Bipartisan Budget Agreement Triggers New Audit Rules for Partnerships; Repeals ACA Automatic Enrollment

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On November 2, 2015, President Obama signed into law the Bipartisan Budget Agreement of 2015, H.R. 1314, which, in addition to lifting mandatory spending caps and raising the federal debt ceiling, has repealed the Affordable Care Act's automatic enrollment requirement and made significant changes to the audit rules for partnerships and LLCs or other entities taxed as partnerships such that audit adjustments will be determined, assessed, and collected at the partnership, rather than the partner, level.

New Rules for Partnership Audits

Beginning with partnership tax years beginning after December 31, 2017, all partnerships will be subject to the new audit rules unless the partnership is eligible to, and does in fact, file an election out of the new rules. A partnership will only be eligible to elect out of the new rules if:

1. each partner of the partnership is either an individual, a C corporation (or foreign equivalent of a C corporation), an S corporation, or an estate of a deceased partner, and
2. the partnership has 100 or fewer partners (each shareholder of an S corporation that is a partner will be treated as a partner for purposes of this requirement).

Most notably, lower tier partnerships, or partnerships with any partner that is also a partnership, will not be eligible to elect out of the new audit rules. However, Congress did leave open the possibility for the Treasury to permit tiered partnerships to elect out of the new rules by way of a "look-through" rule similar to the rule for S corporation partners mentioned above. Eligible partnerships that elect out of the new rules will continue to have audit adjustments made and collected at the partner level.

Under the new rules, audit adjustments will be determined at the partnership level and taken into account by the partnership in the adjustment year. The partnership generally would then pay tax equal to the "imputed underpayment" which is the net of all adjustments multiplied by the highest individual or corporate tax rate. If the partnership can then demonstrate by filing amended partner returns that the underpayment would be lower if partner-level considerations were taken into account, then the

partnership could pay that lower amount.

Alternatively, instead of paying the adjusted tax at the partnership level, the partnership could file an election within 45 days of the notice of final adjustment to issue adjusted K-1s to the reviewed year partners who would then need to take the adjustment into account on their individual returns in the adjustment year through a simplified amended return process.

The Bipartisan Budget Act of 2015 also provides that partners must treat each item of income, gain, loss, deduction, or credit passed through from a partnership in a manner consistent with such treatment on the partnership's return. Partnerships must also designate a partnership representative who shall have the sole authority to act on behalf of the partnership, and the partnership and all partners will be bound by the actions taken by the partnership under these new rules.

Under the new rules, because audit adjustments can be assessed to the partnership, current partners could find themselves on the hook for underpayments of tax that occurred before they became a partner. Therefore, purchasers of partnership interests may wish to secure additional assurances or an indemnity from their sellers. In addition, provision for who has the power to make any elections under these new rules should become an important issue when negotiating partnership or LLC operating agreements.

Changes to Affordable Care Act

The Bipartisan Budget Act of 2015 also repeals the automatic enrollment requirement of the Affordable Care Act (ACA). The ACA amended the Fair Labor Standards Act to require employers with at least 200 full-time employees to automatically enroll new full-time employees in health care coverage. The Department of Labor (DOL) had previously delayed enforcement of the automatic enrollment mandate until it issued implementing regulations. No regulations were ever issued. The ACA automatic enrollment requirement has now been repealed without ever having taken effect.

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