

B-332883

February 2, 2021

Chair
Ranking Member
Committee on Finance
United States SenateThe Honorable Richard Neal
Chairman
The Honorable Kevin Brady
Republican Leader
Committee on Ways and Means
House of RepresentativesSubject: *Department of the Treasury, Internal Revenue Service: Guidance Under Section 1061*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Department of the Treasury, Internal Revenue Service (IRS) entitled "Guidance Under Section 1061" (RIN: 1545-BO81). We received the rule on January 14, 2021. It was published in the *Federal Register* as final regulations on January 19, 2021. 86 Fed. Reg. 5452. The final rule is effective January 13, 2021.

According to IRS, this final rule provides guidance under section 1061 of the Internal Revenue Code (Code). See generally 26 U.S.C. § 1061. IRS stated, section 1061 recharacterizes certain net long-term capital gains of a partner that holds one or more applicable partnership interests as short-term capital gains. IRS also stated, an applicable partnership interest is an interest in a partnership that is transferred to or held by a taxpayer, directly or indirectly, in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business. IRS stated further, these final regulations also amend existing regulations on holding periods to clarify the holding period of a partner's interest in a partnership that includes in whole or in part an applicable partnership interest and/or a profits interest. IRS noted that these regulations affect taxpayers who directly or indirectly hold applicable partnership interests in partnerships and the pass-through entities through which the applicable partnership interest is held.

The Congressional Review Act (CRA) requires a 60-day delay in the effective date of a major rule from the date of publication in the *Federal Register* or receipt of the rule by Congress, whichever is later. 5 U.S.C. § 801(a)(3)(A). The 60-day delay in effective date can be waived, however, if the agency finds for good cause that delay is impracticable, unnecessary,

or contrary to the public interest, and the agency incorporates a statement of the findings and its reasons in the rule issued. 5 U.S.C. § 808(2). IRS asserted that it found, for good cause that a 60-day delay in the effective date is contrary to the public interest. According to IRS, taxpayers continue to express uncertainty regarding the proper application of the statutory rules under section 1061, which this final rule addresses. Additionally, IRS stated, various rules contained within these regulations attempt to curb certain abusive transactions designed to avoid the application of section 1061 and an earlier effective date is necessary to address these abusive transactions.

Enclosed is our assessment of IRS's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shari Brewster, Assistant General Counsel, at (202) 512-6398.

A handwritten signature in cursive script that reads "Shirley A. Jones".

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Carrie E. Mudd
Director, Legal Processing Division
Department of the Treasury

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE
ENTITLED
“GUIDANCE UNDER SECTION 1061”
(RIN: 1545-BO81)

(i) Cost-benefit analysis

The Department of the Treasury, Internal Revenue Service (IRS) conducted an economic analysis that included the establishment of a baseline; summary of economic effects; and economic analysis of specific provisions of this final rule. The economic analysis of the specific provisions included discussion about: (1) the definition of taxpayer; (2) clarification of the treatment of an applicable partnership interest (API) purchased by an unrelated party; (3) capital interest exception; (4) “lookthrough rule” on sale of APIs; and (5) treatment of API transfers to related parties.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

IRS certified that this final rule will not have a significant economic impact on a substantial number of small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

IRS determined that this final rule does not include any federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of \$100 million in 1995 dollars (adjusted annually for inflation).

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

On August 14, 2020, IRS published a notice of proposed rulemaking. 85 Fed. Reg. 49754. According to IRS, it received written and electronic comments responding to the proposed regulations. IRS stated that after full consideration of all comments timely received, this final rule adopts the proposed regulations with modifications in response to the comments as described in the Summary of Comments and Explanation of Revisions section of the preamble.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

IRS determined that this final rule contains information collection requirements (ICRs) under the Act. IRS submitted the ICRs to Office of Management and Budget (OMB) for review. The ICRs in these final regulations include: Form 1040—including Schedule D (OMB Control Number 1545-0074); Form 1041—including Schedule D and K-1 (OMB Control Number 1545-0092); Form 1065—including Schedule K-1 (OMB Control Number 1545-0123); Form 1120S—including Schedule K-1 (OMB Control Number 1545-0123); Form 1099-DIV (OMB Control Number 1545-0110). IRS provided estimates of the cost and burden hours of each of the ICRs.

Statutory authorization for the rule

IRS promulgated this final rule pursuant to sections 1, 1061, and 7805 of title 26, United States Code.

Executive Order No. 12866 (Regulatory Planning and Review)

According to IRS, the Department of the Treasury pursuant to a Memorandum of Agreement (April 11, 2018) with the OMB designated this final rule as economically significant.

Executive Order No. 13132 (Federalism)

IRS determined that this final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law.