Tax Alerts

August 2017

Centralized Partnership Audit Rules Finally Released

The much-anticipated regulations (REG-136118-15) implementing the new centralized partnership audit regime under the Bipartisan Budget Act of 2015 (BBA) have finally been released. The BBA regime replaces the current TEFRA (Tax Equity and Fiscal Responsibility Act of 1982) procedures beginning for 2018 tax year audits, with an earlier "opt-in" for electing partnerships. Originally issued on January 19, 2017 but delayed by a January 20, 2017 White House regulatory freeze, these re-proposed regulations carry with them much of the same criticism leveled against them back in January, as well as several modifications. Most importantly, their reach will impact virtually all partnerships.

Scope

Under the proposed regulations, to which Congress left many details to be filled in, the new audit regime covers any adjustment to items of income, gain, loss, deduction, or credit of a partnership and any partner's distributive share of those adjusted items. Further, any income tax resulting from an adjustment to items under the centralized partnership audit regime is assessed and collected at the partnership level. The applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to any such item or share is also determined at the partnership level.

Immediate Impact

Although perhaps streamlined and eventually destined to simplify partnership audits for the IRS, the new centralized audit regime may prove more complicated in several respects for many partnerships. Of immediate concern for most partnerships, whether benefiting or not, is how to reflect this new centralized audit regime within partnership agreements, especially when some of the procedural issues within the new regime are yet to be ironed out.

Issues for many partnerships that have either been generated or heightened by the new regulations include:

- selecting a method of satisfying an imputed underpayment;
- designating a partnership representative;
- allocating economic responsibility for an imputed underpayment among partners, including situations in which partners' interests change between a reviewed year and the adjustment year; and
- indemnifications between partnerships and partnership representatives, as well as among current partners and those who were partners during the tax year under audit.

Election out

Starting for tax year 2018, virtually all partnerships will be subject to the new partnership audit regime unless an “election out” option is affirmatively elected. Only an eligible partnership may elect out of the centralized partnership audit regime. A partnership is an eligible partnership if it has 100 or fewer partners during the year, and, if at all times during the tax year, all partners are eligible partners. A special rule applies to partnerships that have S corporation partners.

Consistent returns

A partner’s treatment of each item of income, gain, loss, deduction, or credit attributable to a partnership must be consistent with the treatment of those items on the partnership return, including treatment with respect to the amount, timing, and characterization of those items. Under the new rules, the IRS may assess and collect any underpayment of tax that results from adjusting a partner’s inconsistently reported item to conform that item with the treatment on the partnership return as if the resulting underpayment of tax were on account of a mathematical or clerical error appearing on the partner’s return. A partner may not request an abatement of that assessment.

Partnership representative

The new regulations require a partnership to designate a partnership representative, as well as provide rules describing the eligibility requirements for a partnership representative, the designation of the partnership representative, and the representative’s authority. Actions by the partnership representative bind all the partners as far as the IRS is concerned. Indemnification agreements among partners may ameliorate some, but not all, of the liability triggered by this rule.

Imputed underpayment, alternatives and "push-outs"

Generally, if a partnership adjustment results in an imputed underpayment, the partnership must pay the imputed underpayment in the adjustment year. The partnership may request modification with respect to an imputed underpayment only under the procedures described in the new rules. In multi-tiered partnership arrangements, the new rules provide that a partnership may elect to "push out" adjustments to its reviewed year partners. If a partnership makes a valid election, the partnership is no longer liable for the imputed underpayment. Rather, the reviewed year partners of the partnership are liable for tax, penalties, additions to tax, and additional amounts plus interest, after taking into account their share of the partnership adjustments determined in the final partnership adjustment (FPA). The new regulations provide rules for making the election, the requirements for partners to file statements with the IRS and furnish statements to reviewed year partners, and the computation of tax resulting from taking adjustments into account.

Retiring, disappearing partners

Partnership agreements that reflect the new partnership audit regime must especially consider the problems that may be created by partners that have withdrawn, and partnerships that have since dissolved, between the tax year being audited and the year in which a deficiency involving that tax year is to be resolved. Collection of prior-year taxes due from a former partner, especially as time lapses, becomes more difficult as a practical matter unless specific remedies are set forth in the partnership agreement. The partnership agreement might specify that if any partners withdraw and dispose of their interests, they must keep the partnership advised of their contact information until released by the partnership in writing.

For more information about this article, please contact our tax professionals at taxalerts@windes.com or toll free at **844.4WINDES** (844.494.6337).

Cybercriminals Compromise the Student Aid Application Process

Every year, millions of post-secondary students access the IRS Data Retrieval Tool (DRT) to complete the Free Application for Federal Student Aid (FAFSA). This year, the DRT is unavailable for FAFSA filers because of cybersecurity concerns. The information needed to complete the FAFSA can be found on a previously filed federal income tax return.

FAFSA

To apply for federal student aid, an individual must complete and submit the FAFSA. He or she will automatically be considered for federal student aid. In addition, the individual's post-secondary institution may use his or her FAFSA information to determine eligibility for nonfederal aid. The DRT provides tax data that automatically fills in information for part of the FAFSA form.

Individuals who plan to attend post-secondary schools from July 1, 2017 to June 30, 2018 must submit the 2017-2018 FAFSA. Individuals will need tax information from 2015 to complete the 2017-2018 FAFSA.

Suspicious activity

Earlier this year, the IRS reported that cybercriminals may have tried to obtain tax information through the DRT. The agency's security filters identified fraudulent returns using information obtained from the DRT. According to the IRS, as many as 100,000 taxpayer accounts may have been compromised through the DRT by cyber thieves. In response, the IRS took the DRT offline.

Work-around

FAFSA filers can manually provide their tax return information, the IRS has instructed. FAFSA filers can also use the IRS's online Get Transcript Tool. Individuals can obtain a Tax Return Transcript, which reflects most line items including adjusted gross income (AGI) from the original tax return filed, along with any forms and schedules. This transcript is only available for the current tax year and returns processed during the prior three years. Individuals can also obtain a Tax Account Transcript, which reflects basic data such as return type, marital status, adjusted gross income, taxable income and all payment types. This transcript is available for the current tax year and up to 10 prior years. Keep in mind that a transcript is not a photocopy of the return. A transcript can be confusing to read.

Income-driven repayment plan

The DRT also provides tax data that automatically fills in information for the income-driven repayment (IDR) plan application for federal student loan borrowers. The DRT is online for DRT applications.

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Taxes + Leisure:
IRS Revocation of Passports

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Note: Although the exact date is uncertain, the IRS will soon be reporting delinquent tax debts to the State Department.

Starting this year, the IRS will be reporting individuals with "seriously delinquent tax debts" to the State Department for denial or revocation of a passport.

The Fixing America's Surface Transportation Act of 2015 (FAST Act) added Internal Revenue Code (IRC) Section 7345, which provides the IRS with the ability to deny or revoke the passport of any American taxpayer with a seriously delinquent tax debt. That is a debt in excess of $50,000, including penalties and interest, for which a notice of lien or levy has been filed. The $50,000 threshold is indexed yearly for inflation. The IRS has not yet begun certifying delinquent tax debts to the State Department, but their website says they plan to do so in "early 2017." Once implemented, they will post the news on this page: www.irs.gov/businesses/small-businesses-self-employed/revocation-or-denial-of-passport-in-case-of-certain-unpaid-taxes.

A taxpayer will no longer be considered seriously delinquent for the purpose of passport revocation if:

- the debt is being paid in a timely manner under an installment agreement entered into with the IRS;
- the debt is being paid in a timely manner under an offer in compromise accepted by the IRS or a settlement agreement entered into with the Justice Department;
- a collection due process hearing is timely requested in connection with a levy to collect the debt; or
- collection has been suspended because a request for innocent spouse relief under IRC Section 6015 has been made.

Notification and debt resolution

Before denying a passport application, the State Department will hold the application for 90 days to allow the taxpayer to resolve any issue or pay the tax in full or enter into a payment agreement with the IRS. The State Department will notify taxpayers in writing if their passport applications have been denied or their passports revoked. Taxpayers with seriously delinquent tax debts can use their passports until they receive notification from other State Departments. If a passport is revoked while a taxpayer is overseas, they will not be stranded; the State Department will issue a limited validity passport that will allow the taxpayer direct return to the United States. Once taxpayers have resolved their tax debts, the IRS will reverse the certification with the State Department within 30 days of receiving payment. Payment must be made in full, or the taxpayer must enter into a payment arrangement as described above. The IRS will not reverse the certification because the taxpayer pays down the debt below $50,000.

Real ID Act

Until January 22, 2018, if traveling by air, residents from ANY state may still use a driver's license or any of the various other forms of identification accepted by the Transportation Security Administration (TSA). The Department of Homeland Security website has lists of states that are currently compliant, states with various extensions, and noncompliant states:

www.dhs.gov/current-status-states-territories

Effective January 22, 2018, if an individual has a driver's license or identification card issued by a state that does not meet the requirements of the REAL ID Act, unless that state has been granted an extension, the individual must present an alternative form of identification acceptable to TSA in order to board a commercial domestic flight. Starting October 1, 2020, anyone traveling by air on a domestic flight will need a form of ID that is compliant with the requirements set out in the REAL ID Act. This could affect the travel ability of taxpayers who live in states that issue noncompliant driver's licenses, although there are other forms of acceptable federal identification listed at:

www.tsa.gov/travel/security-screening/identification

This means that, barring changes to the licenses in those states to bring them into compliance, passengers will most likely be using passports to board domestic flights.

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Social Security Wage Base Could Increase to $130,500 for 2018

The Social Security Administration's Office of the Chief Actuary (OCA) has projected, under all three of its methods of forecasting, that the Social Security wage base will increase from $127,200 for 2017 to $130,500 for 2018.

The Federal Insurance Contributions Act (FICA) imposes two taxes on employers, employees, and self-employed workers - one for Old Age, Survivors and Disability Insurance (OASDI, commonly known as the Social Security tax) and the other for Hospital Insurance (HI, commonly known as the Medicare tax). There is a maximum amount of compensation subject to the OASDI tax, but no maximum for HI. The FICA tax rate for employers is 7.65%, which consists of 6.2% for OASDI on the first $127,200 of an employee's wages for 2017 (maximum tax is $7,886.40 [6.20% of $127,200]) and 1.45% Medicare tax on the employee's total wages (no ceiling).

For 2017, an employee will pay:

- 6.20% Social Security tax on the first $127,200 of wages (maximum tax is $7,886.40 [6.20% of $127,200]), plus

- 1.45% Medicare tax on the first $200,000 of wages ($250,000 for joint returns; $125,000 for married taxpayers filing a separate return), plus
- 2.35% Medicare tax (regular 1.45% Medicare tax + 0.9% additional Medicare tax) on all wages in excess of $200,000 ($250,000 for joint returns; $125,000 for married taxpayers filing a separate return).

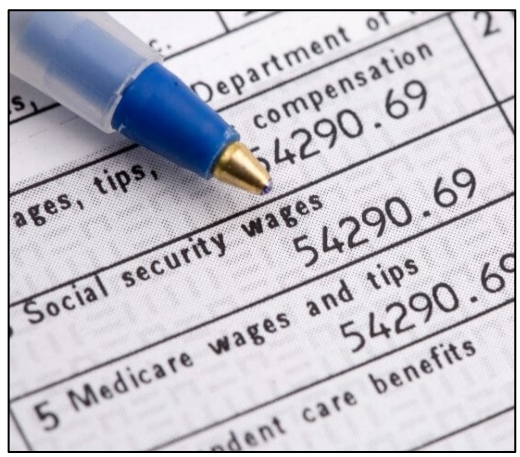
For 2017, the self-employment tax imposed on self-employed people is:

- 12.40% OASDI on the first $127,200 of self-employment income, for a maximum tax of $15,772.80 (12.40% of $127,200); plus
- 2.90% Medicare tax on the first $200,000 of self-employment income ($250,000 of combined self-employment income on a joint return, $125,000 on a separate return); plus
- 3.8% (2.90% regular Medicare tax + 0.9% additional Medicare tax) on all self-employment income in excess of $200,000 ($250,000 of combined self-employment income on a joint return; $125,000 for married taxpayers filing a separate return).

The 2018 projections were included as part of the annual report to Congress by the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Fund programs (the 2017 OASDI Trustees Report). The OCA provides three kinds of forecasts for Social Security wage bases (intermediate, low-cost, and high-cost). All three forecasts predict that the Social Security wage base will increase from $127,200 in 2017 to $130,500 in 2018.

The SSA intermediate forecasts through 2026 are as follows:

- 2018 - $130,500
- 2019 - $135,600
- 2020 - $142,200
- 2021 - $148,500
- 2022 - $155,100
- 2023 - $161,700
- 2024 - $168,000
- 2025 - $174,300
- 2026 - $180,900



Actual annual increases to the wage base are announced in October of the preceding year and are based on then-current economic conditions. As a result, the OCA's forecasts, especially the longer-range ones, are subject to change. Last year, the OCA projected under its intermediate forecast that the Social Security wage base would be $126,000 in 2017; the correct figure turned out to be $127,200.

The OCA is projecting that the Social Security trust fund will become insolvent by 2034, and that the Disability Insurance (DI) trust fund will become insolvent in 2023.

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California Fuel Taxes and Vehicle Fees Increased

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SB 1 (Ch. 17-5) increased the following fuel tax rates effective November 1, 2017:

- Gasoline excise tax, by 12¢ per gallon (according to California Board of Equalization (BOE)'s legislative analysis, in combination with the repeal of the fuel-tax swap adjustment rate, this will result in an increase from the current rate of 27.8¢ to 41.7¢ per gallon).
- Diesel fuel excise tax, by 20¢ per gallon from 16¢ to 36¢.
- Diesel fuel sales and use tax, by 4% from 1.75% to 5.75%.

A new one-time gasoline floor-stock tax (aka storage tax) is imposed against suppliers, wholesalers, or retailers owning 1,000 or more gallons of gasoline or diesel fuel on November 1, 2017, to bring the tax paid on the stored fuel in line with the tax that will be paid effective November 1, 2017.

In addition to the current 0.65% vehicle license fee (VLF) imposed on California-registered vehicles, SB 1 imposes a new annual transportation improvement fee, effective January 1, 2018. The amount of the fee is based on the market value of the vehicle (determined in the same method used for determining the current VLF fee) as follows:

- $25 for vehicles with a market value of $0 - $4,999.
- $50 for vehicles with a market value of $5,000 - $24,999.
- $100 for vehicles with a market value of $25,000 - $34,999.
- $150 for vehicles with a market value of $35,000 - $59,999.
- $175 for vehicles with a market value of $60,000 and higher.

Annual inflation adjustment will be made to the gasoline excise tax, the diesel fuel excise tax, and the transportation improvement fees beginning July 1, 2020.

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Delaware Increased Its Corporate Franchise Taxes

The new law signed by the Delaware governor increased Delaware's maximum corporate franchise tax from $180,000 to $200,000 and creates a second top-tier tax of $250,000 applicable to a "Large Corporate Filer" (i.e. a public company with greater than $750 million in either consolidated revenue or consolidated assets and no less than $250 million in both consolidated revenue and consolidated assets, which otherwise would pay the $200,000 maximum tax) for tax years beginning on or after January 1, 2017. The new law also increased the tax rate for corporations with greater than 10,000 authorized shares (from $75 to $85 per each 10,000 shares or part thereof), greater than $1 million of assumed no-par capital (from $75 to $85 per $1 million or part thereof), or greater than $1 million of assumed par value capital (from $350 to $400 per $1 million or part thereof), as well as increasing the minimum tax for taxpayers using the assumed par value method (from $350 to $400) for tax years beginning on or after January 1, 2018.

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