



Insights

Recent Internal Revenue Code Amendments May Impose Tax on Securitization Vehicles Beginning in 2018

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On November 2, 2015 President Obama signed the Bipartisan Budget Act of 2015, replacing a longstanding set of statutory provisions governing the audit and adjustment of partnership income tax returns. Under existing rules, adjustments to partnership income are generally accounted for, and tax paid, at the partner level. In contrast, the new rules would impose any tax attributable to audit adjustments on the partnership itself. Subject to meeting certain conditions, the new rules provide partnerships with two “pass-through” elections to avoid the partnership-level tax, allowing for payment of tax at the partner level (similar to existing law).

This represents a sea change in the tax treatment of partnerships, which have generally avoided taxation as separate entities, and these new rules will impact a wide variety of securitizations. Securitization structures treated explicitly as partnerships for tax purposes are most clearly affected, and consequently transaction parties are expected to favor making one of the two pass-through elections so as to avoid the issues created by potential entity level taxation on the securitization vehicle (*e.g.*, rating agency issues, stress on enhancement sizing, investor concerns, etc.). Other transactions not initially classified as partnerships for tax purposes, but for which partnership classification is the agreed fallback tax position (*e.g.*, based on multiple subordinated interests potentially characterized as equity rather than debt for tax purposes), generally also may find it necessary to take similar action, for similar reasons. In many instances, however, it may be unclear whether either of the two pass-through elections is actually available or effective, especially where equity interests and interests that might be equity for tax purposes are held through nominees, and taxation at the securitization entity level may continue to present a risk.

The new rules are applicable beginning in 2018; more immediately, however, it will be necessary during the current transition period for the wide variety of affected transactions to address their eventual impact in operative as well as disclosure documents.

For a copy of the Bipartisan Budget Act of 2015, please click [here](#).