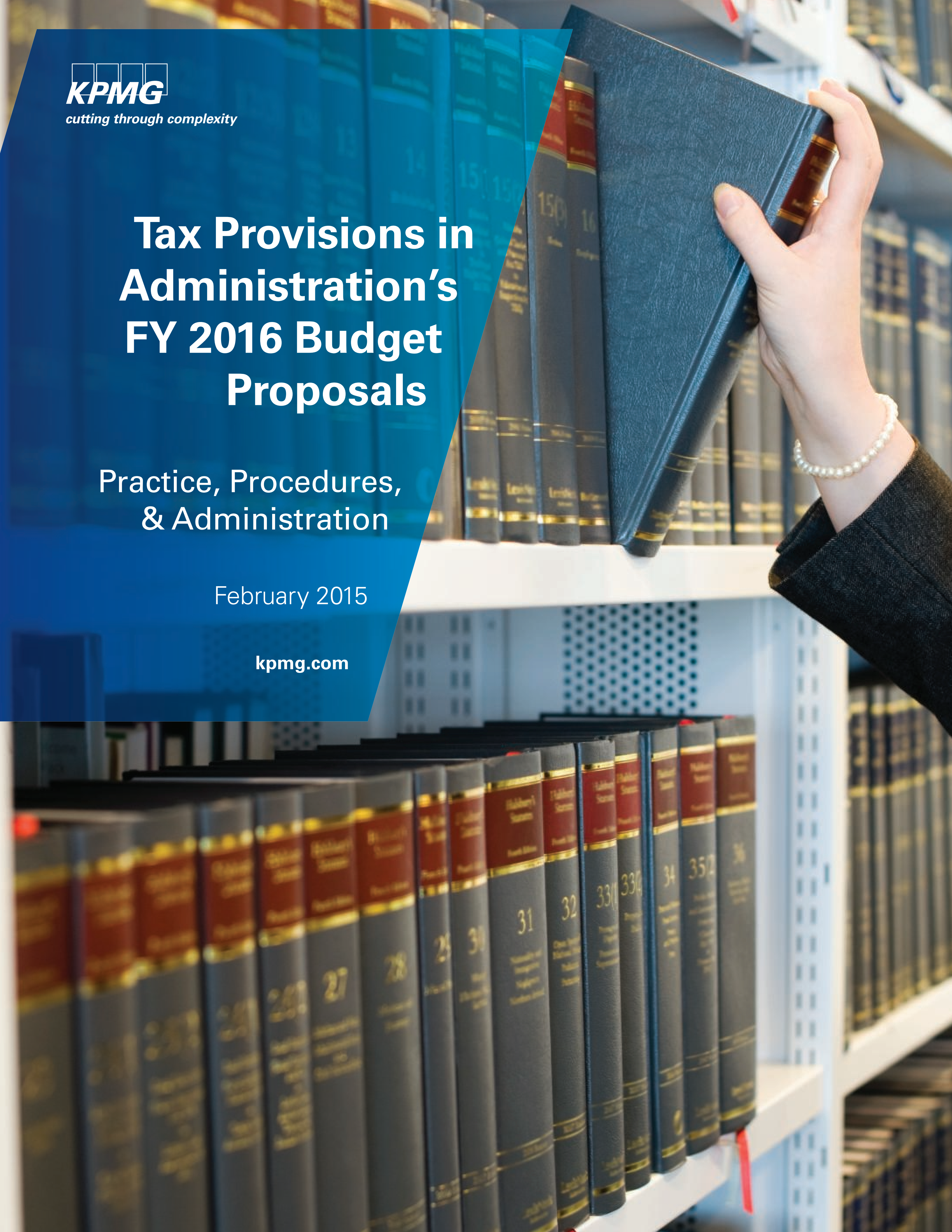

KPMG
cutting through complexity

Tax Provisions in Administration's FY 2016 Budget Proposals

Practice, Procedures, & Administration

February 2015

kpmg.com

HIGHLIGHTS OF TAX PROPOSALS IN THE ADMINISTRATION'S FISCAL YEAR 2016 BUDGET RELATING TO PRACTICE, PROCEDURE, & ADMINISTRATION

KPMG has prepared a 111-page **book** that summarizes and makes observations about the revenue proposals in the Administration's FY 2016 budget. For ease of reference, we have compiled our summaries and observations relating to certain specific industries and topics in separate booklets. This booklet highlights revenue proposals relating to Practice, Procedure, & Administration. Other booklets will address proposals relating to the following topics:

- International Tax
- General Corporate Tax
- Tax Accounting
- Business Tax Credits
- Financial Institutions & Products
- Passthrough Entities
- Charitable Deductions & Exempt Organizations
- Compensation, Benefits, & Qualified Plans
- Energy & Natural Resources
- Insurance
- Real Estate
- Taxation of Individuals

Please note that the Practice, Procedure, & Administration proposals often implicate or are relevant to these other subject matter topics.

Background

On February 2, 2015, President Obama transmitted to Congress the administration's recommendations to Congress for spending and taxation for the fiscal year that begins on October 1, 2015 (i.e., FY 2016).

Among many other things, the president proposed a six-year $478 billion program for transportation infrastructure, the cost of which would be offset in part by a one-time tax on the unrepatriated foreign earnings of U.S. multinational corporations. This tax would be part of a transition to a proposed fundamental change in the taxation of the future foreign earnings of U.S. corporations that would effectively eliminate deferral of tax on foreign earnings, causing them generally to be taxed on a current basis at a reduced rate.

The president also proposed a reserve for business tax reform, but not one of sufficient magnitude for significant rate reduction. The president has called for reducing the corporate income tax rate to 28%, but the budget does not provide revenue to offset the cost of such a reduction. Instead, the budget refers only to eliminating tax expenditures, such as accelerated depreciation and "reducing the tax preference for debt financed investment."

Many of the "general" business tax proposals in the FY 2016 budget are familiar, having been raised in previous budgets. These proposals include, for example:

- Reforms to the international tax system
- Repeal of natural resources production preferences
- Repeal of LIFO and LCM accounting
- Taxation of carried interests in partnerships as ordinary income
- Insurance industry reforms
- Mark-to-market of financial derivatives
- Modification of the like-kind exchange rules
- Modification of the depreciation rules for corporate aircraft
- Denial of a deduction for punitive damages
- Make permanent and reform the credit for research and experimentation
- Make permanent the Subpart F exception for active financing income
- Make permanent look-through treatment of payments between related CFCs

The president also re-proposed a tax on the liabilities of financial institutions with assets in excess of $50 billion. The rate would be reduced relative to the prior proposal from 17 basis points to 7 basis points, but the base of the tax would be different and the application of the tax would be significantly broadened to include insurance companies, savings and loan holding companies, exchanges, asset managers, broker-dealers, specialty finance corporations, and financial captives. These changes have roughly doubled the revenue raised relative to the proposal in the FY 2015 budget.

The budget also includes a host of proposed changes to the individual income tax system. These include increasing the highest tax on capital gains from 23.8% (including the 3.8% net investment income tax) to 28%. In addition, a transfer of appreciated property would generally be treated as a sale of the property, subject to various exceptions and exclusions. For example, relief would be provided to lessen the immediate impact of the proposed change on the transfers of small businesses.

Most of the Practice, Procedure, & Administration proposals were raised in previous budgets. The FY 2016 budget included the following proposals of note:

- Repeal of both the TEFRA and electing large partnership procedures, replacing them with new simplified partnership procedures for any partnership with 100 or more partners or any one partner that is a pass-through partner.

- Numerous proposals that would expand information reporting requirements and information sharing and disclosure by government agencies for purposes of revenue enhancement and targeting tax avoidance, ID theft, and other fraudulent activities.

- Amend the section 6501(e) six-year assessment period applicable to substantial omissions from gross income to provide that an overstated basis constitutes an omission from gross income, in response to *U.S. v Home Concrete & Supply, LLC*.

Practice, Procedure, & Administration Tax Proposals

This booklet addresses the following budget proposals:

Administrative/Procedural

Implement a program integrity statutory cap adjustment for tax administration

Previous administrations and Congresses have used a budget mechanism called "a program integrity cap adjustment" to increase congressional allocations for annual budget appropriations. Under the mechanism, funding above the spending ceiling that is specified in the annual congressional appropriations process is granted for specified "program integrity" purposes. This process has been critical in maintaining the IRS enforcement and compliance functions, allowing the IRS to initiate new programs that generate high returns on investment, and encouraging taxpayers to comply with the tax laws.

The administration's FY 2016 proposal would make an adjustment to the discretionary spending limits for IRS tax enforcement, compliance, and related activities. These resources would help the IRS continue to target international tax compliance and restore previously reduced enforcement levels. The total cost of supporting new initiatives above the funding needed to maintain current levels of enforcement and compliance activity through 2025 would be approximately $18.7 billion over the budget window.

This provision was included in the administration's FY 2015 revenue proposal.

Allow the IRS to absorb credit and debit card processing fees for certain tax payments

Currently, the IRS allows a taxpayer to make credit or debit card payments in certain circumstances, but the providers charge the taxpayer a convenience fee over and above the taxes due.

The administration's FY 2016 proposal would amend section 6311(d) to allow, but not require, the IRS to accept credit or debit card payments directly from taxpayers and to absorb the credit and debit card processing fees for delinquent tax payments, without charging a separate processing fee to the taxpayer.

The provision would be effective for payments made after the date of enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Eliminate certain reviews conducted by the U.S. Treasury Inspector General for Tax Administration (TIGTA)

Section 7803(d) requires TIGTA to conduct reviews of certain administrative and civil actions and reviews of the IRS compliance with respect to certain requirements in order to comply with TIGTA's reporting requirements.

As requested by TIGTA, the proposal would eliminate TIGTA's obligation to do statutory reviews that are of relatively low value such as administrative or civil actions related to fair tax collection practices violations in one of TIGTA's semiannual reports, review and certify annually that the IRS is complying with the requirements of section 6103(e)(8) regarding information on joint filers, and annually report on the IRS's compliance with sections 7521(b)(2) and (c) requiring IRS employees to stop a taxpayer interview whenever a taxpayer requests to consult with a representative and to obtain their immediate supervisor's approval to contact the taxpayer instead of the representative if the representative has unreasonably delayed the completion of an examination or investigation.

The administration's FY 2016 proposal would revise the annual reporting requirement for all remaining provisions in the *IRS Restructuring and Reform Act of 1998* to a biennial reporting requirement.

The proposal would be effective after December 31, 2015.

This provision was included in the administration's FY 2015 revenue proposal.

Modify indexing to prevent deflationary adjustments

Under current law, many income tax amounts, brackets, thresholds, and other parameters are indexed for inflation. In some situations, if an inflation index declines, the relevant parameter would decline. In other situations, the parameter would not be reduced if the index declined. In 2008 and 2009, two of the indexes used in adjusting various parameters declined. In one situation, the relevant amount was statutorily held steady; in the other, a dollar limitation declined.

The administration's FY 2016 proposal would modify inflation adjustment provisions so as to prevent any tax parameters from declining from the previous year's levels if the underlying price index falls. Future inflation-related increases would be based on the highest previous level of the price index relevant for adjusting the particular tax parameter.

The proposal would be effective beginning on the date of enactment.

Assessment, Collection, and Periods of Limitation

Increase levy authority for payments to Medicare providers with delinquent tax debt

As enacted in the *Achieving a Better Life Experience Act of 2014*, Treasury is authorized to continually levy up to 30% of a payment to a Medicare provider in order to collect a delinquent tax debt. Certain Medicare providers fail to comply with their federal income tax and/or employment tax obligations.

The administration's FY 2016 proposal would allow Treasury to levy up to 100% of a payment to a Medicare provider to collect unpaid taxes. This would assist in recovering a greater amount of delinquent taxes and would promote providers' compliance with their federal tax obligations.

The proposal would be effective for payments made after the date of enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Revise offer-in-compromise application rules

The administration's FY 2016 proposal would repeal a 2006 provision that requires an offer-in-compromise applicant to make certain non-refundable payments as part of its application.

The provision would be effective for offers-in-compromise submitted after the date of enactment.

This provision was included in the administration's 2015 revenue proposal.

Extend statute of limitations for assessment for overstated basis and state adjustments

The administration's FY 2016 proposal would create an exception to the three-year statute of limitations for assessment of federal tax liability when the assessment is the result of adjustments to state or local tax liabilities. The statute of limitations would be extended to the greater of: (1) one year from the date the taxpayer files an amended tax return with the IRS reflecting adjustments to the state or local tax return; or (2) two years from the date the IRS receives information from the state or local revenue agency under an information sharing agreement. The statute would be extended only with respect to the increase in federal tax attributable to the state or local tax adjustment.
The statute of limitations on claims for refund would be extended correspondingly so that any overall increase in tax assessed by the IRS as a result of the state or local examination report would take into account agreed-upon tax decreases or reductions attributable to a refund or credit.

The proposal also would amend the rules for determining gross income for purposes of the section 6501(e) six-year assessment period applicable to substantial omissions from gross income to provide that an understatement of gain is treated as an omission from gross income. As a result, an overstatement of basis and other unrecovered amounts that reduce the amount of gain reported on a return will be treated as an omission of gross income for purposes of determining whether the taxpayer omitted gross income in excess of 25% of the gross income stated on the return.

KPMG observation

The overstated basis proposal is similar to a provision contained in the *Tax Reform Act of 2014* proposed by the former Chairman of the House Ways and Means Committee, Dave Camp, in the last congress. It also is a response to the 2012 U.S. Supreme Court case *United States v. Home Concrete & Supply, LLC*, which held that an overstated basis does not constitute an omission from gross income for purposes of the six-year assessment period.

The proposal would be effective for returns required to be filed after December 31, 2015.

The provision regarding state adjustments was included in the administration's 2015 revenue proposal. The provision regarding overstated basis is new in FY 2016.

Provide the IRS with greater flexibility to address correctable errors

In general, if the IRS determines that there is a deficiency, the IRS issues a statutory notice of deficiency and the taxpayer is provided an opportunity to challenge the proposed deficiency in the U.S. Tax Court before the deficiency is assessed. Section 6213(b) provides an exception from the general deficiency procedures by granting the IRS authority to correct certain mathematical or clerical errors made on tax returns, i.e., math error authority. "Mathematical and clerical error" is defined in section 6213(g)(2) and includes, for example, errors in addition, subtraction, multiplication, or division shown on the return or an entry on a return of an item that is inconsistent with another entry of the same or another item on the return. Currently, this section must be amended each time Congress wishes to expand the scope of math error authority.

The administration's FY 2016 proposal would remove the existing specific grants of math error authority, and provide that "math error authority" will refer only to computational errors and the incorrect use of any table provided by the IRS. In addition, the proposal would add a new category of "correctable errors." Under this new category, Treasury would have regulatory authority to permit the IRS to correct errors in cases when: (1) the information provided by the taxpayer does not match the information contained in government databases; (2) the taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or (3) the taxpayer has failed to include with his or her return documentation that is required by statute.

The proposal would be effective on the date of enactment. However, the IRS's current grant of math error authority would continue to apply until Treasury and the IRS issue final regulations addressing correctable errors.

This provision was included in the administration's FY 2015 revenue proposal.

Allow states to send notices of intent to offset federal tax refunds to collect state tax obligations by regular first-class mail instead of certified mail

The administration's FY 2016 proposal would remove the statutory requirement to use certified mail, thereby allowing Treasury's Bureau of Fiscal Service to amend its regulations to permit the States to send notices for delinquent State income tax obligations to debtors by first class mail.

The proposal would be effective on the date of enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Allow offset of federal income tax refunds to collect delinquent state income taxes for out-of-state residents

Generally, an overpayment of federal tax due a taxpayer may be reduced by (i.e., offset by) debts of the taxpayer for past-due child support, debts to federal agencies, fraudulently obtained unemployment compensation, and past-due, legally enforceable state income tax obligations. However, a delinquent taxpayer can escape offset of a federal refund for a state tax liability as long as the taxpayer is not a resident of the state.

The proposal would permit offset of federal refunds to collect state income tax, regardless of where the delinquent taxpayer resides.

The proposal would be effective on the date of enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Disclosure and Information Sharing

Provide an exception to the limitation on disclosing tax return information to expand TIN matching beyond forms where payments are subject to backup withholding

Section 6103 provides that tax returns and tax return information are confidential and cannot be disclosed, unless a statutory exception applies. Section 6103(k) includes exceptions for disclosure of certain tax returns and tax return information for tax administration purposes. Under the broad regulatory authority in section 3406(i) to prescribe regulations necessary or appropriate to carry out the purposes of section 3406, the IRS implemented a voluntary TIN matching program for payors of payments subject to backup withholding. The TIN matching program has proven beneficial to taxpayers and the IRS because mismatches of TINs can be resolved before filing of returns.

Because the authority to disclose taxpayer information under the TIN matching program is limited to reportable payments subject to backup withholding under section 3406, taxpayers required to report information other than reportable payments subject to backup withholding are not eligible to participate in the TIN matching program. However, filers and the IRS would benefit if TIN matching were made more widely available.

The FY 2016 proposal would amend section 6103(k) to permit the IRS to disclose to any person required to provide the TIN of another person to the Secretary whether the information matches the records maintained by the Secretary.

The proposal would be effective on the date of enactment.

Increase information sharing to administer excise taxes

Prior to 2003, customs official were employees of the Treasury Department, and the IRS and the Alcohol Tobacco Tax and Trade Bureau (TTB) were able to share tax information with customs officials. The transfer of customs officials in 2003 to the Department of Homeland Security without a change in the Code has resulted in limitations on the information that the IRS and the TTB may share with customs officials. The proposal would add employees of DHS (customs officials) involved in tax administration to the list of federal officers and employees to whom the IRS and TTB may disclose tax information.

The proposal would be effective on date of enactment.

Expand IRS access to information in the National Directory of New Hires for tax administration (NDNH) purposes

The Department of Health and Human Services maintains the NDNH, a database of new-employee data from Form W-4, quarterly wage data from state and federal employment security agencies, and unemployment benefit data from state unemployment insurance agencies. The administration's FY 2016 proposal would amend the Social Security Act to expand IRS access to NDNH data for general tax administration purposes, including data matching, claim verification and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions.

The provision would be effective upon enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Facilitate tax compliance with local jurisdictions

Although tax returns and return information generally are confidential, the IRS and Treasury may share information with states and certain local governmental entities that are treated as states for this purpose. Indian tribal governments are treated as states for several purposes, including certain charitable contributions, excise tax credits, and local tax deductions, but not for information sharing purposes.

Under the administration's FY 2016 proposal, Indian tribal governments that impose alcohol, tobacco, or fuel excise taxes or income or wage taxes would be treated as states for purposes of information sharing to the extent necessary for tax administration. A tribal government that receives tax information would be required to safeguard it according to prescribed protocols. Criminal and civil sanctions would apply.

The provision would be effective for disclosures made after the date of enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Improve investigative disclosure statute

Taxpayer privacy would be clarified under the administration's FY 2016 proposal by stating that it does not prohibit Treasury and IRS officers and employees from identifying themselves, their organizational affiliation, and the nature and subject of an investigation, when contacting third parties in connection with a civil or criminal tax investigation.

The provision would be effective for disclosures made after enactment.

This provision was included in the administration's 2015 revenue proposal.

Extend IRS authority to require truncated Social Security Numbers (SSN) on Form W-2

Currently, employers are required to include an employee's SSN on the copy of Form W-2 furnished to employees. Other information returns provided to taxpayers, such as Forms 1099, are subject to more general rules that require the taxpayer's "identifying number" to be reported on the information return. When an identifying number is required, Treasury and the IRS have regulatory authority to permit filers to use a number other than the taxpayer's SSN. In an effort to combat identity theft, Treasury and the IRS have permitted filers of certain information returns to truncate a taxpayer's identifying number, including an SSN, on the information return copy provided to the taxpayer.

The administration's FY 2016 proposal would require employers to include an "identifying number" for each employee, rather than an employee's SSN, on Form W-2. This would allow Treasury and the IRS to exercise regulatory authority to require or permit a truncated SSN on Form W-2.

The proposal would be effective upon enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Authorize the limited sharing of business tax return information to improve the accuracy of important measures of the economy

Current law authorizes the IRS to disclose certain federal tax information (FTI) for governmental statistical use. However, the Bureau of Labor Statistics (BLS) is currently not authorized to receive FTI and the Bureau of Economic Analysis (BEA) is only authorized for corporate businesses.

The administration's FY 2016 proposal would give officers and employees of BEA access to FTI of those sole proprietorships with receipts greater than $250,000 and of all partnerships. BEA contractors would not have access to FTI.

The proposal would also give officers and employees of BLS access to certain business (and tax-exempt entities) FTI. In effect, the proposal would allow officers and employees of each of BLS, BEA, and Census Bureau to access the same FTI for businesses, and would permit BLS, BEA, and Census to share such FTI amongst themselves subject to certain restrictions.

The proposal would be effective upon enactment.

This provision was included in the administration's FY 2015 revenue proposal.

Information Reporting

Require Form W-9 from contractors

In general, a reportable payment made in the course of a trade or business to a service provider is not subject to withholding if the service provider furnishes a taxpayer identification number (TIN) to the payor prior to the time payment is made. The administration's FY 2016 proposal would require service providers to furnish their TINs on Form W-9, thereby certifying as to the correctness of their TINs. Service recipients would be required to verify the accuracy of the TIN with the IRS (through the IRS TIN matching program). Service providers that fail to furnish a certified TIN that matches IRS records would be subject to backup withholding. Alternatively, service providers could request (and require) the service recipient to withhold a flat-rate percentage (selected by the service provider) of the gross payment made.

The provision would be effective for payments made to contractors after December 31, 2015.

This provision was included in the administration's FY 2015 revenue proposal.

Require information reporting for private separate accounts of life insurance companies

The administration's FY 2016 proposal would require life insurance companies to report to the IRS—for each contract with cash value that is partially or wholly invested in a private separate account for any portion of the tax year and represents at least 10% of the value of the account—(1) the policyholder's taxpayer identification number; (2) the policy number; (3) the amount of accumulated untaxed income; (4) the total contract account value; and (5) the portion of that value that was invested in one or more private separate accounts.

For this purpose, a private separate account would be defined as any account with respect to which a related group of persons owns policies with cash values, in the aggregate, of at least 10% of the value of the separate account. Whether a related group of persons owns policies with cash values at 10% or greater of the account value would be determined quarterly, based on information reasonably within the contract issuer's possession.

The provision would be effective for private separate accounts maintained on or after December 31, 2015.

This provision was included in the administration's FY 2012 through FY 2015 revenue proposals.

Provide for reciprocal reporting of information in connection with the implementation of the Foreign Account Tax Compliance Act

Under FATCA, foreign financial institutions are required to report account balances, as well as amounts such as dividends, interest, and gross proceeds paid or credited to a U.S. account without regard to the source of such payments. To implement FATCA, the United States has established a broad network of information exchange relationships with other jurisdictions based on established international standards. The success of those information exchange relationships depends on cooperation and reciprocity. Requiring U.S. financial institutions to report to the IRS the comprehensive information required under FATCA with respect to accounts held by certain foreign persons, or by certain passive entities with substantial foreign owners, would facilitate the intergovernmental cooperation contemplated by the intergovernmental agreements by enabling the IRS to provide equivalent levels of information to cooperative foreign governments in appropriate circumstances to support their efforts to address tax evasion by their residents.

The administration's FY 2016 proposal would require certain financial institutions to report the account balance (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value) for all financial accounts maintained at a U.S. office and held by foreign persons. The proposal also would expand the current reporting required with respect to U.S. source income paid to accounts held by foreign persons to include similar non-U.S. source payments. In addition, the Secretary would be granted authority to issue Treasury regulations to require financial institutions to report the gross proceeds from the sale or redemption of property held in, or with respect to, a financial account, information with respect to financial accounts held by certain passive entities with substantial foreign owners, and such other information that the Secretary or his delegate determines is necessary to carry out the purposes of the proposal. Finally, the proposal would require financial institutions that are required by FATCA or this proposal to report to the IRS information with respect to financial accounts to furnish a copy of the information to the account holders.

The proposal would be effective for returns required to be filed after December 31, 2016.

KPMG observation

This proposal could result in a significant increase in costs and burdens on U.S. businesses with respect to the proposed expansion of reporting. The addition requiring the furnishing of information to account holders is new to this proposal in 2016 and could further exacerbate these costs and burdens.

This provision was included in the administration's FY 2015 revenue proposal.

Improve mortgage interest deduction reporting

A deduction is allowed for qualified residence interest paid or accrued with respect to a primary residence and one secondary residence. A deduction is also allowed for property taxes paid. Any person, such as a lender or loan servicer, who in the course of their trade or business, receives from any individual interest aggregating $600 or more for any calendar year on any mortgage is required to report to the IRS on a Form 1098, *Mortgage Interest Statement*, with respect to each individual from whom interest is received. The IRS uses the information it receives on the Form 1098 to verify the deduction of qualified residence interest claimed by the individual on their tax return.

Under the FY 2016 proposal, in addition to the information already reported on the Form 1098, filers would also be required to include information regarding the outstanding principal balance of the mortgage as of the beginning of the calendar year; the address of the property securing the mortgage; information on whether the mortgage is a refinancing of an existing mortgage during the calendar year; property taxes, if any, paid from escrow; and the loan origination date.

The proposal would be effective for information returns due for calendar years beginning after December 31, 2015.

Require Form W-2 reporting for employer contributions to defined contribution plans

Employers file Form W-2 to provide to each employee an annual statement showing the remuneration paid by the employer to the employee during the calendar year. A copy of the Form W-2 must also be filed with the Social Security Administration, which shares information on the form with the IRS. Employers are required to report an employee's elective deferrals under a cash or deferred arrangement, such as contributions to a 401(k) plan, on the employee's Form W-2. Employers are not currently required to report the employer's contributions to an employee's defined contribution retirement plan on the employee's Form W-2.

The administration's FY 2016 proposal would require employers to report the amounts an employer contributed to an employee's accounts under a defined contribution plan on the employee's Form W-2.

The proposal would be effective for information returns due for calendar years beginning after December 31, 2015.

Partnership Audits, Adjustments, and Return Due Dates

Streamline audit and adjustment procedures for large partnerships

The IRS encounters many auditing and adjustment problems for partnerships that have a large number of partners. The *Tax Equity and Fiscal Responsibility Act of 1982* (TEFRA) established certain rules applicable to all but certain small partnerships. The purpose of the TEFRA partnership rules is to provide consistent treatment of partnership items among all partners on both partnership returns and partnership audits, and to lessen the administrative and judicial burdens placed on the government. The Tax Relief Act of 1997 established a second streamlined audit and adjustment procedure for a large partnership, as well as a simplified reporting system for partnerships that have 100 or more partners during the preceding tax year and that elect to be treated as an electing large partnership (ELP).

According to the Treasury Department's general explanation of the tax proposals of the budget—the so-called "**Green Book**"—the present TEFRA partnership procedures remain inefficient and more complex than those applicable to other large entities. Further, few large partnerships have elected into the ELP regime, which was intended to mitigate the problems associated with large partnerships.

The administration's FY 2016 proposal would repeal the existing TEFRA and ELP procedures and create new simplified partnership procedures (SPP) for any partnership that has 100 or more direct partners in the aggregate during the tax year of the adjustment or has any one partner that is a pass-through partner, i.e., another partnership, estate, trust S corporation, nominee or similar person. A partnership subject to the SPP regime, because it has a passthrough partner, may elect out of the SPP regime if it can demonstrate that it has fewer than 100 direct and indirect partners in the aggregate in the year of the proposed adjustment.

The IRS would audit the partnership (source partnership) and make adjustments at the partnership level that flow to the partners who held interests in the year of the adjustments. Any additional tax due would be assessed in accordance with the direct partner's ownership interest for that year, and any direct partner that is a passthrough partner would be required to pay the tax for its members. Passthrough partners would have 180 days to challenge the assessment based on the tax attributes of its direct and indirect partners for the year to which the adjustments are made.

Unlike the TEFRA rules, the SPP would allow only the partnership to request a refund and partners would have no right to participate in the partnership level proceedings. The IRS would not be required to give notice to partners of the partnership audit or the final partnership adjustment. The IRS would be required to give notice only to the source partnership, and only the source partnership through an authorized person, a U.S. individual identified on the partnership return, could participate in the examination. If the partnership fails to make a designation, the IRS would make the designation of the authorized person.

Similar to TEFRA, the SPP require partners to report partnership items consistent with the partnership, and failure to notify the IRS of inconsistent treatment allows the IRS to assess any tax under its math error authority. However, if the partner does notify the IRS of inconsistent treatment, the IRS is required to audit the partnership to assess tax against the partner, which is different from TEFRA where the IRS could issue a notice of deficiency against the partner without a partnership audit.

Treasury would be given authority to promulgate necessary and appropriate regulations to implement the proposal to: include rules about the designation of a person to act on behalf of the partnership; ensure that taxpayers do not transfer partnership interests with a principal purpose of utilizing the SPP regime to alter taxpayer's tax liability; address foreign passthrough partners issues; and provide rules for passthrough partners to challenge an assessment.

KPMG observation

This proposal has many unanswered questions concerning its implementation and consequences especially with respect to passthrough partners. For example, if a passthrough partner is a 10% partner, does the IRS simply assess tax on 10% of the adjustment at the highest rate of tax without regard to whether any of the indirect partners are: (1) tax-exempt entities; (2) would not have any additional tax liability if the adjustments were passed through, etc. This would result in a tremendous burden and cost on each partnership in a multi-tiered partnership arrangement to challenge the adjustment and have its partners file amended returns or prove that the tax has been paid. The change in the SPP that does not allow a partner to participate in the audit is also troubling as a partner's rights to challenge the merits of the adjustment have been abrogated and the failure of the authorized person to present a robust defense may cause the partner to have a deficiency on a partnership item that the partner cannot challenge. The partner may challenge the calculation of the deficiency but not the merits of the adjustment. This proposal incorporates some of the principles discussed in the Camp tax reform bill.

The proposal would apply to a partnership's tax year ending on or after the date that is two years from the date of enactment.

The 2015 proposal also would have eliminated TEFRA but retained ELP and created a new regime that was much different from the SPP proposal.

Rationalize tax return filing due dates so they are staggered

Third-party information is used by taxpayers to assist them in preparing their income tax returns. However, many taxpayers do not receive Schedules K-1 before their income tax returns are due.

The administration's FY 2016 proposal would rationalize income tax return due dates so that taxpayers receive Schedules K-1 before the due date for filing their income tax returns. Under the proposal, calendar year S corporation filing deadlines would remain the same, and partnership filing deadlines would be made to conform to the current deadlines imposed on S corporations. Accordingly, all calendar year partnership and all calendar year S corporation returns (Forms 1065 and 1120-S) and Schedules K-1 furnished to partners and shareholders would be due March 15. In addition, returns of calendar year corporations other than S corporations would be due April 15 instead of March 15. Fiscal year partnership returns would be due the 15^{th} day of the third month following the close of the tax year and fiscal year corporations other than S corporations would be due by the 15^{th} day of the fourth month following the close of the tax year.

The proposal would also accelerate the due date for filing information returns and eliminate the extended due date for electronically filed returns. Under the proposal, information returns would be required to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would be required to be filed with the IRS by February 15. The due dates for the payee statements would remain the same.

The proposal would be effective for returns required to be filed after December 31, 2015.

This provision was included in the administration's FY 2015 revenue proposal.

Penalties, Criminal, and Tax Shelters

Impose liability on shareholders to collect unpaid income taxes of applicable corporations

The administration's FY 2016 proposal would add a new provision to the Code designed to impose liability on shareholders who engage in "Intermediary Transaction Tax Shelters." Previously, the IRS and Treasury identified Intermediary Transaction Tax Shelters as listed transactions that require disclosure on a tax return to avoid certain penalties. Intermediary Transaction Tax Shelters typically involve: (1) a sale of a controlling interest (at least 50%) in the stock of a C corporation; (2) that is undertaken as part of a plan; (3) to cause the C corporation to recognize income or gain from the sale of its assets shortly before or shortly after the sale of the C corporation's stock. The C corporation is ultimately left with insufficient assets from which to pay the tax owned from the asset sale. This would occur, for example, when sales proceeds from the asset sale are used to repay acquisition financing.

Despite the IRS identifying such transactions as listed transactions, taxpayers continue to engage in these transactions due to the federal government's inability to efficiently collect the unpaid taxes, interest, additions to tax, or penalties owed by a C corporation that has insufficient assets to pay such amounts. Specifically, the proposal notes that under current law, outside of the consolidated return context, when a C corporation fails to pay income taxes, the federal government is often unable to collect amounts owed by the C corporation from its former shareholders.

The administration's FY 2016 proposal would create a new provision that would impose liability on shareholders who enter into Intermediary Transaction Tax Shelters. Specifically, the proposal would apply to shareholders who, pursuant to a plan, directly or indirectly, dispose of a controlling interest (at least 50%) in the stock of an applicable C corporation within a 12-month period in exchange for consideration other than stock issued by the acquirer of the C corporation. Such secondary liability would be imposed only after the C corporation is assessed income taxes and penalties and fails to pay such amounts within a specified time period. This deficiency would be governed by the general notice and demand rules of the Code but with an additional year added to the statute of limitations for assessment. Treasury would be granted authority to prescribe regulations to carry out the proposal.

For purposes of the proposal, an applicable C corporation is any C corporation (or successor) two-thirds or more of whose assets consist of cash, passive investment assets, or assets that are the subject of a contract of sale or whose sale has been substantially negotiated on the date that a controlling interest in its stock is sold.

The provision would not apply to the disposition of certain publicly traded corporations, REITS, or RICs or the acquisition by a publicly traded entity or an entity that is consolidated for financial reporting purposes with a publicly traded entity.

The provision would be effective for sales of controlling interests in the stock of applicable C corporations occurring on or after April 10, 2013.

This provision was included in the administration's FY 2015 revenue proposal.

Make repeated willful failure to file a tax return a felony

Under the administration's FY 2016 proposal, any person who willfully fails to file tax returns for three years within any five consecutive year period—if the aggregated tax liability for such period is at least $50,000—would be subject to a felony and an aggravated failure to file criminal penalty of not more than $250,000 ($500,000 in the case of a corporation) or imprisonment for not more than five years or both.

The penalty would be effective for returns required to be filed after December 31, 2015.

This provision was included in the administration's FY 2015 revenue proposal.

Index all civil tax penalties for inflation

The Code currently contains numerous penalty provisions in which a fixed penalty amount was established when the penalty was initially added to the Code. These provisions contain no mechanism to adjust the amount of the penalty for inflation, and thus, these penalties are only increased by amending the Code.

The *Achieving a Better Life Experience Act of 2014*, enacted on December 19, 2014, has already adjusted the following penalties for inflation after 2014: section 6651 penalty for failure to file a tax return or pay tax; section 6652(c) penalty for failure to file certain information returns; section 6695 return preparer penalty; section 6698 penalty for failure to file a partnership return; section 6699 penalty for failure to file an S corporation return; section 6621 penalty for failure to file correct information returns; and section 6722 penalty for failure to furnish correct payee statements.

The administration's FY 2016 proposal would index all penalties to inflation and round the indexed amount to the next hundred dollars.

The proposal would be effective upon enactment.

This provision was included in the administration's 2015 revenue proposal.

Add tax crimes to the aggravated identity theft statute

The "aggravated identity theft statute" permits an increased sentence when the identity of another individual is used to commit certain crimes, which currently do not include any tax crimes. A conviction for aggravated identity theft adds two years to the sentence imposed for the underlying felony.

The administration's FY 2016 proposal would subject certain tax-related crimes to the "aggravated identity theft statute."

The proposal would be effective upon enactment.

Impose a civil penalty on tax identity theft crimes

Tax identity theft has increased exponentially in recent years. The IRS issued an identity protection personal identification number to 1.2 million individuals for the 2014 filing season an increase from about 777,000 such numbers in the previous year. Current law does not impose a civil penalty for tax-related identity theft.

The administration's FY 2016 proposal would add a $5,000 civil penalty on individuals who file a fraudulent return in connection with a tax identity theft case. Under the proposal, the IRS would be able to immediately assess a separate civil penalty for each incidence of identity theft, with no limit on the penalty amount imposed.

The proposal would be effective upon enactment.

These provisions were separately included in the administration's FY 2015 revenue proposal.

Enhance administrability of the appraiser penalty

Currently, there is no coordination between the section 6695A penalty on appraisers and the section 6694 understatement penalty on return preparers in cases when the person providing the appraisal is also treated as a paid tax return preparer with respect to the position on the return or claim for refund relying on the valuation in the appraisal. Therefore, a paid tax return preparer could be subject to penalties under both section 6694 and section 6695A with respect to the same conduct.

The administration's FY 2016 proposal would replace the existing "more likely than not" exception to the section 6695A appraiser penalty with a reasonable cause exception. In addition, the proposal would coordinate the section 6694 and section 6695A penalties so that an appraiser would not be subject to the penalty under section 6695A if, by reason of that appraisal, the appraiser is also subject to a penalty under section 6694.

The proposal would be effective for returns required to be filed after December 31, 2015.

This provision was included in the administration's FY 2015 revenue proposal.

Practitioner and Return Preparer Issues

Extend paid preparer earned income tax credit (EITC) due diligence requirements to the child tax credit

Currently, paid preparers who prepare federal income tax returns that involve an EITC must meet certain due diligence requirements or face a penalty of $500 for each return for which the requirement was not met. For each tax return, a paid preparer must complete the *Paid Preparer's Earned Income Credit Checklist* (Form 8867) and the checklist must be filed with the taxpayer's return. The paid preparer is also responsible for fulfilling record-keeping requirements.

The administration's FY 2016 proposal would extend the due diligence requirement to include all federal income tax returns that claim the child tax credit, including the additional child tax credit. The existing checklist would be expanded and adapted to reflect the differences in requirements between the EITC and the child tax credit, while ensuring that the additional burden to preparers and filers is minimized.

The proposal would be effective for returns required to be filed after December 31, 2015.

Explicitly provide that Treasury and the IRS have authority to regulate all paid return preparers

In 2009, Treasury and the IRS amended Circular 230 to regulate practice of all paid tax return preparers, including individuals who are unlicensed and unenrolled. Paid tax return preparers challenged these regulations in *Loving v. Commissioner*. The U.S. Court of Appeals for the District of Columbia Circuit determined that these regulations exceeded the IRS's authority.

The proposal would explicitly provide that the Secretary has the authority to regulate all paid tax return preparers.

The proposal would be effective on or after the date of enactment.

Increase the penalty applicable to paid tax preparers who engage in willful or reckless conduct

Currently the same 50% of the income derived (or to be derived) penalty may apply to preparers regardless of whether the preparer's conduct was willful and reckless. The proposal increases the penalty rate in section 6694(b) on paid tax returns for understatements due to willful or reckless conduct to the greater of the $5,000 or 75% of the income derived (or to be derived) by the prepared with respect to the return or claim for refund.

The proposal would be effective for returns required to be filed after December 31, 2015.

These provisions were separately included in the administration's FY 2015 revenue proposal.

Whistleblower Rules

Provide whistleblowers with protection from retaliation

Section 7623 allows whistleblowers to file claims for an award for information that allowed the IRS to detect tax underpayments or detect and bring to trial and punishment persons guilty of violating the internal revenue laws.

Other whistleblower statutes, such as the False Claims Act, explicitly provide whistleblowers with protection from retaliatory actions and allow whistleblowers to file claims in U.S. district courts for relief, including reinstatement, back pay, and other damages. There are currently no protections from retaliatory action for whistleblowers who file claims under section 7623. This lack of protection from retaliation may discourage whistleblowers from filing claims with the IRS.

The administration's FY 2016 proposal would amend section 7623 to explicitly protect whistleblowers from retaliatory actions, consistent with the protections currently available to whistleblowers under the False Claims Act.

The proposal would be effective upon enactment.

Provide stronger protection from improper disclosure of taxpayer information in whistleblower actions

Section 6103 provides that tax returns and tax return information are confidential, unless an exception applies. Section 6103(p) imposes safeguarding requirements on certain disclosures of tax return information. In addition, civil and criminal penalties may be imposed on an unauthorized inspection or disclosure of tax return information.

Currently, the IRS Whistleblower Office may share tax return information with whistleblowers and their legal representatives in a whistleblower administrative proceeding under section 6103(h) or by entering into a written agreement with the IRS under section 6103(n). Whistleblowers and their representatives who receive tax return information under section 6103(n) are subject to the section 6103(p) safeguarding requirements, including civil and criminal penalties for unauthorized inspections and disclosures. The same section 6103(p) safeguards do not extend to information disclosed to whistleblowers under section 6103(h).

The administration's FY 2016 proposal would extend the section 6103(p) safeguarding requirements to whistleblowers and their legal representatives who receive tax return information in whistleblower administrative hearings. In addition, the proposal would extend the penalties to unauthorized inspections and disclosures of tax return information to whistleblowers and legal representatives.

The proposal would be effective upon enactment.
These provisions were separately included in the administration's 2015 revenue proposal.

Worker Classification

Improve compliance by businesses increase certainty with respect to worker classification

Under a special non-Code provision (*Section 530 of the Revenue Act of 1978*), the IRS is prohibited from reclassifying an independent contractor to employee status, even when the worker may be an employee under the common law rules, if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met. In addition to providing so-called "Section 530 relief" to service recipients, the 1978 legislation prohibited the IRS from issuing guidance addressing the proper classification of workers.

The administration's FY 2016 proposal would allow the IRS to require service recipients to prospectively reclassify workers who are currently misclassified. It is anticipated that, after enactment, new enforcement activity would focus mainly on obtaining the proper worker classification prospectively, since in many cases, the proper classification of workers may have been unclear. In addition, the proposal would lift the prohibition on worker classification guidance, with Treasury and the IRS being directed to issue guidance that: (1) interprets the common law in a neutral manner; and (2) provides narrow safe harbors and/or rebuttable presumptions. Service recipients would be required to give notice to independent contractors explaining how they will be classified and the implications of such classification. Independent contractors receiving payments totaling $600 or more in a calendar year from a service recipient would be permitted to require the service recipient to withhold federal income tax from their gross payments at a flat rate percentage selected by the contractor.

The provision would be effective upon enactment, but prospective reclassification of those workers covered by Section 530 would not be effective until the first calendar year beginning at least one year after the date of enactment. The transition period could be up to two years for independent contractors with existing written contracts establishing their status.

KPMG observation

This proposal could result in a significant increase in costs and burdens on U.S. businesses that have service providers currently classified as independent contractors. The reclassification to employees may have wide-spread implications outside of federal employment taxes and affect such matters as workers compensation, unemployment benefits, pension requirements, and state employment taxes.

This provision was included in the administration's FY 2015 revenue proposal.

Contact a KPMG professional:

Lawrence Mack
Washington National Tax
Director
Practice, Procedure & Administration
T 202-533-3381
E lawrencemack@kpmg.com

Harve Lewis
Washington National Tax
Director
Practice, Procedure & Administration
T 202-533-6024
E harvelewis@kpmg.com

Lauren Roberts
Washington National Tax
Director
Practice, Procedure & Administration
T 202-533-5616
E lgroberts@kpmg.com

Norlyn Miller
Washington National Tax
Director
Practice, Procedure & Administration
T 202-533-4130
E nmillerjr@kpmg.com

Steven Friedman
Washington National Tax
Director
Practice, Procedure & Administration
T 202-533-4110
E smfriedman@kpmg.com

Michael Dolan
Washington National Tax
Director-in-Charge
Practice, Procedure & Administration
T 202-533-6150
E mpdolan@kpmg.com

John Gimigliano
Washington National Tax
Principal in Charge
Federal Legislative and Regulatory Services
T 202-533-4022
E jgimigliano@kpmg.com