



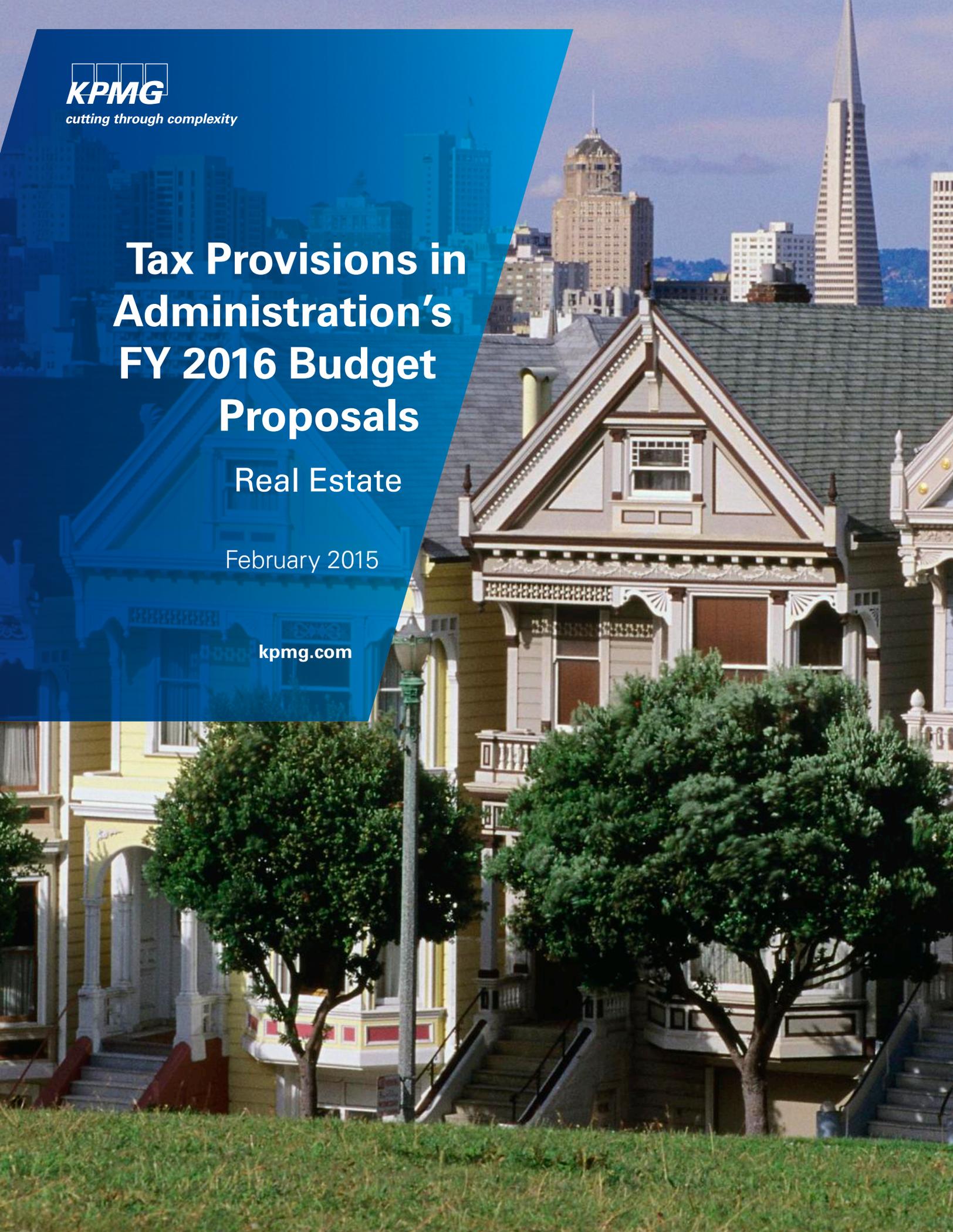
cutting through complexity

# Tax Provisions in Administration's FY 2016 Budget Proposals

## Real Estate

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[kpmg.com](http://kpmg.com)



## HIGHLIGHTS OF TAX PROPOSALS IN THE ADMINISTRATION'S FISCAL YEAR 2016 BUDGET OF POTENTIAL INTEREST TO THE REAL ESTATE INDUSTRY

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 that may be of interest to the real estate industry. 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
- Practice, Procedures, & Administration
- Charitable Deductions & Exempt Organizations
- Compensation, Benefits, & Qualified Plans
- Energy & Natural Resources
- Insurance
- Taxation of Individuals
- Closely-Held Businesses and Their Owners

### 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.

## Tax Proposals of Interest to Real Estate Industry

This booklet addresses the following budget proposals:

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## Real Estate-Specific Proposals

### **Exempt foreign pension funds from the application of the Foreign Investment in Real Property Tax Act (FIRPTA)**

The administration's FY 2016 proposal to exempt from the application of FIRPTA gains of foreign pension funds from the disposition of U.S. real property interests (USRPIs) is substantially similar to the provision included in the administration's FY 2015 budget, except it would be effective for dispositions occurring after December 31, 2015.

### **Modify like-kind exchange rules for real property**

Current law provides that no gain or loss is recognized when business or investment property is exchanged for "like-kind" business or investment property.

The Treasury Department's general explanation of the tax proposals of the budget—the so-called "[Green Book](#)"—indicates that the administration believes there is little justification for allowing deferral of the capital gain on the exchange of real property (as opposed to personal property used in a trade or business, such as machinery and equipment). Among other things, the ability to exchange unimproved real estate for improved real estate encourages "permanent deferral" by allowing taxpayers to continue a cycle of tax deferred exchanges, with potentially no tax ever being imposed on increased value of the disposed properties.

As was the case for the previous fiscal year's budget proposal, the administration's FY 2016 proposal would limit the amount of capital gain deferred under these rules from the exchange of real property to \$1 million (indexed for inflation) per taxpayer per tax year. It would not affect the treatment of exchanges of personal property. Treasury would be granted regulatory authority necessary to implement the provision, including rules for aggregating multiple properties exchanged by related parties.

The proposal would be effective for like-kind exchanges completed after December 31, 2015.

### **KPMG observation**

The *Tax Reform Act of 2014* proposed by the former Chairman of the House Ways and Means Committee, Dave Camp, in the last congress proposed repealing section 1031 entirely. Thus, there appears to be an increased focus on section 1031, both by the administration and by key lawmakers.

## **Modify and permanently extend the deduction for energy-efficient commercial building property**

Section 179D provides a deduction in an amount equal to the cost of “energy efficient commercial building property” placed in service during the tax year. The section 179D deduction expired on December 31, 2014.

The proposal would extend the current law for property placed in service before January 1, 2016, and update it to apply Standard 90.1-2004.

For facilities placed in service after December 31, 2015, the proposal would permanently extend and modify the current deduction with a larger fixed deduction. The proposal would raise the current maximum deduction for energy-efficient commercial building property to \$3.00 per square foot (from \$1.80 per square foot). The maximum partial deduction allowed with respect to each separate building system would be increased to \$1.00 per square foot (from \$0.60 per square foot).

For taxpayers that simultaneously satisfy the energy savings targets for both building envelope and heating, cooling, ventilation, and hot water systems, the proposal would increase the maximum partial deduction to \$2.00 per square foot (from \$1.20 per square foot). Energy-savings targets would be updated every three years by the Secretary of Treasury in consultation with the Secretary of Energy to encourage innovation by the commercial building industry.

A deduction would also be allowed, beginning in 2016, for projected energy savings from retrofitting existing commercial buildings with at least 10 years of occupancy.

A taxpayer could only take one deduction for each commercial building property.

### **KPMG observation**

By increasing the basic deduction from \$1.80 to \$3.00, the proposal would substantially enhance the incentive for taxpayers.

## **Extend exclusion from income for cancellation of certain home mortgage debt**

Gross income generally includes income realized from the discharge of indebtedness. Under current law, an exception to this general rule exists for qualified principal residence interest (QPRI), which is acquisition indebtedness with respect to a taxpayer's principal residence, limited to \$2 million (\$1 million if married filing separately). Pursuant to this exception, taxpayers are allowed to exclude income from the discharge of QPRI. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for QPRI relief, which applies to debt forgiven in calendar years 2007 through 2014.

The administration's FY 2016 proposal would extend the exclusion from income for QPRI to amounts that are discharged before January 1, 2018, and to amounts that are discharged pursuant to an agreement entered into before that date.

### **Reform and expand the low-income housing tax credit (LIHTC)**

For private activity bonds (PABs) to be tax-exempt (i.e., to be "qualified private activity bonds"), the face amount of PABs issued by the issuing authority in any state must not exceed the maximum amount of such bonds that the authority may issue for the year ("PAB volume cap"). Under the Code, a state is allowed a limited amount of PAB volume cap per year.

Also, each year, a state is provided with a limited amount of low-income housing tax credits (LIHTCs) for the state to allocate among proposed low-income housing projects. Often, states are faced with more proposed low-income housing projects than their LIHTC allocation can support. Increasing the amount of LIHTCs could allow deserving projects that would not otherwise be viable to obtain the LIHTC needed to go forward.

#### *Allow conversion of private activity bond (PAB) volume cap into LIHTCs*

The administration's FY 2016 proposal would provide two ways in which the PAB volume cap could be converted into LIHTCs.

First, states would be allowed to convert an annual maximum PAB volume cap into LIHTC allocations for the same year. The conversion ratio would be reset each calendar year to respond to changing interest rates. For each \$1,000 of PAB volume cap surrendered, the state would receive additional allocable LIHTCs equal to:  $\$1000 \times$  twice the applicable percentage that applies for PAB-financed buildings (30% present value applicable percentage) based upon the appropriate percentages as of December of the preceding calendar year. The aggregate amount of PAB volume cap that a state may convert with respect to a calendar year is 18% of its PAB volume cap for that year. The proposal would be effective for PAB volume cap received in, and additional LIHTC allocation authority received for calendar years beginning after the date of enactment.

Second, a taxpayer would be able to qualify for the 30% present value LIHTC—generally allowed for projects at least 50% financed with tax exempt bonds—without actually getting such financing if there is an allocation of PAB volume cap in the required amount of financing. Such allocation would reduce the state's remaining volume cap as if tax-exempt bonds had been issued. The proposal would be effective for projects that are allocated volume cap after the date of enactment.

#### *Encourage mixed income occupancy by allowing LIHTC-supported projects to elect a criterion employing a restriction on average income*

An investor in low-income rental housing can qualify for a low-income housing tax credit (LIHTC), generally for the first 10 years in which the housing project is in service, if the

building meets various requirements. Currently, a taxpayer may elect between two criteria for a building: (1) at least 20% of the units must be rent restricted and occupied by tenants with income at or below 50% of area median income (AMI); or (2) at least 40% of the units must be rent restricted and occupied by tenants with incomes at or below 60% of AMI.

The administration's FY 2016 proposal would add a third elective criterion to qualify a building for the LIHTC. Under this new criterion, at least 40% of the units would have to be occupied by tenants with incomes that average no more than 60% of AMI. At the election of the owner, a special rule would apply for income qualification for tenants in HUD or the Department of Agriculture subsidized units. These proposals would be effective for elections made after the date of enactment.

#### *Change formulas for 70% PV and 30% PV LIHTCs*

The owner of rental housing occupied by tenants having incomes below specified levels may claim the LIHTC over a 10-year period. The credits earned each year generally depend on, among other things, a credit rate, called the "applicable percentage." There are two applicable percentages—the 70% present value credit rate and the 30% present value credit rate. The applicable percentage is generally set monthly, for credit allocations made in that month, and applies to the future LIHTCs related to that allocation. There has been a statutorily set temporary minimum applicable percentage of 9% for the 70% present value credit rate. This minimum 9% rate expired for credit allocations made before January 1, 2014.

The administration's FY 2016 proposal would not extend the 9% temporary minimum applicable percentage, but would increase the discount rate used in the present value calculation for allocated LIHTCs. The change would apply to both 70% and 30% LIHTCs. Under the proposal, the discount rate to be used would be the average of the mid-term and long-term applicable federal rates for the relevant month, plus 200 basis points (although the 30% present value credit rate for LIHTCs that result from tax-exempt bond financing would continue to be computed under current law). The proposal would be effective for buildings that receive allocations on or after the date of enactment.

#### *Add preservation of federally assisted affordable housing to allocation criteria*

Under current law, each state must adopt a qualified allocation plan (QAP) to guide the allocation of LIHTCs. The Code requires 10 selection criteria to be included in every plan. The administration's FY 2016 proposal would add preservation of federally assisted affordable housing as an eleventh selection criterion that QAPs must include. The proposal would be effective for allocations made in calendar years beginning after the date of enactment.

### *Remove the qualified census tracts (QCT) population cap*

LIHTC projects located in qualified census tracts (QCTs) receive a “basis boost” of up to 30% of their eligible basis thus increasing the owner’s LIHTCs by 30%. A QCT is designated by the Department of Housing and Urban Development (HUD). The combined aggregate population of census tracts in a metropolitan statistical area (MSA) designated as QCTs cannot exceed 20% of population of the MSA.

The administration’s FY 2016 proposal would allow HUD to designate as a QCT any census tract that meets the current statutory criteria of a poverty rate of at least 25% or 50% or more of households with an income less than 60% of AMI. That is, the proposal would remove the current limit under which the aggregate population in census tracts designated as QCTs cannot exceed 20% of the metropolitan area's population. This proposal would apply to buildings that receive allocations of LIHTCs or volume cap after the date of enactment.

### *Implement requirement that LIHTC-supported housing protect victims of domestic abuse*

The administration’s FY 2016 proposal would require protections for victims of domestic abuse to be included in the “long-term use agreement” that is entered between the owner of a low-income housing project and the state housing credit agency.

In addition, the proposal would clarify that occupancy restrictions or preferences that favor persons who have experienced domestic abuse would qualify for the “special needs” exception to the general public use requirement.

The proposed change would be effective for agreements that are either first executed, or subsequently modified, 30 days or more after enactment. The proposed clarification of the general public use requirement would be effective for tax years ending after the date of enactment.

### **Enhance and modify the conservation easement deduction**

Under current law, a donor may deduct the fair market value of certain conservation contributions made to a qualified charitable organization. Although the current tax deduction provides important incentives for conservation, it has been of limited value to some donors while being susceptible to abuse and difficult to administer in other cases. The administration’s FY 2016 proposal would make permanent the temporary enhanced deduction for conservation easement contributions that expired on December 31, 2014, and modify the conservation easement deduction, as follows:

- The proposal would require new regulations, based on the experiences and best practices developed in several States and by voluntary accreditation programs, to establish minimum requirements for organizations to qualify to receive deductible contributions of conservation easements by requiring such organizations to meet

minimum requirements. The proposal states that an organization would jeopardize its status as a “qualified organization” by accepting contributions that it knows (or should know) are substantially overvalued or do not further an appropriate conservation purpose. The proposal also suggests that the regulations could specify, among other things, that a “qualified organization” (1) must not be related to the donor or to any person that is or has been related to the donor for at least ten years; (2) must have sufficient assets and expertise to be reasonably able to enforce the terms of all easements it holds; and (3) must have an approved policy for selecting, reviewing, and approving conservation easements that fulfill a conservation purpose.

- The proposal would modify the definition of eligible “conservation purposes” to require that all contributed easements further a clearly delineated federal conservation policy (or an authorized state or tribal government policy) and yield significant public benefit.
- The proposal would require the donor to provide a detailed description of the conservation purpose or purposes furthered by the contribution, including a description of the significant public benefits it will yield. It would also require the donee organization to attest to the accuracy of the conservation purpose, public benefits, and fair market value of the easement reported to the IRS. The proposal would also impose penalties on organizations and organization managers that attest to values that they know (or should know) are substantially overstated or that receive contributions that do not serve an eligible conservation purpose.
- The proposal would amend section 6033 by requiring electronic reporting and public disclosure by donee organizations of the following: (1) deductible contributions of easements, including detailed descriptions of the subject property and the restrictions imposed on the property, the conservation purposes served by the easement, and any rights retained by the donor or related persons; (2) the fair market value of both the easement and the full fee interest in the property at the time of the contribution; and (3) a description of any easement modifications or actions taken to enforce the easement that were taken during the tax year.
- The proposal would also authorize a pilot of an allocable credit for conservation contributions. The pilot would provide a non-refundable credit for conservation easement contributions as an alternative to the conservation contribution deduction. A federal agency would allocate \$100 million in credits per year to qualified charitable organizations and governmental entities, which would allocate the credits to donors. The proposal would permit donors to receive up to a maximum of 50% of the easement’s fair market value and carry forward any unused credit amounts for up to 15 years. The Secretary of the Treasury, in collaboration with the Secretaries of Agriculture and the Interior, would be required to report to Congress on the relative merits of the conservation credit and the deduction for conservation contributions, including an assessment of the conservation benefits and costs of both tax benefits.

- The proposal would eliminate the deduction for contributions of conservation easements of a partial interest in property that is, or is intended to be, used as a golf course.
- The proposal would restrict deductions and harmonize the rules for contributions of conservation easements for historic preservation, by disallowing a deduction for any value of a historic preservation easement associated with the restricted upward development above a historic building. To maintain consistency, the proposal would also extend the special rules applicable to buildings in registered historic districts to apply to buildings listed in the National Register.

The proposals would be effective for contributions made after the date of enactment.

## Modification to REIT Rules

### **Repeal preferential dividend rule for publicly traded and publicly offered real estate investment trusts (REITs)**

The administration's FY 2016 budget proposal would repeal the preferential dividend rule for publicly traded REITs and publicly offered REITs. That is, the preferential dividend rule would not apply to a distribution with respect to stock if:

- As of the record date of the distribution, the REIT was publicly traded
- As of the record date of the distribution—
  - The REIT was required to file annual and periodic reports with the SEC under the Securities Act of 1934
  - Not more than one-third of the voting power of the REIT was held by a single person (including any voting power that would be attributed to that person under the rules of section 318)
  - Either the stock with respect to which the distribution was made is the subject of a currently effective offering registration, or such a registration has been effective with respect to that stock within the immediately preceding 10-year period

Treasury would also be given explicit authority to provide for cures of inadvertent violations of the preferential dividend rule when it continues to apply and, when appropriate, to require consistent treatment of shareholders.

The provision would apply to distributions that are made (without regard to section 858) in tax years beginning after the date of enactment.

## Partnership Proposals of Potential Interest to Real Estate Funds

### **Treat income from certain carried (profits) interests as ordinary**

The administration's FY 2016 proposal includes a measure to tax carried interests in investment partnerships as ordinary income, effective for tax years ending after December 31, 2015. The proposal appears to be substantially the same as the proposal that was included in the administration's budget for the previous fiscal year. The proposal, however, reflects a different approach than that taken in the Camp tax reform bill.

The Green Book generally indicates that the proposal would tax as ordinary income a partner's share of income from an investment services partnership interest (ISPI) in an investment partnership; would require the partner to pay self-employment taxes on such income; and generally would treat gain recognized on the sale of such interest as ordinary. An ISPI generally would be a carried interest in an investment partnership that is held by a person who provides services to the partnership. A partnership would be an investment partnership only if: (1) substantially all of its assets were investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash or cash equivalents, or derivative contracts with respect to such assets); and (2) over half of the partnership's contributed capital was from partners in whose hands the interests constitute property not held in connection with a trade or business. The administration's proposal continues to provide exceptions for "invested capital," as well as anti-abuse rules applicable to certain "disqualified interests."

As was the case for the previous fiscal year's budget proposal, the Green Book continues to indicate that:

...to ensure more consistent treatment with the sales of other types of businesses, the [a]dministration remains committed to working with Congress to develop mechanisms to assure the proper amount of income recharacterization where the business has goodwill or other assets unrelated to the services of the ISPI holder.

The proposal would be effective for tax years beginning after December 31, 2015.

### **Repeal partnership technical termination rules**

Under current law, a partnership can "technically terminate" under section 708(b)(1)(B) if, within a 12-month period, there is a sale or exchange of 50% or more of the total interest in both partnership capital and partnership profits. If a partnership technically terminates, certain events are deemed to take place to effectuate the tax fiction that the "old" partnership has terminated and a "new" partnership has begun.

As was generally the case for the FY 2015 proposal, the administration's FY 2016 proposal would repeal the technical termination rule of section 708(b)(1)(B), effective for transfers after December 31, 2015.

### **KPMG observation**

Technical terminations can raise significant federal tax issues, many of which can be unfavorable from a taxpayer's perspective, but some of which can be favorable in particular fact situations. In addition, technical terminations raise compliance considerations. As a result, under current law, it can be important for partnerships to monitor sales and exchanges of their interests to determine if technical terminations may be triggered and to assess the consequences of such terminations based on their particular facts. Repealing the technical termination rules would reduce compliance burdens and would eliminate consequences—favorable and unfavorable—that can result in particular cases.

### **Extend partnership basis limitation rules to nondeductible expenditures**

Under current law, a partner's distributive share of partnership losses for a tax year is allowed only to the extent of the partner's adjusted basis in its partnership interest at the end of the partnership tax year. Losses that are disallowed under this rule generally are carried forward and are allowed as deductions in future tax years to the extent the partner has sufficient basis at such time. The IRS issued a private letter ruling in 1984 concluding that this loss limitation rule does not apply to limit a partner's deduction for its share of the partnership's charitable contributions.

As was the case for the previous fiscal year's budget proposal, the administration's FY 2016 proposal would modify the statutory loss limitation rule to provide that a partner's distributive share of expenditures not deductible by the partnership (or chargeable to capital account) are allowed only to the extent of the partner's adjusted basis in the partnership interest at the end of the year.

A JCT explanation of a substantially similar budget proposal for FY 2013 indicates that the current loss limitation rule is intended to limit a taxpayer's deductions to its investment in the partnership (taking into account its share of partnership debt). The JCT explanation suggests that the administration's proposal is intended to address the following concern:

Because of a technical flaw in the statute, which was written in 1954, it appears that the limitation does not apply, for example, to charitable contributions and foreign taxes of the partnership, because those items are not deductible in computing partnership income. Because a partner's basis cannot be decreased below zero, a partner with no basis is allowed a deduction (or credit) for these items without having to make the corresponding reduction in the basis of his partnership interest that would otherwise be required.

The provision would apply to partnership tax years beginning on or after the date of enactment.

### **Expand the definition of substantial built-in loss for purposes of partnership loss transfers**

Under current law, if there is a transfer of a partnership interest, the partnership is required to adjust the basis of its assets with respect to the transferee partner if the partnership at that time has a substantial built-in loss in its assets, i.e., if the partnership's adjusted basis in its assets exceeds the fair market value of its assets by more than \$250,000. This rule is intended to prevent the duplication of losses.

As was the case for the previous fiscal year's budget proposal, the administration's FY 2016 proposal would extend the mandatory basis adjustment rules for transfers of partnership interests to require an adjustment with respect to the transferee partner if such partner would be allocated a net loss in excess of \$250,000 if the partnership were to sell its assets for cash for fair market value in a fully taxable transaction immediately after the transfer. This adjustment would be required even if the partnership as a whole did not have a substantial built-in loss.

The Joint Committee on Taxation (JCT) provided an example of when the provision could apply in its description of a substantially similar budget proposal for FY 2013. In that example, a partnership has two assets, one of which (Asset X) has a built-in gain of \$1 million and the other of which (Asset Y) has a built-in loss of \$900,000. The partnership has three taxable partners—A, B, and C. The partnership agreement specially allocates to A any gain on sale or exchange of Asset X; the partners share equally in other partnership items. Although the partnership does not have an overall built-in loss, B and C each have a net built-in loss of \$300,000 allocable to their partnership interest (one-third of the loss attributable to Asset Y). If C were to sell the partnership interest to another person (D), the proposal would require a mandatory basis adjustment with respect to D. The JCT explanation notes that, if an adjustment were not made, the purpose of the current mandatory basis adjustment rules for built-in losses arguably would not be carried out.

The provision would apply to sales or exchanges after the date of enactment

### **Tax gain from the sale of a partnership interest as "ECI" on look-through basis**

The administration's FY 2016 proposal to tax gain from the sale of a partnership interest as effectively connected income on a look-through basis is substantially similar to the provision included in the administration's FY 2015 budget, except it would be effective for sales or exchanges after December 31, 2015. Very generally, the proposal would provide that gain or loss from the sale or exchange of a partnership interest would be effectively connected with the conduct of a trade or business in the United States to the extent attributable to the transferor partner's distributive share of the partnership's unrealized gain or loss attributable to ECI property

## **Modification to Employment Tax Rules for Passthrough Entities**

As was the case for the previous fiscal year's budget proposal, the administration's FY 2016 proposal would change the employment tax rules with respect to professional services businesses that are passthrough entities. "Professional services businesses" would include S corporations and entities classified as partnerships for federal tax purposes, substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, investment advice or management, brokerage services, and lobbying. Thus, an expansive list of businesses would be covered.

Under the proposal, individual owners of professional services businesses that are passthrough entities would all be subject to Self-Employment Contributions Act (SECA) taxes in the same manner and to the same degree. More specifically, an individual owner and service provider who materially participates would be subject to SECA tax on his entire distributive share of passthrough income (subject to current law exceptions for items such as rents, dividends, and capital gains), while an owner who does not materially participate would be subject to SECA taxes only on an amount of income equal to "reasonable compensation," if any, for services provided to the business. Material participation generally would be determined using the section 469 rules, except that the exception for limited partners would not apply in the SECA context. Reasonable compensation would be as large as guaranteed payments received from the business for services. Distributions of compensation to shareholders of professional services businesses that are S corporations would no longer be treated as wages subject to Federal Insurance Contributions Act (FICA) taxes, but would be included in earnings subject to SECA taxes.

The proposal would be effective for tax years beginning after December 31, 2015.

## **Individual Tax Increases of Relevance to Real Estate Owners**

### **Increase capital gain and qualified dividend rates**

Under current law, capital gains are taxable only on the sale or other disposition of an appreciated asset. The long-term capital gains tax rate (which also applies to qualified dividends) is generally 20% with an additional 3.8% net investment income tax, which may also be applicable on the gain.

The administration's proposal would increase the tax rate on long-term capital gains and qualified dividends to 24.2% which, in conjunction with the 3.8% net investment income tax, would tax long-term capital gains at 28%. The proposal would be effective for long-term capital gains realized, and qualified dividends received, in tax years beginning after December 31, 2015.

## **Treat transfers of appreciated property as sales, including transfers on death**

Currently, when an individual transfers assets at death, the recipient generally receives the assets with a basis equal to the fair market value of the asset on the date of death. When an individual transfers assets during life, the recipient generally receives the assets with a basis equal to the donor's basis in the assets on the date of the gift. There is no recognition of capital gain on the date of death or gift.

The administration's proposal would treat the transfer of appreciated property (during life or at death) as a sale of the property, with any inherent gain realized and subjected to capital gains tax at that time. Tax incurred on gains deemed realized at death would be deductible for estate tax purposes. Transfers to a spouse or to a charity would not trigger the capital gains tax and would instead carry over the basis of the donor or decedent to the recipient. In addition, the proposal would exempt any gain on tangible personal property (items like furniture, clothing and other household items) other than art and similar collectibles, exempt up to \$250,000 per person of gain on a residence, and exempt up to \$100,000 per person (indexed for inflation) of other gain. The residence and general exemptions would be portable between spouses such that couples could collectively exempt \$500,000 of gain on a residence and \$200,000 of other gain.

The exclusion under current law for capital gain on certain small business stock would also apply. The proposal makes tax due on the gain attributable to certain small family-owned and family-operated businesses only once they are actually sold or cease to be family-owned and operated. It also includes an option to pay tax on any gains not associated with liquid assets over 15 years using a fixed rate payment plan.

The proposal would be effective for gains on gifts made and for decedents dying after December 31, 2015.

### **KPMG observation**

This is a new provision, i.e., it was not included in a prior budget.

Gifts made during life do not currently receive stepped-up basis but instead have carry-over basis and any related gain is realized when the recipient of the gift sells the asset. As such, the "loophole" the administration is trying to close does not exist in the gift tax context as such gains are ultimately taxed when the asset is sold.

Prior discussions around eliminating stepped-up basis have generally contemplated a corresponding elimination of the estate tax (i.e., suggesting that there should be an estate tax or a capital gains tax at death but not both). This proposal, however, does not appear to affect the existence of the estate tax and seems to contemplate its continuing applicability by allowing for the capital gains taxes triggered at death to be taken as a deduction on the decedent's estate tax return. If this provision and the provision seeking to return the estate tax provisions back to 2009 levels were both fully

implemented, an estate worth more than the exemption amount (\$3,500,000 per person under 2009 law) could face an estate tax of 45%, a tax on capital gains of 28%, plus, where applicable, state estate and state income taxes. While the interplay of the various taxes is not completely spelled out in detail in the proposal, it is conceivable that, in a high tax state, zero basis assets held at death could bear a total tax of 70-75% (taking into account the potential deductibility of the capital gains tax on the estate tax return).

### **Impose a new “fair share tax” on upper-income taxpayers**

Under current law, individual taxpayers may reduce their taxable income by excluding certain income such as the value of health insurance premiums paid by employers and interest on tax-exempt bonds. They can also claim certain itemized or standard deductions in computing adjusted gross income such as state and local taxes and home mortgage interest. Qualified dividends and long-term capital gains are taxed at a maximum rate of 23.8% while ordinary income, including wages, is taxed at graduated rates as high as 39.6%.

The wage base for much of the payroll tax is capped at \$118,500 in 2015, making average marginal rates for those earning over that amount lower than the 15.3% rate paid by those making at or below that amount (although half this amount is the liability of the employer).

The administration’s FY 2016 proposal would impose a new minimum tax, called the “fair share tax” (FST), phasing in for taxpayers having \$1 million of AGI (\$500,000 if married filing separately). The tentative FST would equal 30% of AGI less a credit for charitable contributions. The charitable credit would equal 28% of itemized charitable contributions allowed after the limitation on itemized deductions (the “Pease limitation”). Final FST would be the excess of the tentative FST over regular income tax (including AMT and the 3.8% surtax on investment income, certain credits, and the employee portion of payroll taxes). The tax would be fully phased in at \$2 million of AGI (\$1 million if married filing separately). AGI thresholds would be indexed for inflation beginning after 2016.

The proposal would be effective for tax years beginning after December 31, 2015.

## Incentives for Investment in Infrastructure

### **Provide America Fast Forward Bonds and expand eligible uses**

The proposed America Fast Forward Bond (AFFB) program is similar to the administration's FY 2014 proposal for making permanent the Build America Bond (BAB) program. Under the BAB program, the federal subsidy level for refund payments processed on or after October 1, 2014, and on or before September 30, 2015, has been reduced by a sequestration rate of 7.3%. The proposed AFFB program would provide direct payments to state and local governmental issuers in an amount equal to 28% of the coupon interest, a federal subsidy level that is intended to be approximately revenue neutral relative to the estimated future federal tax expenditures for tax-exempt bonds. Further, the proposal also recommends that the AFFB program be protected from sequestration.

In addition to containing all the eligible uses that the BAB program contained, the proposed AFFB program would provide another eligible use: financing for the types of projects and programs that can be financed with qualified private activity bonds, subject to the applicable state bond volume caps for the qualified private activity bond category. The proposal would be effective for bonds issued on or after January 1, 2016.

### **Allow current refundings of state and local governmental bonds**

With respect to tax-exempt bonds issued by state and local governments, a "current refunding" or "current refunding issue" refers to bonds issued to refinance another outstanding bond issue in circumstances when the outstanding bonds are redeemed or retired within 90 days after issuance of the current refunding bonds. Typically, state and local governments engage in current refunding transactions primarily to reduce interest costs.

Currently, the extent to which statutory provisions address current refunding varies among different state and local bond provisions. In order to promote greater uniformity and increased certainty, the administration's FY 2016 proposal would set forth a general Code provision to authorize current refunding of state or local bonds upon satisfaction of certain requirements related to the size and maturity of the bonds. The provision would generally apply to state and local bond programs that do not otherwise allow current refunding or expressly address the treatment of current refunding. It would not affect refunding of bonds when current refundings are already allowed.

The proposal would be effective as of the date of enactment.

### **Provide a new category of qualified private activity bonds for infrastructure projects referred to as "Qualified Public Infrastructure Bonds"**

The administration proposes to create a new category of tax-exempt qualified private activity bonds called "Qualified Public Infrastructure Bonds" (QPIBs). These bonds would

be eligible to finance certain specific categories of infrastructure projects that are permitted to be financed with exempt facility bonds under current law. The proposal would impose two core eligibility requirements for QPIBs: the projects financed by QPIBs must be owned by a state or local governmental unit, and they must meet a public use requirement by serving a general public use or being available on a regular basis for general public use. Further, the proposal would require that, in general, QPIBs meet the existing eligibility restrictions for qualified private activity bonds.

The proposal would make the bond volume cap requirement and the AMT preference for interest on specified private activity bonds inapplicable to QPIBs.

The proposal would remove those existing categories of exempt facilities that overlap with QPIBs effective upon the effective date of the proposal, subject to a transitional exception for qualified highway or surface freight transfer facilities.

The proposal would be effective for bonds issued starting January 1, 2016.

### **Modify qualified private activity bonds for public educational facilities**

Current law permits tax-exempt private activity bond financing for “qualified public educational facilities.” A private “corporation” must own the public school facilities and must transfer the ownership of the school facilities to the public agency at the end of the term of the bonds for no additional consideration. In addition, a special separate annual volume cap applies to these bonds.

The proposal would eliminate the private corporation ownership requirement and would allow any private person either to own the public school facilities, or to operate those school facilities through lease, concession, or other operating arrangements. The proposal also would remove the requirement to transfer the school facilities to a public agency. Further, it would remove the separate volume cap for qualified public educational facilities; these facilities instead would be included under the unified annual state bond volume cap for private activity bonds under section 146.

The proposal would be effective for bonds issued after the date of enactment.

### **Modify treatment of banks investing in tax-exempt bonds**

Banks, thrift institutions, and other financial institutions generally may not deduct any portion of their interest expenses allocable to tax-exempt obligations acquired after August 7, 1986. Financial institutions, however, generally can deduct 80% of their interest expenses allocable to tax-exempt interest on qualified tax-exempt obligations. Qualified tax-exempt obligations include certain tax-exempt obligations issued by issuers that issue no more than \$10 million of certain tax-exempt bonds annually (the qualified small issuer limit).

The *American Recovery and Reinvestment Act of 2009* (ARRA) provided a temporary rule that generally allowed financial institutions to deduct 80% of interest expense allocable to any tax-exempt bond issued in 2009 or 2010, regardless of whether the bond was a qualified tax-exempt obligation. However, the bonds that benefited from this temporary rule could not exceed 2% of the financial institution's total assets. In addition, for obligations issued during 2009 and 2010, the ARRA made several modifications to the definition of qualified small issuer, including an increase in the annual issuance limit to \$30 million.

The administration proposes to permanently expand the qualified small issuer limit to permit such issuers to issue up to \$30 million of tax-exempt bonds annually. In addition, the amended qualified small issuer exception would not be limited to 2% of a financial institution's assets. This increase would allow financial institutions to deduct 80% of interest expenses allocable to qualifying bonds of these issuers. In addition, beginning with bonds issued in 2016, the proposal would permanently allow financial institutions to deduct 80% of interest expense allocable to any tax-exempt bond, regardless of whether the bond is a qualified tax-exempt obligation. This exception would continue to be limited to 2% of the taxpayer's assets. Finally, the same rules that are applicable to C corporation financial institutions would also be applied to financial institutions that are S corporations or qualified subchapter S subsidiaries.

The proposal would apply to bonds issued in calendar years beginning on or after January 1, 2016.

#### **KPMG observation**

This proposal would expand the bonds subject to the more favorable interest disallowance rules in section 291, but still preserve differences in treatment of different bonds. This proposal would only apply to tax-exempt bonds issued in 2016 or later. Bonds issued before 2008 or from 2011 to 2015 would continue to be subject to the current rules for interest disallowance, even if held in 2016 or in later years. Additionally, this proposal would continue to maintain slightly different treatment for qualified tax-exempt obligations and other tax-exempt obligations, primarily the 2% limit.

The proposal also would not reinstate all of the ARRA provisions on tax-exempt obligations. Importantly, this proposal would not reinstate the ARRA provision that treated section 501(c)(3) organizations as separate issuers in certain cases for purposes of determining whether a bond was a qualified tax-exempt obligation. There is no indication as to why this provision was omitted.

The proposal would also provide for different treatment than under the Seventh Circuit decision in *Vainisi v. Commissioner*, 599 F.3d 567 (7th Cir. 2010), *rev'g* 132 T.C. 1 (2009). This decision allowed S corporations and qualified subchapter S subsidiaries to stop applying the 20% disallowance rule after three years. The proposal would apply

the same 20% disallowance rules to S corporations and qualified subchapter S subsidiaries that would apply to C corporations.

### **Repeal tax-exempt bond financing of professional sports facilities**

State and local bonds are classified as either governmental bonds or private activity bonds. The exclusion from income for state and local bond interest does not apply to private activity bonds issued to finance professional sports facilities. Bonds generally are classified as private activity bonds under a two-part test if: (1) more than 10% of the bond proceeds are used for private business use (private business use test); and (2) the debt service on more than 10% of the bond proceeds is payable or secured from property or payments derived from private business use (private payments test). Thus, if debt service is paid from sources other than sports facility revenues or other private payments, current law permits the use of tax-exempt governmental bond proceeds for professional sports facilities.

The proposal eliminates the private payments test for professional sports facilities. As a result, bonds issued to finance professional sports facilities would be taxable private activity bonds if more than 10% of the facility is used for private business use. By removing the private payment test, tax-exempt governmental bond financing of sports facilities with significant private business use by professional sports teams would be eliminated.

The proposal would be effective for bonds issued after December 31, 2015.

### **Modify tax-exempt bonds for Indian tribal governments**

Section 7871(c) generally restricts the authority of Indian tribal governments to issue tax-exempt bonds by limiting them to the financing of “essential governmental function” activities that are “customarily” performed by state and local governments with general taxing powers. The ARRA provided \$2 billion in bond authority for a new category of Indian tribal government tax-exempt bonds known as “Tribal Economic Development Bonds.” This authority, in section 7871(f), generally permits use of tax-exempt bond financing under standards that are comparable to those applied to state and local governments. ARRA also directed Treasury to study the Tribal Economic Development Bond provisions and report recommendations. Treasury issued its report in December 2011. The proposal follows the recommendations.

Under the administration’s proposal, Indian tribal governments would be permitted to issue governmental bonds and private activity bonds under standards comparable to those applicable to state and local governments. The proposal would retain the existing location restriction, which generally requires that financed projects be located on Indian reservations. It would also retain the prohibition on financing certain gaming projects.

The provision would be effective as of the date of enactment.

## Other bond proposals

The administration's FY 2016 budget also contains several bond proposals intended to provide incentives for investment in infrastructure, including private investment, and to repeal certain existing incentives. These are:

- Repeal the \$150 million non-hospital bond limitation on qualified section 501(c)(3) bonds
- Increase national limitation amount for qualified highway or surface freight transfer facility bonds from \$15 billion to \$19 billion
- Allow more flexible research arrangements for purpose of the private business use limitations
- Simplify arbitrage investment restrictions for tax-exempt bonds
- Simplify single-family housing mortgage bond targeting requirements

## Other Relevant Proposals

### **Increase the limitations for deductible new business expenditures and consolidate provisions for start-up and organizational expenditures**

The *Creating Small Business Jobs Act of 2010* increased the limit on deductible start-up expenditures, but only for tax years beginning in 2010. The administration's FY 2016 proposal would increase the limitations on a permanent basis and consolidate the provisions for start-up and organizational expenditures, effective for tax years beginning after 2015.

Start-up expenditures under section 195 consist of any amount (other than interest, taxes, or research and experimental expenditures) that would be deductible if paid or incurred in connection with the operation of an existing active trade or business, but that is instead incurred in connection with: (1) investigating the creation or acquisition of an active trade or business; (2) creating an active trade or business; or (3) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business.

Organizational expenditures under sections 248 and 709 are expenditures that are incident to the creation of a corporation or partnership, chargeable to a capital account, and are of a character that, if expended incident to the creation of a corporation or partnership having a limited life, would be amortizable over such life.

Apart from the exception for tax years beginning in 2010, current law permits taxpayers to deduct up to \$5,000 of start-up expenditures in the tax year in which the active trade or business begins (with the amount reduced by the amount by which such expenses exceed \$50,000) and to amortize the remaining amount ratably over the 180-month period beginning with the month in which the active trade or business begins. The 2010

legislation increased the amounts of this rule from \$5,000 to \$10,000 and from \$50,000 to \$60,000, but only for a single tax year beginning in 2010.

Similarly, current law permits taxpayers to deduct up to \$5,000 of organizational expenditures in the tax year in which the corporation or partnership begins business (with the amount reduced by the amount by which such expenses exceed \$50,000) and to amortize the remaining amount ratably over the 180-month period beginning with the month in which the corporation or partnership begins business.

The administration's FY 2016 proposal would permanently allow up to \$20,000 of new business expenditures to be deducted in the tax year in which a trade or business begins (with the amount reduced by the amount by which such expenses exceed \$120,000) and the remaining amount to be amortized ratably over the 180-month period beginning with the month in which the business begins. New business expenditures would include amounts incurred in connection with: (1) investigating the creation or acquisition of an active trade or business; (2) creating an active trade or business; (3) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business; and (4) expenditures that are incident to the creation of an entity taxed as a corporation or partnership, that are chargeable to a capital account and are of a character which, if expended incident to the creation of a corporation or partnership having a limited life, would be amortizable over such life.

According to the Green Book, the administration believes that a permanent doubling of currently deductible start-up expenses would support new business formation and job creation, and consolidating the provisions relating to expenditures incurred by new businesses would simplify tax administration and reduce new business owners' tax compliance burden.

### **Require current inclusion in income of accrued market discount and limit the accrual amount for distressed debt**

Market discount generally arises when a debt instrument is acquired in the secondary market for an amount less than its stated principal amount (or adjusted issue price, if it was issued with original issue discount (OID)). A holder of a debt instrument with market discount generally treats gain from a disposition of the instrument and principal payments under the instrument as ordinary income to the extent of the accrued market discount. Generally, market discount accrues ratably over the term of a debt instrument unless the holder elects to accrue on a constant yield basis instead. A holder may also elect to include market discount into income as it accrues.

The administration's FY 2016 proposal would require holders of debt instruments with market discount to include market discount currently in taxable ordinary income as it accrues. The proposal would require accrual of market discount on a constant yield basis. The proposal would also limit the accrual of market discount to the greater of: (1)

the bond's yield to maturity plus 5%; or (2) the applicable federal rate for such bond plus 10%.

The proposal would apply to debt securities acquired after December 31, 2015.

### **KPMG observation**

The proposal is based upon the premise that market discount that arises as a result of changes in interest rates or decreases in an issuer's creditworthiness subsequent to issuance is economically similar to OID, and like OID is to be accrued into income currently.

The proposal notes that current inclusion of market discount has historically been complicated by the fact that the amount of market discount on a debt instrument can vary from holder to holder since it is based upon each holder's acquisition price. The new information reporting rules would require brokers to include, on annual information returns, market discount accruals together with basis and other information for debt instruments, simplifying taxpayer compliance as well as the administrability of the proposal. Brokers are required to report cost-basis information, including market-discount accruals, for less complex debt instruments acquired after 2013 and more complex debt instruments acquired after 2015.

## **Compliance Changes**

### **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 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.

### **Change return filing due dates**

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<sup>th</sup> 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<sup>th</sup> 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.

## **Require greater electronic filing of returns**

Currently, corporations that have assets of \$10 million or more and that file at least 250 returns (including information returns) per year and partnerships with more than 100 partners are required to file electronically. Under the administration's FY 2016 proposal, all corporations and partnerships with \$10 million or more in assets would be required to file electronically. In addition, regardless of asset size, corporations with more than 10 shareholders and partnerships with more than 10 partners would be required to file their tax returns electronically, and preparers that expect to prepare more than 10 corporation income tax returns or partnership returns would be required to file these returns electronically.

Regulatory authority would be expanded to allow reduction of the 250-return threshold in the case of information returns such as Forms 1042-S, 1099, 1098, 1096, 5498, 8805, and 8966. Any new regulations would be required to balance the benefits of electronic filing against any burden that might be imposed on taxpayers, and implementation would take place incrementally to afford adequate time for transition to electronic filing. Taxpayers would be able to request waivers of this requirement if they cannot meet the requirement due to technological constraints, if compliance with the requirement would result in undue financial burden, or as otherwise specified in regulations.

The proposal would be effective for tax years beginning after the date of enactment.

## **Impose a penalty on failure to comply with electronic filing requirements**

A return that is required to be e-filed but is instead filed on paper can be treated as a failure to file, but no penalty may result if the corporation is in a refund, credit, or loss position (as the penalty is based on the underpayment of tax). The administration's FY 2016 proposal would establish an assessable penalty for a failure to comply with a requirement of electronic (or other machine-readable) format for a return that is filed. The penalty would be \$25,000 for a corporation and \$5,000 for a tax-exempt organization unless reasonable cause for the failure to file electronically is established. For failure to file in any format the existing penalties would remain and the proposed penalty would not apply.

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

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

## **Authorize the limited sharing of partnership tax return information**

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.

### **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.

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