA:
>
> > A. The partnership may only have partners each of whom is an individual, a C corporation, an estate of a deceased partner, or an S Corporation, and
> >
> > B. The partnership is required to furnish 100 or fewer Schedule K-1s.
>
> 2. If either one of these requirements is not met, the partnership is not eligible to elect out and is automatically subject to the BBA regime.[40]

An interesting provision is found in the discussion of S corporation shareholders, with the memo noting:

> S Corporations may have shareholders (such as QSSTs and/or ESBTs) that would otherwise be ineligible if they were direct partners. The type of shareholders doesn't factor into the determination of eligible partners.
>
> **Note:** Partnerships that have Q-Sub(s) as a partner are not permitted to elect out.[41]

A similar analysis is provided by the memo with regard to beneficiaries of a decedent's estate:

> An estate of a deceased partner filing Form 1041 may issue Schedule K-1s to its beneficiaries. Similar to S Corporations, an estate may have beneficiaries that would otherwise be ineligible if they were direct

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[39] LB&I-04-1019-010, p. 20

[40] LB&I-04-1019-010, p. 20

[41] LB&I-04-1019-010, p. 21

> partners. The type of beneficiaries doesn't factor into the determination of eligible partners.[42]

The memo reminds agents that having the following types of entities as a partner during the year under examination would automatically render the election invalid:

- A partnership or limited liability company
- Any type of trust, even a grantor trust
- A foreign entity that would not be treated as a C Corporation if it were a domestic entity
- A disregarded entity for federal tax purposes
- An estate of an individual other than a deceased partner or
- A nominee.[43]

As well, the memo notes that "[i]f any of the partners are LLC whose type of entity is reported as a corporation, IDRS must be researched to verify the filing status of the LLC as a corporation and not a pass-through entity."[44]

The memo also notes the 100 K-1 limitation and some quirks there. First, the memo makes clear the limit is based on the number of K-1s *required* to be issued for a year, not the number actually issued. So a partnership that failed to issue one or more K-1s would have to add those required but not issued K-1s to the number actually filed to determine the 100 K-1 limit.[45]

For an S corporation partner, the 100 K-1 count includes *both* the K-1 issued to the corporation and each K-1 issued by the S corporation to its shareholders:

> Because S corporations are allowable partners and issue Schedule K-1s to their shareholders, in the determination of whether the partnership has furnished 100 or fewer Schedule K-1s, the Schedule K-1 furnished to the S corporation partner counts as one Schedule K-1 while all of

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[42] LB&I-04-1019-010, p. 21

[43] LB&I-04-1019-010, p. 21

[44] LB&I-04-1019-010, p. 21

[45] LB&I-04-1019-010, p. 22

> the Schedule K-1s required to be furnished to the shareholders of the S corporation partner count as additional Schedule K-1s.[46]

The memo provides the following example of counting K-1s for an S corporation partner.

EXAMPLE – S CORPORATION K-1S

For example, the partnership PS has two partners, S1 and S2, each of which is an S corporation. S1 has 20 shareholders and S2 has 35 shareholders. Solely for purposes of determining eligibility to elect out, partnership PS is deemed to be required to furnish 57 Schedule K-1s, consisting of S1 and S1's 20 shareholders (21 total) and S2 and S2's shareholders (36) for a total count of 57

But the same rule does *not* apply to eligible estates:

> With regard to a partner that is an estate of a deceased partner, the estate may file Form 1041 and furnish Schedule K-1s to its beneficiaries. For purposes of determining the number of Schedule K-1s required to be furnished by the partnership, any Schedule K-1s furnish by the estate are NOT taken into account for purposes of determining whether the partnership has furnished 100 or fewer K-1 statements.[47]

Multiple Revocations of the Partnership Representative

The memo discusses how the IRS should respond to multiple revocations of a partnership representative (PR) within a 90 day period. Under the final BBA regime regulations, the IRS may, but is not required to, treat such a multiple revocation as having the effect of the partnership having no PR designation in place. In such a case, the IRS has the authority to appoint a PR for the partnership.

The memo provides the agent with the following guidance in this situation:

> 1. The IRS's goal is to conduct effective and efficient examinations. Multiple revocations within a relatively short timeframe can have a negative impact on achieving this goal.
>
> > A. If you receive two revocations within a 90-day period, you may (but are not required to) determine that the second

[46] LB&I-04-1019-010, p. 22

[47] LB&I-04-1019-010, p. 22

revocation (the "current" revocation) results in no PR designation in effect.

i. Do not send out Letter 6053 responding to the current revocation if you contemplate determining that no PR designation in effect.

B. If you and your manager understand the reasons for multiple revocations within the 90-day period based on facts and circumstances, you may accept the current revocation (if valid) and confirm the latest PR of record. You will send Letters 6053, 6007 and 6008.

2. If you do determine there's no PR designation in effect, you must provide notice within 90 days of receiving the current revocation to indicate that there is no designation in effect. Otherwise, you can't later determine that no designation is in effect because of these multiple revocations. You will send Letters 6053 and 6007 only.

A. Although there is no set time to designate a new PR after you've declared there's no designation in effect, you must select a new PR with reasonable due diligence while balancing the need to continue the examination in an efficient and effective manner. For factors to consider when designating a PR, see below, "Service's Selection of a PR".

3. Once you have selected a PR, the partnership cannot revoke the PR without the permission of the IRS. Permission is granted if the partnership submits a Form 8979 and the IRS accepts the submittal as valid.[48]

Powers of Attorney

The memo notes that a partnership *cannot* use a Form 2848 to appoint a partnership representative. However, the form can be used to appoint a party to represent the partnership representative who is acting on behalf of the partnership.

The memo provides the following information related to the use of powers of attorney in BBA regime cases:

1. Form 2848, Power of Attorney and Declaration of Representative, is used to authorize an individual to represent a PR who is acting on

[48] LB&I-04-1019-010, p. 27

behalf of the partnership under the centralized partnership audit regime. Refer to IRM 4.11.55 for POA rights and responsibilities.

A. A power of attorney (including a Form 2848, Power of Attorney) may not be used to designate a partnership representative.

2. The PR or DI (for an EPR) of record must sign the Form 2848 and the authorized individual must be eligible to practice before the IRS.

3. You must contact the BBA POC if you receive a Form 2848 because instructions for Form 2848 may change.

4. For matters unrelated to the centralized partnership audit regime, a separate Form 2848 must be signed by a partner that has authority to do so under state law. For dissolved partnerships, see 26 CFR 601.503(c)(6).

Note: Any statute extension (Form 872-M) should be signed by the PR or DI (for an EPR).[49]

Grouping of Adjustments

The memorandum contains a detailed discussion of the grouping of adjustments at the partnership level and how they will be taken into account.[50] What may be even more useful to practitioners are a pair of examples of how the grouping options work. They are relatively simple and, in real life, things will get much more complicated. But they can help advisers understand the existence of separate groups and how that will impact the exam.

EXAMPLE 1 - GROUPINGS[51]

The AB Partnership's 2019 return is under examination. Form 1065, page 1 consists of gross receipts of $1,000 and COGS of $250 for a net ordinary business income of $750 from a single activity. The $750 of net ordinary business income was included on Schedule K, line 1. The revenue agent proposes to increase gross receipts by $100 and increase COGS by $30. The $100 increase in gross receipts represents a positive adjustment while the increase in COGS represents a negative adjustment. Both of these adjustments are placed in the residual grouping since neither is properly classified as a reallocation, credit or creditable expenditure grouping. Since one of the adjustments is negative, subgrouping is required. The agent verified that AB Partnership netted the gross receipts and COGS as a single partnership-related item on Schedule K, line 1, and therefore, the negative adjustment for COGS will be

[49] LB&I-04-1019-010, pp. 38-39

[50] LB&I-04-1019-010, pp. 50-59

[51] LB&I-04-1019-010, pp. 58-59

subgrouped with the positive gross receipts adjustment. After netting these adjustments, the result is a net positive adjustment of $70 in the Schedule K, line 1 subgroup as well as a net positive adjustment in the residual grouping. The $70 will be included in the total netted partnership adjustment for purposes of computing the imputed underpayment.

EXAMPLE 2 - GROUPINGS[52]

The facts are the same as example 1 above, except the partnership's operations included two distinct activities ("Activity A" and "Activity B"). The net income from each activity were separately stated on a statement attached to Form 1065. The audit adjustment to gross receipts of $100 (increase) was identified as being related to Activity "A" while the adjustment to COGS of $30 (increase) was identified as being related to Activity "B." Again, both the positive adjustment to gross receipts of $100 and the negative adjustment of $30 to COGS are placed in the residual grouping. Since the separate net income from each activity are required to be separately stated on line 1 of Schedules K/K-1 (via an attached schedule), those amounts were not treated as a single partnership-related item for purposes of section 702(a) and were not allocated as a single item on the filed tax return as was proper. Therefore, each adjustment must be placed into a separate subgroup within the residual grouping. The two subgroups (within the residual grouping) could be identified as "Schedule K, line 1, Activity A" and "Schedule K, line 1, Activity B" or similar. Under the netting rules, netting adjustments across subgroups is not permitted and the positive $100 adjustment and the negative $30 adjustment may not be netted. Thus, the residual grouping contains a net positive adjustment of $100 (netting rules only allow positive adjustments to be added together in each grouping to arrive at a net positive adjustment). This amount will be included in the total net partnership adjustment for purposes of computing the imputed underpayment. The net negative adjustment of $30 is an adjustment that does not result in an imputed underpayment and must be included on the partnership's tax return for the year in which such adjustment becomes final.

We have summarized only a few key items discussed in this document. Until the document is replaced by the updates made to the Internal Revenue Manual, advisers working with BBA regime issues will find the memo useful to help understand what would occur in a BBA exam or to deal with one should an examination notice arrive in the mail.

[52] LB&I-04-1019-010, p. 59