




**Responding to the New IRS  
Partnership Audit Procedures**  
Chattanooga Tax Practitioners  
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## Presenter Information



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Ronald's practice focuses on two main areas of practice. First, he handles federal and state controversy matters, including planning and defending conservation easements. Second, his practice focuses on business and tax planning, particularly for closely held and family owned businesses. Specifically, he counsels clients in business planning, succession planning, estate planning, charitable deduction planning, entity formation, representation of S Corporations, Limited Liability Companies and other flow-through entities, mergers and acquisitions, purchases and sales of businesses, and healthcare law (representing physician practices).



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In his practice at Sirote, Greg focuses heavily on tax controversy and tax litigation work, while also performing tax planning for individuals and businesses. Greg's tax litigation experience includes the representation of TEFRA partnerships, corporations and individuals in multi-million dollar tax controversies in Tax Court trials throughout the United States. Greg has appealed Tax Court decisions to various U.S. Courts of Appeals. Greg's tax litigation experience includes complex tax litigation in the Court of Federal Claims. Greg also works in the area of international taxation, including helping individuals and businesses comply with international tax obligations and curing past filing omissions or errors. Greg is a frequent speaker and writer in national tax journals on tax controversy and litigation subjects, and has served as an adjunct professor in taxation for the Birmingham School of Law. Greg has been consistently recognized as a "Rising Star" in the area of tax by Super Lawyer's Magazine.



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Michelle is a member of the firm's Tax Controversy Practice Group. She represents clients during all phases of federal income tax controversies, including IRS audit, administrative appeals, and court proceedings in the U.S. Tax Court, U.S. Court of Federal Claims and, federal district court. Her experience includes a wide range of complex tax issues. Prior to joining Sirote, Michelle worked as a trial attorney at the Tax Division of the Department of Justice where she represented the United States in federal district court.





**Let's get  
CLEAR on  
the new  
Rules!**

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## FOR 2017 & PRIOR YEAR TAX RETURNS

### 3 Sets of Rules for Partnerships:

- **TEFRA**
  - (IRC §§6221-6234)
- **PRE-TEFRA (normal) deficiency procedures**
  - (IRC §§6211-6213)
- **Electing Large Partnerships**
  - (IRC §§6241-6255)



## FOR 2018 & AFTER YEAR TAX RETURNS

- ❖ Bipartisan Budget Act of 2015 **REPEALS** TEFRA & Electing Large Partnerships
- ❖ Creates a **NEW --**  
**Centralized Partnership Audit Regime**
  - Unless Partnership **ELECTS OUT**,
  - If elects out, then Pre-TEFRA deficiency procedures apply – NOT TEFRA

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## GOING FORWARD, For Next Few Years

- ❖ Audits of **Tax Years 2017 & PRIOR** audited under OLD RULES
- ❖ Audits of **Tax Years 2018 & AFTER** audited under NEW RULES
- ❖ Examinations of **MIXED** Tax Years may present some challenges

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## TEFRA STILL HAS A HEARTBEAT

### TEFRA Procedures TEFRA Partnership Non-Partnership Items

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## THE GOAL OF TEFRA

- ❖ Meant to establish unified procedures for treatment of partnership items at the partnership level.
- ❖ Resolve partnership items in one consolidated proceeding.
- ❖ Consistent treatment of partners.
- ❖ Efficiencies by avoiding duplicative audits/litigation and dealing with widespread & numerous partners

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## PARTNERSHIPS SUBJECT to TEFRA

- ❖ TEFRA applies to any entity that required to file – or electing to file – a partnership return, other than “small partnerships.” IRC §6231(a)(1).
  - LLCs that file Form 1065 are thus TEFRA partnerships.
  - TEFRA does NOT apply to S Corporations.
    - Although there once was a statutory provision for similar rules; since repealed

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## PARTNERSHIPS SUBJECT to TEFRA

- ❖ “SMALL PARTNERSHIPS” –
  - Those having 10 or fewer partners, each is individual, C-corporation, or estate of a deceased partner. § 6231(a)(1)(B)(i)
  - TEFRA does not apply; however --
  - A small partnership can **elect** to have the TEFRA rules apply. § 6231(a)(1)(B)(ii)

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## TWO-STAGE PROCESS under TEFRA

- ❖ Partnership items, those relevant to partnership as a whole, determined at the partnership level.
- ❖ Final determinations are applied at partner level by “computational adjustments,” and are directly assessed.
  - Partner-level deficiency proceedings are needed, if computational adjustments are attributable to “affected items,” and require partner level determinations.
  - See *Woods v. U.S.*, 134 S. Ct. 557 (2013).

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## TEFRA “TAX MATTERS PARTNER”

- ❖ Role, responsibilities and duties of TMP
  - Coordinates audit with the IRS.
  - Coordinates notices & involvement of partners (notice and non-notice partners)
  - Extends statute of limitations on behalf of the partnership. §6229(b)(1)(B)
  - May bind non-notice partners to settlement at the administration level
  - May file refund claim or suit for partnership

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## TAX MATTERS PARTNER – WHO?

- ❖ General partnership: **any partner**.  
Reg. §301.6231(a)(7)-1(b)
- ❖ Limited partnership: a **general partner**.  
Reg. §301.6231(a)(7)-1(b)
- ❖ LLC: a **member-manager**.  
Reg. §301.6231 (a)(7)-2(a)
  - If no member-manager, any **member**.  
Reg. §301.6231(a)(7)-2(b)(3)

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## TMP AUTHORITY TO BIND PARTNERS

- ❖ TMP can bind non-notice partners to any settlement negotiated with the IRS during the administrative proceedings unless a non-notice partner files notification with the IRS that it does not wish to be bound by TMP. §6224(c)(3)(A).
  - Cannot bind notice partners or notice group partners.
  - Can prevent by preemptively notifying IRS that TMP cannot bind.
  - Pass-thru partner binds indirect partners unless they have been properly identified to the IRS. Treas. Reg. 301.6224(c)-2.

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## **TMP DUTIES -- Treas. Reg. §301.6231(g)**

- ❖ Notify of NBAP (within 75 days) and FPAA (60)
- ❖ Furnish partners with information relating to:
  - Closing conference with examining agent;
  - Proposed adjustments, rights of appeal, and requirements for filing of a protest;
  - Time and place of any Appeals conference;
  - Acceptance by the IRS of any settlement offer;
  - Extension of the period of limitations with respect to all partners;
  - Filing of an Tax Court petition or RAA on behalf of the partnership, or any appeal

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## **WHO IS A “PARTNER”**

- ❖ A “partner” includes:
  - “a partner in a partnership” and
  - “any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership.”
    - IRC §6231(a)(2).

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## PASS-THRU AND INDIRECT PARTNERS

- ❖ Pass-thru partner: “ a partnership, estate, trust, S-corporation, nominee, or other similar person through whom other persons hold an interest in the partnership... .”

IRC § 6231(a)(9).

- ❖ Indirect partner: “a person holding an interest in a partnership through one or more pass-thru partners.”

IRC § 6231(a)(10).

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## NOTICE PARTNERS

- ❖ For partnership with 100 or fewer partners (including indirect partners): all partners are notice partners. § 6223(a).
- ❖ For partnerships with more than 100 partners (including indirect partners): only partners with 1% or more interest are notice partners. § 6223(b)(1).
  - Thus, partners in large partnerships with a less than 1% interest are generally non-notice partners.

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## TEFRA PARTNERSHIP ITEMS

- ❖ A TEFRA audit addresses only partnership items. § 6221.
  - Partnership items are items required to be taken into account for the partnership's taxable year ... to the extent regulations require them to be determined at the partnership level, instead of the partner level.

IRC §6231(a)(3); Treas. Reg. §301.6231(a)(3)-1(a) and -1(b).

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## TEFRA PARTNERSHIP ITEMS (cont)

- ❖ What about:
  - Validity of a partnership?
  - Penalties? Partnership v. partner-level defenses?
    - Under *Woods v. U.S.*, 134 S.Ct. 557 (2013), penalties may be determined at the partnership level but partner-level defenses can be raised in a subsequent partner-level proceeding.

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## TEFRA STATUTE OF LIMITATIONS

- ❖ TEFRA provides for a single partnership proceeding to resolve all partnership items, but does it provide for a single SOL that applies to all partners?
  - Not according to the IRS, the Tax Court (*Rhone Poulenc*), 5<sup>th</sup> Circuit (*Curr-Spec Partners*), Federal Circuit (*A.D. Global Fund*), C.D. Circuit (*Andantech*).
  - All circuit courts that have considered the issue agree.

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## TMP Extension of SOL

The TMP can extend the Statute of Limitations for the partnership return and TEFRA adjustments.

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## BIPARTISAN BUDGET ACT OF 2015 (The New Law)

### The Centralized Partnership Audit Regime

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## BIPARTISAN BUDGET ACT of 2015

- ❖ TEFRA replaced with a new regime focused on partnership-level determinations and assessments.
  - Effective Dates:
    - Partnership returns for tax years beginning after 2017.
    - Partnerships may elect to have the rules apply earlier (to TY 2015-2017)

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## **PURPOSE of BBA of 2015**

- ❖ TEFRA retained many inefficiencies, e.g.:
  - Imposing computational adjustments requires locating and dealing with each partner
  - Collection problems with lots of partners
  - Tiered partnerships multiply the issues
- ❖ Desire to simplify adjustments, limit number of persons dealt with & accelerate collection
- ❖ New rules were “scored” to generate \$10 billion in tax revenue. Thrown into BBA2015 to keep it revenue neutral

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## **NEW PARTNERSHIP AUDIT REGIME & AUDIT PROCEDURES**

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## KEY ELEMENTS OF “CPAR”

- ❖ Centralized, partnership-level resolution of all partnership items
- ❖ Place ALL taxpayer responsibility in one person, including settlement authority
- ❖ Accelerated assessment & collection of taxes at conclusion of partnership proceeding
- ❖ Computation of an alternative to tax determined on partner tax returns -- the “Imputed Underpayment”

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## PARTNERSHIP LEVEL DETERMINATION

- ❖ Consistency required between partner returns & partnership return (K-1's & as adjusted)
- ❖ Partners are bound by the final resolution in partnership proceeding
- ❖ “Partnership Representative” has full authority
- ❖ Tax-Substitute (“Imputed Underpayment Amount”) is assessed in the “Adjustment Year” (year tax adjustments are final); NOT the “Reviewed Year” (year/partnership items being examined).

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## PARTNERSHIP DETERMINATION (cont.)

- ❖ Penalties determined at the partnership level; no partner level defenses to penalties
- ❖ Statute of limitations of partnership controls (partner SOL no longer matters)
  - e.g., §6501(e) (6-year statute of limitations for substantial omissions of income) determined at partnership instead of partner level.
- ❖ **EXCEPTIONS APPLY – Lots of exceptions**

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## PARTNERSHIP REPRESENTATIVE

- ❖ Partnership must designate a “Partnership Representative” (“PR”)
  - Replaces the “Tax Matters Partner” under TEFRA
  - Proposed Regs: Partnership designates a PR (on EACH year’s tax return)
  - PR can resign or be removed, but only after a Notice of Admin. Proceeding is issued by IRS
- ❖ PR is NOT required to be a partner in the partnership
- ❖ PR must be a “person” with substantial U.S. presence (able to meet; US address, phone, TIN)

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## **PARTNERSHIP REPRESENTATIVE (cont.)**

- ❖ Under 7701(a)(1), the term “person” includes, an individual, trust, estate, partnership, association, company, or corporation.
  - if an entity is designated as the PR, a responsible person (corporate officer, partner, trustee, etc.) must act on behalf of the PR.
- ❖ IRS will appoint a PR if the partnership does not designate one.

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**ELECTION OUT FOR SMALL  
PARTNERSHIPS**

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## ELECTION OUT - SMALL PARTNERSHIPS

- ❖ Partnerships of 100 or fewer partners can opt out
- ❖ Partners must be individuals, C-Corporations, S-Corporations or estates of deceased partners (no upper-tier partnerships & no trusts).
  - S-Corp. shareholders counted for purposes of 100 partner test.
- ❖ Election made on timely return
- ❖ Annual election; must be made EACH year
- ❖ May not be revoked for that year without IRS OK

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## EFFECT OF ELECTION OUT

- ❖ With election, partnership must disclose names & TINs of all partners
- ❖ Partnership & Partners are audited, assessed and taxes are paid and collected under the Pre-TEFRA (normal) deficiency procedures
- ❖ IRS is expected to resist Opt Outs, and construe requirements narrowly
- ❖ See generally, Prop. Treas. Reg. §301.6221(b)-1

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## EFFECT OF ELECTION OUT

- ❖ Audits are conducted at PARTNER level
- ❖ May result in inconsistent results among partners;  
Statutes of limitations may run to different dates  
and extensions are not coordinated
- ❖ Partnership records/resources may not be  
available to partners readily, or at all
- ❖ IRS may develop methods for coordination; but  
who knows?

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## PARTNERSHIP TAX ASSESSMENT

The “**IMPUTED UNDERPAYMENT**”

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## CPAR GOVERNS CHAPTER 1 TAXES ONLY

- ❖ Taxes under other Chapters will be determined separately under existing procedures
- ❖ Taxes NOT handled under CPAR include:
  - Self-employment tax
  - Payroll tax
  - Unearned income Medicare contribution
  - Withholding on foreign persons & FBAR
  - Consolidated returns

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## IMPUTED UNDERPAYMENT

- ❖ In lieu of the traditional tax on partnership income paid by partners, a partnership will now pay an “Imputed Underpayment” (“IUP”)
- ❖ All partnership adjustments are netted and multiplied by the HIGHEST RATE in Code Section 1 or 11
- ❖ Partnership is assessed and pays IUP in “Adjustment Year”
  - Adjustment Year = Year of final determination

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## MODIFICATION OF RATES

### **PARTNERSHIP CAN SUBMIT EVIDENCE TO MODIFY “APPLICABLE HIGHEST TAX RATE”**

Tax Exempt Partner receiving allocation of capital gains and dividends is an individual subject to reduced tax rates.

Secretary is authorized make additional modifications to the Imputed Underpayment

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## MODIFICATION BY PARTNER PAYMENTS

- Partnership IUP is reduced by partner payments with partner amended returns filed within 270 days of notice of proposed adjustment (§6225(c)(2))
- Amended returns must
  - Be for the Reviewed Year
  - Include the partner's distributive share of ALL partnership adjustments
  - Pay the tax, notwithstanding the statute of limitations Reduction in Imputed

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**ALTERNATIVE TO  
PARTNERSHIP-LEVEL  
ASSESSMENT:  
“PUSH OUT” OF TAX LIABILITY  
IRC §6226**

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**PARTNERSHIP ELECTION TO “PUSH OUT”  
TAX TO “REVIEWED YEAR” PARTNERS**

- ❖ IRC §6226 provides the Partnership with an election to “Push Out” the tax responsibility to its Partners (those of the Reviewed Year)
- ❖ Partnership makes the election within 45 days after IRS issues an FPAA
- ❖ Partnership must issue “statements” (amended K-1s) to the Partners, and copy IRS with the statements
- ❖ Partners increase the tax on their return for the year of the statement (NOT the Reviewed Year)

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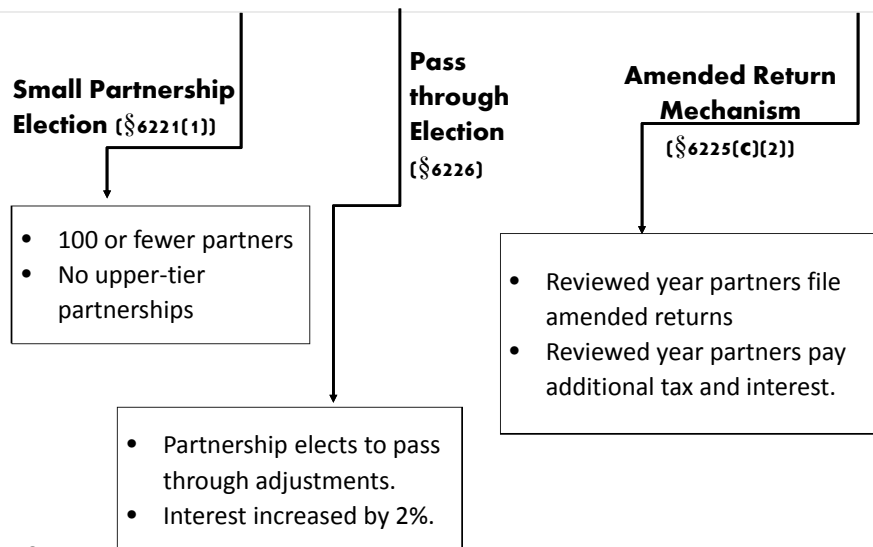
## “PUSH OUT” ELECTION -- EFFECTS

- ❖ Partners are liable for penalties.
- ❖ Interest is charged at higher 5% rate (2 percentage points higher than rate in Section 6221(c))
- ❖ Interest runs from due date of partnership return
- ❖ Partners have no right to any administrative or judicial review; bound by partnership-level determination & Partnership election
  - ❖ The election is within the discretion of the Partnership Representative

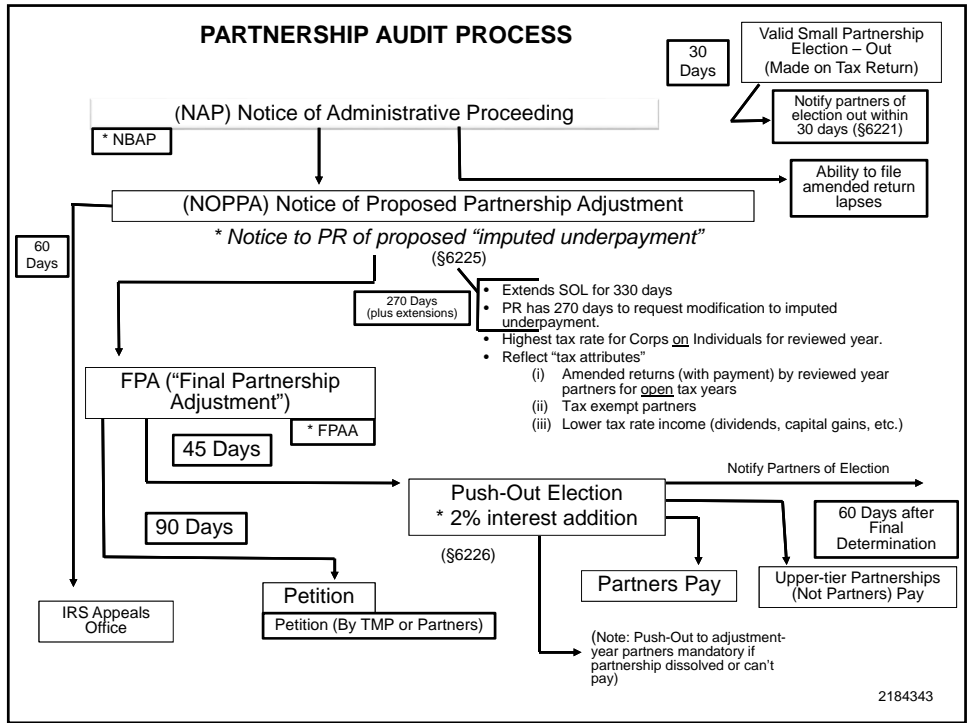
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## Methods of Allocating Tax to Reviewed Year Partners



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# PARTNERSHIP AGREEMENTS AMENDMENTS & ACTIONS TO CONSIDER

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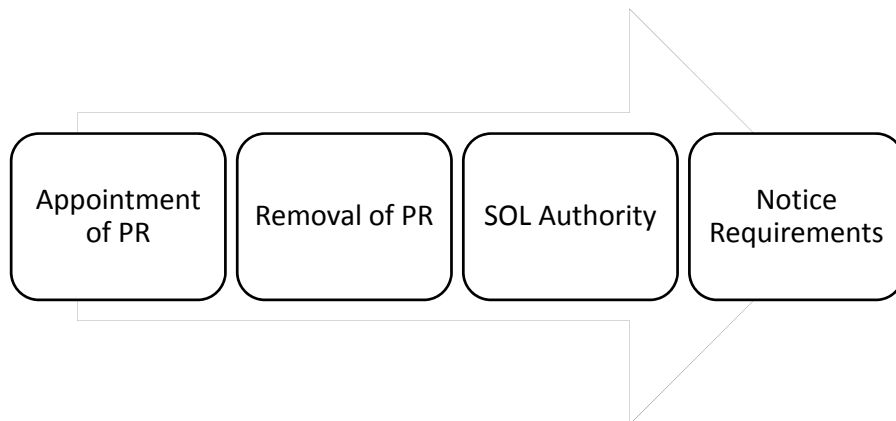
## IN GENERAL

- ❖ CPAR will require Amendments and Actions
  - Partnership agreements, LLC operating agreements or other governing document
- ❖ Timing: Needs to be completed by 12/31/2017
  - Adopt amendments early; provide an effective date of 1/1/2018

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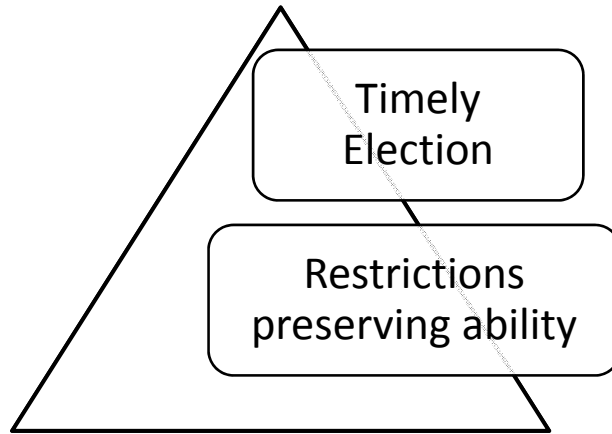
## Partnership Representative



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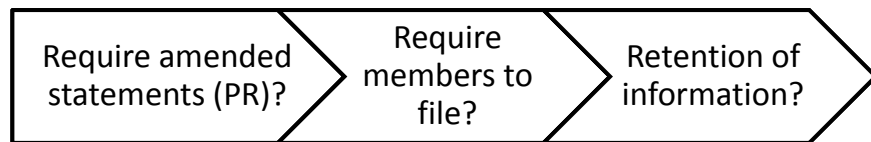
## Election Out of BBA



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## Amended Statements



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## PUSH-OUT ELECTION



- Require election by PR?
- Require economic analysis?
- Require notice to partners if made?

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## LITIGATION

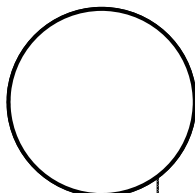


- Notify Members during process?
- Who chooses attorney?
- Settlement authority / parameters?
- Costs?

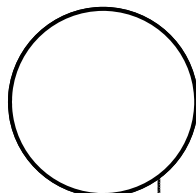
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# OTHER ITEMS



STATUE OF  
LIMITATIONS  
EXTENSIONS?



APPEALS  
OFFICE  
DISCUSSION?



## PARTNERSHIP PROCEDURES UNDER "BiBPA"

### Repeal of TEFRA & Large Partnership

Replace with BBA ("BiBPA")  
Result: Pre-TEFRA applies if NOT BiBPA  
e.g., if Elect Out of BiBPA

### PP – Pr – PR: "Taxpayer" Identity (1065 vs. 1040)

- §6221 (a) GEN RULE: TAX DETERMINED AT PP LEVEL
- (b) ELECTION OUT OF BiBPA
- §6222 (a) CONSISTENCY REQUIRED (1065 to K-1 to 1040)
- (b) SUMMARY ASSESSMENT for inconsistent 1040
- (c) Partner "Inconsistency Option" (see below)
- §6223 "PARTNERSHIP REPRESENTATIVE"
  - (a) Designated by PP (Pr or not Pr; IRS selects if no designation)
  - (b) Given ABSOLUTE AUTHORITY over TAX matters
    - o Including consent to any PP adjustments
    - o Subject to Partner's "Inconsistency Option"

### §6221(b): ELECTION OUT OF BiBPA

- Annual PP election, with timely filed return, each TY
  - ≤ 100 K-1's (counting each S Corp ~~subd~~ as 1)
  - All ~~Pr's~~ are individuals, Corp (C, S or foreign), ~~Pr's~~ estate
    - o IRS authorized to include Trusts – Not Yet
  - PP provides IRS list of ~~Pr's~~ with ~~TIN's~~ (& S ~~6060~~ ~~6060~~)
  - PP notifies all ~~Pr's~~
- EFFECT: PP & ~~Pr's~~ audited, adjusted, taxed & pay per Pre-TEFRA Rules
- Pr controls audit/decisions, including S/L & settlement
  - IRS must deal with each Pr
  - ~~Pr's~~ must ensure access to PP records/explanations

### "Side Agreement" among partners & PP Rep

- Best if in PP Agreement
- No effect on IRS; IRS ignores
- Contractual obligation of partners & Partnership Representative
  - o Damages
  - o Specific Performance, maybe?

### §6222(a): CONSISTENCY

- Pr is required to treat each PP item consistently with PP
- IRS may summarily adjust inconsistent items & assess
  - o Treated as "Math Error" per §6213(b)(1)
  - o But without automatic abatement per (b)(2)
- Pr has "disregarded rules and regs" per §6662(b)(1) subject to penalty = 20% of underpayment, if no reasonable cause per §6664(c)

### EXCEPTION: PARTNER NOTIFIES IRS OF INCONSISTENT TREATMENT

- OR, if PP fails to file a return
  - THEN, Consistency & Summary Adjustment DO NOT APPLY
  - So, Penalty for Disregard also not applicable
  - BUT, other penalties could apply; e.g., substantial understatement, value misstatement
- Exception for consistency with K-1
- Treated as having notified IRS of inconsistency, if consistent with K-1 received (even though inconsistent with PP return)

**ADJUSTMENTS – TAX COMPUTATION – TAX PAYMENT**

**§6225 (a) PP pays "IMPUTED UNDERPAYMENT" ("IP," in lieu of tax "Deficiency")**

- Added to tax of the "ADJUSTMENT YEAR" ("ADJ YR")
- **ADJ YR = year of Final Ct Decision or year FPAA mailed**

(b) IP = Net of Adjustments X HIGHEST TAX RATE (100% or 50%) for REVIEWED YEAR

- Adjustment of loss, treated as adjustment of income
- Adjustment of credit, treated as adjustment of IP
- Changes in Pr distributive shares (from Adj) disregarded [??]
- **RATE is ADJUSTED for PORTIONS** allocable to C corps, & Cap Gain & Qualified Dividends allocable to Individuals [§6225(c)(2)-(3)]

**§6226 (a) "PUSH OUT" ALTERNATIVE TO PP PAYMENT**

- Election by PP (45 days after FPAA)
- PP notifies IRS & Reviewed Year Partners of Share of Adjustments

(b) REVIEWED YR PARTNERS have **Additional TAX In Year the Statement**

- TAX = "Adjustment Amount" = amount tax would have increased in REVIEWED YEAR if Adjustments were included

**§6227 Administrative Adjustment Request ("AAR" i.e., amended return)**

(a) & (b) Made by PP; Determined @ PP Level

- **Adjustment made in TY of Request**
- If Underpayment, Adjusted in manner similar to 6225 or 6226, as applicable
- If Overpayment (refund), Adjust per 6226

IP is REDUCED by [§6225(c)(2)-(3)]

- Amended Returns & Payment by Partners within 270 days of Notice of Proposed Adj
- portions allocable to EXEMPT Partners

Because ADJ YR can be delayed by a delay in the Exam/Appeals/Tax Court process – PP may have ability to **CONTROL TIMING** of ADJ YR. See §6225(d)(2)

If Adjustment does not result in an IP, then Items

NOTE: This a **PERIODIC ELECTION** by PP; not revocable for this TY; but NOT permanent

NOTE: **Power to make the "Push Out" election**

- Partnership Rep has the power
- Done at the END of the IRS Proceeding
- Affecting possibly Former Partners

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**TEFRA vs. BBA AUDIT PROCESS**

TEFRA AUDIT PROCESS	BBA AUDIT PROCESS
1 IDRs issued to TMP * No obligations	1 IDRs issued to PR * Obligations?
2 NBAP issued to TMP * Issued to TMP, Partnership and to Notice Partners	2 Notice of Administration Proceeding (NAP) * Only issued to PR and Partnership
3 Statute Extension Request * TMP can extend for "Partnership Items" * TMP <u>should</u> send notice to Partners	3 Statute Extension Request * PR can authorize * No notice required
4 60-Day Letter * Not statutorily required * Does not extend SOL * TMP must send to non-notice Partners	4 Notice of Proposed Partnership Adjustment (PPA) * Statutorily required * SOL extended for 330 days after notice. * Notification of proposed "imputed underpayment" * <u>Submit information to seek modification of imputed underpayment.</u> (270 Days) - Tax Exempt Partners - Amended Returns - Capital Gains - C Corporation
5 FPAA * Ticket to Tax Court  * 90 days to Petition by TMP - Partners can file if TMP does not.	5 Notice of Final Partnership Adjustment ("FPA") * PR can make partner assessment election ("Push-Through Election") - 45 days from FPA * PR can file a Petition - 90 days form FPA

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