HERBEIN ALERT

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New Centralized Partnership Audit Regulations

NEW CENTRALIZED PARTNERSHIP AUDIT REGULATIONS

The Internal Revenue Service (IRS) released final guidance regarding the new centralized partnership audit regulations effective beginning January 1, 2018.

The purpose of new regulations is to minimize the administrative burden on the IRS conducting partnership audits. The IRS generally conducted partnership audits in accordance with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) before Congress enacted the Bipartisan Budget Act (BBA). TEFRA did not provide a statutory mechanism for collecting tax at the entity level. Instead, the IRS generally had to seek payment of any tax underpayment directly from the partners who would have owed that tax had the partnership properly reported its items of income and deductions on its original return. The BBA brought in a new regime to allow for assessment and collection of tax at the partnership level along with other changes to the partnership audit process.

According to the new partnership audit regime, the adjustment, assessment and collection process will become more streamlined, since all communication regarding the tax examination will be made through a designated "partnership representative" (PR), as opposed to the current Tax Matters Partner. The PR will have sole authority to act on behalf of the partnership. Most importantly, the new rules will allow the IRS to collect unpaid tax at the partnership level (rather than from each partner). The BBA basically grants the PR authority to act on the partnership's behalf and to bind the partnership and its partners without the partners' direct involvement.

The PR can be an individual or an entity. The representative does not need to be an owner (partner/member) of the partnership or limited liability company, but the individual or entity must have a substantial U.S. presence.

The PR will be responsible for:

1. Binding the partnership, and the partners, to an adjustment or settlement in an IRS audit or court proceeding
2. Choosing whether to push out an underpayment liability to the partners or have the partnership pay the underpayment
3. Managing all phases of a partnership tax dispute
4. Choosing whether to extend the statute of limitations
5. Deciding whether, and in what court, to seek judicial review and to be the sole representative of the partnership in those court proceedings

DO YOU HAVE AN OPTION TO ELECT OUT?

A partnership has an option to elect out of the new partnership level audit regime, if the partnership has 100 or fewer "eligible partners." Read more for details on who qualifies.

OPTION TO ELECT OUT

A partnership has an option to elect out of the new partnership level audit regime, if the partnership has 100 or fewer "eligible partners." An eligible partner is defined as an individual, C corporation, S corporation, eligible foreign entity, and estate of a deceased partner. It is also important to note that all eligible foreign partners, even those with no U.S. filing requirements, must apply for and obtain a valid U.S. federal employer identification number (TIN) for the partnership to file a valid election. In addition, a formal election out of the new audit regime is required to be made annually on a timely filed return.

If the PR is a partner in the partnership, potential conflicts of interest may arise between the PR's interest in the audit outcome and the interest of the other partners in resolving partnership audit matters. Therefore, it is very important to determine the appropriate designated partnership representative.
Although eligible partnerships under the new law may elect out of these procedural rules, the IRS will be required to open deficiency proceedings at the partner level to adjustments associated with the partnership, resolve issues and collect any tax that may result from the adjustment. Therefore, it is recommended that consideration be given to amending existing partnership (and LLC) agreements as well as modifying the tax audit provisions of future agreements to address these new partnership audit procedural rules.

If a partnership proceeds to make the election out, its partners should confirm that they will have enough access to the partnership's books and records if they need to substantiate the amounts allocated by the partnership in an IRS audit. A more crucial aspect is the fact that if a partnership makes a valid election out, the applicable statute of limitation for assessment of tax will be determined at the partner level and is further determined separately for each partner.

The partnership has an option even if the partnership does not elect out under Code Section 6221 (b) of the new partnership audit regime, to make an election under Code Section 6226 to push out partnership audit adjustments and the applicability of any penalties, additions to tax, or additional amounts to its partners from the audit reviewed year as an alternative to payment of the imputed underpayment. This election may only be made after the Notice of Final Partnership Adjustments (FPA) is mailed to the partnership. After making this election, the partnership must furnish statements to its reviewed-year partners containing their applicable share of the partnership adjustments and the applicability of any penalties, additions to tax, or additional amounts within 60 days of when the partnership adjustments become finally determined. The partnership must also file the statements with the IRS.

Please contact a Herbein team member for assistance in understanding the new partnership audit regulations and whether you can or should elect out of the partnership audit regulations, or email us at info@herbein.com.

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