

IRS Eliminates Signatures on Section 754 Elections, Offering Tax Regulatory Reform Preview (and its Complexity?)

Tax Talks Blog on **October 18, 2017**

In a notice of proposed rulemaking issued on October 11, 2017 (the “NPRM”), the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) proposed an amendment to existing regulations (the “Proposed Regulation”) under Section 754 of the Internal Revenue Code of 1986, as amended (the “Code”). The Proposed Regulation eliminates the requirement under current Treasury regulations (the “Current Regulation”) that an election under Code Section 754 be signed in order to be effective.

This is among the first of what may be a long series of notices modifying or eliminating existing Treasury Regulations, as indicated in the Treasury’s Second Report to the President on Identifying and Reducing Tax Regulatory Burdens (the “Second Regulatory Reform Report”), which was released by Treasury Secretary Mnuchin on October 2, 2017. The substantive effect of the Proposed Regulation is as simple as it sounds – the literal extent of the change is the deletion of the existing signature requirement in the Current Regulation – but the proposed applicability date provisions in the NPRM contain provisions of interest. Read this blog post for background, information about the Proposed Regulation and its proposed applicability date, and some context relating to the Second Regulatory Reform Report.

Background and the Current Regulation

Very briefly, if a partnership makes a Code Section 754 election, the basis of partnership property is adjusted on certain distributions of property by a partnership and on the transfer of a partnership interest, as provided in Code Sections 734 and 743, respectively. The effect of a Code Section 754 election applies to the year the election is validly made and all subsequent taxable years unless validly revoked by the partnership in the manner prescribed in the Treasury regulations.

The Current Regulation provides that the Code Section 754 election be made by attaching a written statement to the partnership tax return in the year in which the election is made, and that such return be filed no later than the time prescribed for filing the return for such taxable year, including extensions. The Current Regulation requires, among other things, that the written statement be signed by any one of the partners. If unsigned, the Current Regulation would deem the Code Section 754 election for the partnership invalid unless automatic relief under Treas. Regs. Sec. 301.9100-2, if available, is sought (“9100 relief”) or a private letter ruling is secured.

The Proposed Regulation and the Proposed Applicability Date Provision of the NPRM

The Proposed Regulation, as mentioned above, would eliminate the signature requirement, full stop. The NPRM states that the Proposed Regulation would apply to partnership taxable years ending on or after the date the Proposed Regulations are published in final form (which is the usual applicability date provision for proposed regulations, except in extraordinary circumstances). However, the NPRM’s proposed applicability date provision provides that “taxpayers” may rely on the Proposed Regulation for periods *preceding* the proposed applicability date, and specifically states that a partnership with an otherwise valid Code Section 754 election in place need not seek 9100 relief just for want of a signature. Some observations about this:

- It appears that all pending 9100 relief requests relating to missing signatures on Code Section 754 elections may be withdrawn, and although not explicitly stated, all pending private letter ruling requests may also be withdrawn. The NPRM provides no information on whether user fees paid in connection with such pending ruling requests will be refunded. If the NPRM or Proposed Regulation were withdrawn (which seems highly unlikely) and the period in which 9100 relief would otherwise have been available were to have lapsed, it is not clear whether the 9100 relief period would be treated as tolled during the pendency of the NPRM, or if a taxpayer would need to seek a private letter ruling (at substantially greater cost) instead.
- The indefinite retroactive reliance provision in the NPRM seems to mean that effectively any partnership that attempted a Code Section 754 election that was submitted unsigned now has the ability to redetermine whether such election was desirable when made – even if no relief was ever sought or even considered in the past – subject only to general rules relating to time limits for filing amended returns and various statutes of limitation. A partnership that has determined the unsigned Code Section 754 election was desirable when made is entitled by the terms of the

NPRM to rely on the Proposed Regulation now, and give full effect to such election. Conversely, a partnership that has determined that the unsigned Code Section election was *not* desirable when made arguably could revoke that election without complying with the revocation requirements under current Treasury regulations – although query whether this would be an impermissible change in method of accounting or could trigger other limits on taxpayers changing reporting positions.

- In either case described above, the NPRM does not indicate what steps a taxpayer retroactively relying, or not, on the Proposed Regulation would have to take to communicate that decision to the IRS. Additionally, the reliance provision refers to “taxpayers”. This might literally be read to mean that partners in a partnership with an unsigned Code Section 754 election can selectively apply the Proposed Regulation, although this is rather plainly not the intent and such a literal reading could permit a potentially distortive application of the rule. It remains to be seen whether and how these issues will be addressed in final regulations.

The Second Regulatory Reform Report and the Context of the Proposed Regulation

The NPRM is the first regulatory amendment to be issued subsequent to the Second Regulatory Reform Report, and presumably the first of the “over 200” regulations earmarked for modification or revocation by Treasury and identified in the Second Regulatory Reform Report beyond the eight specifically discussed there. It remains to be seen whether the open-ended taxpayer reliance provision contained in the NPRM is indicative of the approach Treasury and the IRS intend to take in modifying or revoking these regulations generally.

Finally, following from the above, these observations about the NPRM and the Proposed Regulation – while seemingly slight in this context – highlight the voluminous details that even the wholesale revocation of existing regulations will require the Treasury and IRS to address. Given that the Second Regulatory Reform Report states that there are potentially *hundreds* more notices of proposed rulemaking (and subsequent Treasury Decisions finalizing regulations) or notices withdrawing regulations entirely to come pursuant to this project, taxpayers and anyone else affected by the operation of the U.S. tax laws will need to be prepared to evaluate carefully with their advisors the effect of each such notice that potentially applies in their individual circumstances. And, the effect of such a massive undertaking on the further hundreds of existing issues on the IRS’s priority guidance plan also remains to be seen.

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