The Final Partnership Audit Regulations

What’s New and Where Do We Go From Here

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Overview

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How did we get here?
The Challenges Before TEFRA

• Pre-TEFRA

  › Audits were conducted at the partner-level; if the IRS wanted to adjust a partnership item, IRS had to audit each partner individually

  › Created duplication of efforts

  › Led to inconsistencies in how partners were treated
How did we get here?  
The Challenges of TEFRA

- TEFRA
  - Enacted in 1982 to address inconsistent partner treatment and inefficiencies of partner-level audits by allowing the IRS to audit partnership items at the partnership level.
  - Two Problems with TEFRA:
    - Procedures are administratively complex. Tax Court described the TEFRA rules as “distressingly complex and confusing.”
    - Tax is assessed and collected at the partner level. In complex tiered-entity structures, it is time consuming and difficult for the IRS to identify and assess the tax from the ultimate tax-paying partners.
Source of the Partnership Audit Rules

- **Enacted Legislation:**
  - Bipartisan Budget Act of 2015 (the “BBA”) as modified by the Protecting Americans from Tax Hikes Act (the “Path Act”) and the Consolidated Appropriations Act of 2018

- **Regulations**
  - June 2017: proposed regulation with several bracketed items
  - Nov. 2017: proposed regulations on coordination for international issues
  - Dec. 2017: proposed regulations on “push out” through tiers and administrative issues
  - Jan. 2018: final regulations on electing out
  - Aug. 2018: final regulations on partnership representative
  - Aug. 2018: proposed regulations withdrawn and reproposed to reflect changes made by Technical Corrections Act of 2018
  - Dec. 2018: final regulations released
Final Regulation Take Aways

- Overall structure and operation of the regime remains the same
- Final regulations didn’t include basis/capital account rules
- Appeals
  - Appeals is outside scope of regulations, however on p.133: “IRS pans to adopt procedures for [appeal of] adjustments made during the examination prior to the mailing of a NOPPA.”
- Effective date: partnership taxable years beginning after December 31, 2017, and ending after August 12, 2018
Final Regulation Take Aways

- Scope clarified
- Imputed underpayment computation clarified
- Revised rules for computing “negative adjustments” to penalties
- Consistency requirement:
  - New: notice of inconsistent position not permitted after NAP
  - Unlike the NPRM, the final regulations permit a notice of inconsistent treatment for an AAR item
- Were final regulations published?
Overview of the Partnership Audit Rules
Defined Terms

- **“Reviewed Year”:** Partnership tax year under audit
- **“Adjustment Year”:** when the “reviewed year” adjustment is finalized:
  - If you go to court, when the court decision is final
  - If you file an administrative adjustment request (AAR), when the AAR is made
  - All others, when final partnership adjustment (FPA) is mailed
- **“Imputed Underpayment”:** Net positive adjustments to the partnership tax year multiplied by the highest applicable tax rate and then applying any adjustments to credits
- **“Partnership Representative”:** replaces Tax Matters Partner
The new centralized partnership audit regime only applies to “partnership-related items” under chapter 1 of subtitle A.

- Partnership-related item defined as any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person.

- The new centralized audit regime does not apply to taxes imposed by other chapters (e.g., self-employment taxes and net investment income taxes) although partnership adjustments are taken into account to determine these taxes.
Examples of Partnership-Related Items

- Examples of partnership-related items:
  - Character, timing, source, and amount of a partnership’s income, gain, loss, deductions, or credits
  - Contributions to and distributions from the partnership
  - Transactions between a partnership and a partner (e.g. a disguised sale)
  - Items relating to partnership terminations and partners’ capital accounts
  - Whether a person is a partner and whether a partnership exists
  - Partnership’s basis in its assets
  - Amount and character of partnership liabilities
  - Partnership allocations
Final Regulations Clarify Scope

- Moved definition of partnership-related item to the general definition section, rather than including it in its own section

- Clarifies rules for items reported by 3rd parties—
  - Limits “with respect to the partnership” to include on items reflected or required to be reflected on the partnership return or required to be maintained in partnership books and records
  - New examples show that the 170 limitation is not a partnership-related item

- Imputed underpayment is always a partnership-related item
Audits are conducted at the partnership level

- Penalties determined at the partnership level but partnership defenses to penalties must be raised during partnership proceeding or in refund suit
- Only partnership-level statute of limitations is relevant

The partnership must pay the IU unless it elects to “push out” the adjustments to the reviewed year partners

Partnerships must select an eligible PR who has sole authority to act on behalf of the partnership for purposes of the partnership audit regime

All partners and the partnership are bound by the actions taken in and the results of the partnership-level proceeding

- Unlike TEFRA, partners do not have the right to participate in the proceeding or receive notice of the proceedings from the IRS
- Like TEFRA, partners must report items consistent with the partnership return unless they attach notification of the inconsistency to their return
Who can elect out?

- Partnerships with 100 partners or less all of whom are eligible partners

- **Counting Partners.** Partnership has 100 or fewer partners if required to furnish 100 or fewer K-1s for the taxable year
  - Any K-1s furnished to an S corporation shareholder are counted for purposes of the 100-partner test

- **Eligible Partners.** Partners must be individuals, C Corporations (including any foreign entity that would be treated as a C corporation if domestic), S Corporations, or estates of deceased partners
  - A partnership, trust (including a grantor trust), disregarded entity, nominee or agent are not eligible partners

- If an election is made, the IRS must open an audit of each partner and assess/collection from each partner individually
Eligible Partners Example

- C is not an eligible partner because it is a partnership.
- B is not an eligible partner because it is a disregarded entity.
- A cannot elect out.
- D is an eligible partner because it is an individual.
- E is an eligible partner because it is a C corporation.
- C can elect out.

**Conclusion:** E must be a direct partner to be an eligible partner for election out. Individual D cannot hold her partnership interest through a pass-through entity to be an eligible partner for election out for A. However, because E and D are direct partners in C, and both are eligible partners, C can elect out.
Election Out

● **How to elect out?**
  › Election is made on timely filed partnership return (line 25 of Schedule B on Form 1065) by the partnership.
  › Partnership must provide the names, TINs and federal tax classifications of all partners and, if there is an S corporation partner, all of its shareholders.
    o See Appendix for Schedule B-2 (Form 1065), Election Out of Centralized Partnership Audit Regime
  › Partnerships must notify each partner of the election out within 30 days of the election.
  › See Appendix for line 25 of Schedule B of Form 1065
### Is Election Out the Right Answer?

<table>
<thead>
<tr>
<th>Election Out</th>
<th>No Election Out</th>
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<tbody>
<tr>
<td>Most of the audit burden on the partners</td>
<td>Burden on the partnership rather than the partners</td>
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<td>Partnership not subject to potential tax liability</td>
<td>The partnership retains control of the audit and resolution</td>
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<td>The tax liability accurately reflects each partner’s circumstances</td>
<td>BBA reduces the likelihood of partners having different tax consequences for the same item or transaction</td>
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<td>More complex for IRS to have separate deficiency audits of each partner</td>
<td>BBA reduces redundant requests for partnership information</td>
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<td>Audit rules more familiar and settled</td>
<td>BBA has mechanisms to have the tax liability accurately reflect each partners circumstances if there is no election out</td>
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The partnership representative has the **sole** authority to act on behalf of the partnership and binds both current and former and direct and indirect partners

- Includes the authority to extend the statute of limitations, enter into a settlement, agree to partnership adjustments, and make an election to push-out the adjustments to the reviewed-year partners

- Authority for federal tax purposes may not be limited by state law or agreement (including the partnership agreement)
  - The PR can, however, agree with its partners that decisions will not be made unless certain procedures are followed.
  - Partnerships should carefully consider the impact of local law on actions taken by the partnership and the PR (e.g., potential claims by partners).
  - Consider separate agreement between PR and partnership
Who can be the Partnership Representative?

- In order to be the partnership representative, the person must have a substantial presence in the United States.
  - Unlike TEFRA, the partnership representative does not have to be a partner.
- A person has a substantial presence in the United States if the person:
  - makes themselves available to meet in person with the IRS at a reasonable time and place;
  - has a U.S. street address and telephone number; and
  - has a U.S. taxpayer identification number.
- If the partnership representative is an entity, the partnership must identify an individual that can act on the entity’s behalf that satisfies the eligibility requirements. The final regulations permit a disregarded entity or the partnership itself, in certain circumstances, to serve as partnership representative.
- **Note**: Actions taken by an ineligible partnership representative are valid and designation remains in effect until terminated (by resignation, revocation, or IRS determination).
Designating the Partnership Representative

- Partnership designates the partnership representative on its return each year (line 25 of Schedule B on Form 1065).
  - This means that in a multi-year audit the partnership may have a different partnership representative for each year under audit.
  - Partnership cannot notify the IRS of a change the partnership representative until the IRS issues a notice of selection for examination or a notice of administrative proceeding or the partnership files an AAR.
    - An AAR cannot be filed solely to change the partnership representative
    - Avoids unnecessary paperwork for IRS to process changes that have no impact because the partnership is not under audit.
  - No need to designate a partnership representative if the election out is made
  - See Appendix for Form 8979, Partnership Representative Revocation, Designation, and Resignation Form
Resignation and Revocation of the Partnership Representative

- Partnership representative may resign by notifying the partnership and the IRS in writing (after the notice of administrative proceeding is issued).
  - The final regulations removed the ability of a resigning partnership representative to designate a successor or resign on an AAR.

- Partnership can revoke a designation of the partnership representative.
  - The revocation must be signed by a partner for the year in which the designation was in effect (i.e., the reviewed year).
  - Revocation must include a statement under penalties of perjury that the partner is authorized by the partnership to revoke the designation.
  - In the case of revocation, the partnership must designate a successor partnership representative.

- A partnership representative’s resignation or revocation is generally effective immediately upon receipt by the IRS. When there is a revocation of a partnership representative designated by the IRS, the final regulations provide that the revocation is effective the date the IRS sends notification.
If there is no partnership representation designation in effect, the IRS may select any person and will consider the following factors:

› Whether there is a suitable partner for the reviewed year or the time the selection is made
› The views of the partners having a majority interest
› General knowledge of tax matters and the partnership’s administrative operations
› Access to the partnership’s books and records
› Whether the person is a U.S. person
› In the case of a partner, the profits interest of the partner

The IRS will generally provide the partnership with an opportunity to designate a partnership representative before the IRS designates one.

› If multiple revocations in a 90-day period results in an IRS determination that a partnership designation is not in effect, the partnership will not be given the opportunity to designate.

Once designated, the partnership cannot revoke the IRS designation without IRS consent.

Unless unavoidable, the IRS will not designate an IRS employee, agent, or contractor as a partnership representative.
Imputed Underpayment

- The IU is a tax imposed on the partnership
  - It is assessed and collected in the same manner as a tax under subtitle A of the Code except deficiency procedures do not apply
  - The IU is a nondeductible expense allocated to adjustment year partners

- Determination of the IU
  - All adjustments are appropriately netted and multiplied by the highest rate in Section 1 or 11 for the reviewed year
  - Changes in credits are taken into account as an increase or decrease in the IU, as appropriate under the circumstances

- For adjustments that reallocate the distributive share of any item from one partner to another, such adjustment shall be taken into account by disregarding any adjustment that results in a decrease in the imputed underpayment to avoid the adjustment netting to $0

- Adjustments that do not result in an IU are allocated to adjustment year partners
There are three occasions when the IU is determined:

- By IRS on examination
  - The IU set forth in the NOPPA does not take into account modifications and is based on facts and circumstances most favorable to the government
  - FPA addresses modifications and reduces IU.
- By the partnership when filing an AAR
  - The partnership can take into account some modifications (e.g., rate, tax exempt) when computing the IU
- By a partnership or S corporation that receives a push-out statement
  - The partnership or S corporation can consider modifications approved by IRS and set forth on the statement received
Step 1 - Group Adjustments: Adjustments placed in one of four groupings
  › Reallocation
  › Credit
  › Residual
  › Foreign Tax Creditable Expenditures (FTCEs)

- Residual grouping further put into subgroupings based on character, etc., so items of different character are not netted.
- Adjustments resulting from reallocations are placed into separate subgroups

Step 2 – Net Groups and Subgroups: Items in same group or subgroup are netted. Net positive amounts aggregated.
  › Net Negative Adjustment (i.e., taxpayer favorable adjustment) in residual or reallocation group is NOT an imputed underpayment.
    o Taken into account in the adjustment year

Step 3 – Compute Imputed Underpayment (Multiply by Highest Tax Rate and Apply Credits): Multiply aggregated amount by highest tax rate for reviewed year and apply adjustments to credits. This is the imputed underpayment.
Multiple Imputed Underpayments

- **Multiple Imputed Underpayments**
  - IRS may designate, in its discretion, a single or multiple imputed underpayment(s) with respect to a partner or various partners
    - Decision is based on the nature of the partnership adjustments
      - IRS may decline to designate multiple imputed underpayments if result is an increase in net negative adjustments
    - If multiple imputed underpayments designated by the IRS, the partnership may separately elect to push out each imputed underpayment
    - Partnerships may request in modification that the IRS create multiple imputed underpayments, but the IRS is not required to do so

**Example:** IRS determines that Partner A’s contribution of property to the partnership in the reviewed year was a disguised sale. IRS may designate the adjustments relating to the disguised sale as one imputed underpayment and the remaining adjustments as a separate imputed underpayment. The partnership can elect to push out one, both, or neither of the imputed underpayments.
Modification Procedures

- **Who?** Only the partnership representative may request a modification and the modification must be approved by the IRS.

- **When?** Within 270 days of the NOPPA all necessary information to substantiate the request must be submitted.
  - 270-day period can be waived or extended by agreement.

- **How?** Procedures expected in forms and instructions.
  - Request must be substantiated to satisfaction of IRS.
  - Must provide detailed description of the structure, allocations, ownership and ownership changes, and relevant partners (e.g., including any indirect partners if modification related to them).
  - Documents and information may vary based type of modification.
  - Necessary documents and information may include tax returns, partnership operating documents, certifications.
Modification of Imputed Underpayment

- Types of Modifications that the IRS will Consider:
  1. Amended Return (and Pull-in)
  2. Tax-Exempt Partner
  3. Rate Modification (corporate or individual partner)
  4. Passive Activity Losses of PTPs
  5. Closing agreements
  6. Deficiency dividends for RICs and REITs
  7. Tax treaty modifications
  8. Other modifications
Amended Return Modification

- The IU is reduced by the allocable share of adjustments taken into account by a reviewed year partner on an amended return filed for the reviewed year and all intervening years and the partner pays the applicable tax, interest and penalties
  - The partnership representative must provide affidavits from each partner that partner filed amended returns and paid tax due
  - In a reallocation adjustment, all partners affected must file amended returns unless the adjustment is taken into account by some other type of modification
  - After filing amended return, partner cannot file additional amended returns with respect to partnership adjustments unless partner receives IRS permission.
  - A pass-through partner may file an amended return taking into account the adjustments and pay tax using the tax rate determined by substituting the total net income of the partner for the taxable year (as adjusted) for taxable income in § 1(c).
- Indirect partners can file amended returns.
Pull-In Modification Procedure

- Instead of filing amended returns, the IU is reduced by adjustments taken into account by the partner for the reviewed year and intervening years and paid by the partner under alternative procedures that will be set forth by the IRS in sub-regulatory guidance
  - Possibly similar to the computation of the additional chapter 1 tax due under the push-out procedures
  - Adjustments to tax attributes are binding for future years and failures subject to math error assessment
  - Statute provides that the IRS can require that information be provided on an amended return

- A partner can file an amended return or use the pull-in procedure even if the statute of limitations is closed for assessment
  - Amended return and pull-in can result in refunds
Example 1 – Multiple Modifications (Amended Return and Tax-Exempt Entity)

NOPPA shows $100 increase in ordinary income resulting in $40 imputed underpayment.

- Partnership can submit evidence that C owns an indirect 25% interest in Partnership and is a tax-exempt entity. No tax on C’s $25 share, reducing imputed underpayment to $30.
- Can D also file an amended return reporting D’s $25 share? Yes
- A cannot file an amended return reporting A’s share because A is a disregarded entity.
- E can file an amended return since E is a relevant partner.
- B **can** file an amended return reporting B’s share.

\[ \text{NOPPA shows } 100 \times 40\% = 40 \]
For 2018 tax year, NOPPA shows $100 increase in long-term capital gain resulting in $40 imputed underpayment.

- Partnership can submit evidence to reduce the imputed underpayment as follows:
  - C’s share = $50 x 21% = $10.50
  - A’s share = $25 x 20% = $5
  - B’s share = $25 x 20% = $5

- Total tax burden reduced from $40 to $27.50.
• IRS has yet to provide guidance on the role of appeals in the partnership audit regime, other than to say that there will be an opportunity to go to Appeals

  › Will the IRS offer a single opportunity to go to appeals after the modification process or will there be two opportunities, one after the adjustments are determined and another after the modifications are approved or denied?

  › If there are two opportunities, will the same Appeals officer hear both appeals?

  › When in the process will Appeals apply and how will the strict time frames within the regime for modification, judicial review, and push-out be addressed?
Only the partnership-level period of limitations is relevant

- A partner’s period of limitations is no longer taken into account, unless the partnership elects out of the new rules

Important note – the period of limitations under section 6235 is a period of limitations on making adjustments, not a period of limitations on making assessments
IRS may make adjustments if one of three following periods is open under Section 6235(a):

- (1) – Three years after later of date return is due or filed (can be extended), or AAR is filed
- (2) – 270 days (plus the number of days of any extension of the time to request modification of the imputed underpayment) after the date everything is required to be submitted in modification
- (3) – 330 days (plus the number of days of any extension of the time to request modification) after the NOPPA is issued – when no modification documentation submitted

For (2) and (3), NOPPA will be issued within three years of the later of the date the tax return is due or filed (including extensions) or AAR is filed.
Example – NOPPA Issued, Modification Period Extended, and Modification Request Submitted

- Calendar-year partnership files its return for 2020 tax year on March 15, 2021 (the due date). No AAR filed.
- June 1, 2023 – Parties agree to extend the period under Section 6235(a)(1) to December 31, 2025.
- June 2, 2025 – IRS issues a NOPPA.
- Parties agree to extend modification period 45 days from February 27, 2026 to April 13, 2026.
- April 13, 2026 – PR required to submit all documentation supporting modification request.
- February 22, 2027 – Statute expires 315 days after modification period ends on April 13, 2026 (270 days + 45 day extension of modification period).
Period of Limitations

- **Example – NOPPA Issued, Modification Period Extended, and Modification Request Submitted (cont’d)**
  - 6235(a)(1): March 15, 2021 (date return filed) + 3 years = **March 15, 2024**
  - 6235(a)(2): April 13, 2026 (date all mod stuff must be submitted) + 270 + 45 (the mod. extension) = **February 22, 2027**
  - 6235(a)(3): June 2, 2025 (date of NOPPA) + 330 + 45 (the mod. extension) = **June 12, 2026**
Notice of Final Partnership Adjustment

- At the end of the examination, the IRS will issue a notice of final partnership adjustment (FPA)
  - Mailed to the partnership and partnership representative
The Push-Out Election

- Rather than pay the IU, the partnership can elect to push out adjustments to reviewed year partners
  - A valid push-out election means the partnership is no longer liable for the IU
  - Push-out results in correct tax being paid by correct partners

- Valid election = Election + Statements
  - A push-out election is valid until the IRS determines it is not. If the IRS determines the push-out election is invalid, the IRS will notify the partnership representative within 30 days
  - If the IRS makes a final determination that the election is invalid, would the IU come back to life?
  - What could result in IRS determining the election is invalid? A failure to send corrected statements? A failure by an upper tier partner to send statements Penalties and additional collection options (like new 6234(f) and cease to exist) may dissuade the IRS from invalidating a push-out election
The Push-Out Election

- Partnership must make the election within 45 days of the date the FPA was mailed, though statements not due until 60 days after the 90-day period to go to court has lapsed or the court determination of adjustments is final
  - The partnership may still challenge the FPA in court following a push-out election because the statements are due 60 days after the final court determination
- A push-out election must include the following information:
  - the name, address and TIN of the partnership;
  - the taxable year to which the election relates;
  - a copy of the FPA to which the election relates;
  - if the FPA includes more than one imputed underpayment, identification of the imputed underpayment(s) to which the election applies;
  - each reviewed-year partner’s name, address, and correct TIN; and
  - any other information prescribed by the IRS in forms, instructions, and other guidance.
The statement must include each reviewed year partner’s share of various partnership-related items, its share of adjustments and modifications as finally determined and any penalties, additions to tax and additional amounts.

A reviewed-year partner must pay additional chapter 1 tax on the return for the year the statement is received equal to the aggregate of the “correction amounts,” plus penalties and interest.

The correction amounts are any changes in taxes payable for the reviewed year and all intervening years had the adjustments been properly reported.

Interest on the tax due is two percentage points higher than the normal underpayment interest rate.
Adjustments can be pushed out through the multiple tiers of ownership to the ultimate owner.

Pass-through partner must furnish statements to its partners (the affected partners). If the pass-through partner does not furnish statements, the pass-through partner must pay an imputed underpayment.

- Pass-through affected partners can elect to push or pay.
- A pass-through partner is a partnership, S corporation, non-grantor trust, or estate
- In the case of a wholly-owned grantor trust or disregarded entity, the owner is treated as the affected partner
Each partner that is a pass-through partner must either:

- Take the adjustments into account and pay the resulting IU, or
- Furnish statements with allocable share of adjustments to each partner/shareholder/beneficiary:
  - File copy of statements with IRS
  - Statements must be furnished by the extended due date of the audited partnership’s adjustment year return
- Must pay IU if fail to timely furnish and file statements

Each pass-through partner paying or pushing must file an adjustment tracking report with IRS identifying their partners/shareholder/beneficiary.
Push Out in Tiers

- **2018 Form 1065 filed 3/15/2019**
- **2018 Form 1065 selected for audit**
- **90 days to file for redetermination in court**
- **60 days to issue statements to 1st tier**

1. **NAP NOPPA**
2. **FPA mailed 3/1/2022**
3. **Final determination of adjustment**

Within 45 days partnership makes the push out election

- If the 90 day period lapsed and no petition filed, adjustment year is 2022
  - If the court decision on the petition is final on 2/1/2025, adjustment year is 2025
- Each pass-through partner* in a tier must file adjustment tracking report AND pay or furnish/file statements by:
  - If 2022 adjustment year, 9/15/2023
  - If 2025 is adjustment year, 9/15/2026

Note: A partner that is a pass-through partner is not required to take these steps if the pass-through partner in which they are a partner pays all imputed underpayments

*Assume all partners are calendar year taxpayers
Scenario 1

- P1 makes a timely push out election.
- P1 sends statements to A, P2, P3, and P4.
- P2 files an adjustment tracking report with IRS and furnishes statements to C1 and B and files copies of statements with the IRS.
- P3 and P4 pay the IU based on their allocable share of the adjustments on the statement. P3 and P4 are not required to furnish or file statements, but must file the adjustment tracking report with the IRS.
- P5 is not required to furnish or file statements or file an adjustment tracking report.

Scenario 2

- Same as Scenario 1 except P4 furnishes statements to C2 and P5 and files copies with the IRS.
- P5 must file an adjustment tracking report and either send C3 and C4 statements and file copies with the IRS or pay any IU resulting from taking into account its allocable share of the adjustments.

Scenario 3

- Same as Scenario 2 except P4 does nothing. P4 will be subject to penalties for failure to file the adjustment tracking report and will be required to pay the IU.
Summary -- BBA Audit Process

2018 Form 1065 filed 3/15/2019
2018 Form 1065 selected for audit

Where is Appeals?

Notice of Selection for Examination
• Not required by statute
• Issued only to the partnership
• No time limit, but practically limited by 6235 time for making adjustments
• Partnership can revoke PR

Notice of Administrative Proceeding (NAP)
• Required to be mailed to the P’ship and PR by 6231(a)(1)
• No time limit, but practically limited by 6235 time for making adjustments
• Can’t file AAR after receipt
• Can be unilaterally withdrawn by IRS
• Time for PR to resign/p’ship to revoke PR/DI

During this period:
• Work with the agent to determine scope of issues
• Opportunity to provide info about partners informally
• Get/respond to IDR s

At least 270 days unless waived (6231(b)(2))

Notice of Proposed Partnership Adjustment (NOPPA)
• Required to be mailed to the P’ship and PR by 6231(a)(2)
• Must be sent by the later of 3 years after date return or AAR filed (or due date if no return filed) (6235(b)(1))
• Can be unilaterally withdrawn by IRS
• Date mailed begins 270 day modification period

Notice of Final Partnership Adjustment (FPA)
• Required to be mailed to the P’ship and PR by 6231(a)(3)
• Can be rescinded with P’ship consent
• Must be sent on or before the later of:
  • The later of 3 years after date return or AAR filed (or due date if no return filed)
  • 270 days (plus extension, if any) after all modification info submitted
  • 330 days (plus any extension for modification) after NOPPA (6235(a))

*Exception if 905(c) applies

45 days to elect push out
90 days to file for redeterminatio n in court

Where is Appeals?

- 90 days to file for redeterminatio n in court
- 45 days to elect push out

Notice of Selection for Examination
Notice of Administrative Proceeding (NAP)
Notice of Proposed Partnership Adjustment (NOPPA)
Notice of Final Partnership Adjustment (FPA)

*Exception if 905(c) applies

Summary -- BBA Audit Process

Where is Appeals?
Judicial Review

- Suit may be brought by the Partnership Representative within 90 days of when an FPA is mailed in
  - Tax Court
  - District Court in which the partnership’s principal place of business is located; or
  - The Court of Federal Claims

- Court has jurisdiction to determine:
  - Adjustments
  - Modifications
  - The proper allocation of items among partners; and
  - Penalties, additions to tax and other amounts for which the partnership may be liable
Penalties

- Penalties determined at partnership level as if partnership had been an individual in the reviewed year and imputed underpayment were an underpayment of tax.
  - In the case of amended returns or push out, applicability of penalties is determined based on the partner’s facts and circumstances (e.g., whether understatement is substantial is based on the partner’s entity type)

- Calculating the Penalty – NPRM
  - Excluded adjustments that did not go into the imputed underpayment calculation
  - Grouped adjustments by penalty and penalty rate, disregarding section 6225
  - Applied tax rate used in imputed underpayment calculation to determine amount subject to penalty and apply penalty rate.
  - Applied decreasing adjustments in the least taxpayer favorable manner by offsetting adjustments not subject to a penalty first, then adjustments subject to lowest penalty
Penalties

- Calculating the Penalty – Final Regulations use section 6225 groupings
  - Generally provides that negative adjustments first offset positive adjustments within a group or subgroup not subject to penalty, then against adjustments subject to lowest penalty; special rules for negative credits
  - Six-step calculation of portion of imputed underpayment subject to penalty after applying all negative adjustments
    - 1) Total all non-credit adjustments subject to penalty at highest rate
    - 2) Multiple this total by the highest rate of tax under section 1 or 11
    - 3) Repeat steps 1 and 2 for all other modified tax rates
    - 4) Total results of steps 1-3
    - 5) Net all credit adjustments. If positive, increase total in step 4. If negative, decrease total, applying first to portion of imputed adjustment to which no penalty imposed, then against portion with lowest penalty rate
    - 6) Multiple step 5 total by penalty rate
Partnership issued NOPPA proposing:

- $100 *positive* adjustment to ordinary income, subject to 20% negligence penalty
- $10 *positive* adjustment to credits, subject to 20% negligence penalty
- $300 *positive* adjustment to long-term cap gain, no penalty applies
- $50 *negative* adjustment to ordinary income, subgrouped with $100 adjustment

Calculation of imputed underpayment subject to 20% penalty:

- **Step 1:** $(100 - 50) = 50$
- **Steps 2-4:** $50 \times 40\% \text{ [tax rate]} = 20$
- **Step 5:** $20 + 10 = 30$
- **Step 6:** $30 \times 20\% = 6$
Partnership issued NOPPA proposing:

- $80 *positive* adjustment to ordinary income, no penalty applies
- $100 *positive* adjustment to ordinary income, subject to 20% negligence penalty
- $10 *positive* adjustment to credits, subject to 20% negligence penalty
- $300 *positive* adjustment to long-term cap gain, no penalty applies
- $120 *negative* adjustment to ordinary income, subgrouped with $180 adjustments

Calculation of imputed underpayment subject to 20% penalty:

- First apply negative adjustments: $120 negative applied to $80 not subject to penalty first, then used to reduce the $100 to $60
- Step 1-4: $60 X 40% [tax rate] = $24
- Step 5: $24 + $10 = $34
- Step 6: $34 X 20% = $6.80
Partnership is treated as the taxpayer for the Reasonable Cause and Good Faith (RCGF) defense

- Partnership’s facts and circumstances are the relevant facts and circumstances for the defense
  - The actions of a partner could be relevant to the partnership’s RCGF defense
- Partner-level RCGF defense may **not** be raised in partnership proceeding
  - Partner-level RCGF defense may be raised in a refund suit by the partner
A partnership subject to the partnership audit regime amends their return by filing an administrative adjustment request (AAR)

- Must be filed within 3 years after the later of the date the return is filed or the unextended due date if no return is filed
- Can’t file an AAR after IRS mails a Notice of Administration Proceeding (NAP)

A partnership may either pay the IU or push out adjustments to reviewed year partners

- Adjustments that do not result in an IU must be pushed out to reviewed year partners

Filing an AAR restarts the period of limitations for IRS to make adjustments
Section 6241(7) provides that if a partnership ceases to exist, the former partners must pay the tax on the partnership adjustments.

Under the Regulations, if the IRS determines that any partnership ceases to exist before a partnership adjustment takes effect, the partnership adjustment is taken into account by the former partners.

The IRS may determine that a partnership ceases to exist if:

- The partnership terminates because no part of its business, financial operations or venture of the partnership continues to be carried on by any of its partners; or
- The partnership does not have the ability to pay assessments for which the partnership is liable.
Section 6232(f) provides that if an imputed underpayment or specified similar amount that is not paid within 10 days of the date of a notice and demand for payment, the IRS can collect from partners (or former partners if the partnership ceased to exist) their proportionate share of the imputed underpayment plus interest at a rate 2% higher than the underpayment rate. The total amount collected can’t exceed the total imputed underpayment.

- Specified similar amount refers to the imputed underpayment due during push-out through the tiers.
- Proposed regulations have not been issued on this provision.
Section 6241(11) allows the IRS to except partnership-related item from the partnership audit regime and subject them to “special rules (including rules related to assessment and collection)” by regulation if the item involves special enforcement matters.

- Examples of special enforcement matters in the statute:
  - Failure of partnerships and S corporations in the tiers to comply with the requirements to furnish statements or pay an imputed underpayment
  - Termination and jeopardy assessments
  - Criminal investigations
  - Indirect methods of proof of income
  - Foreign partners or partnerships
  - Other matters that are determined by regulation to present special enforcement considerations

- Notice 2019-6
IRS intends to propose regulations under the “special enforcement matters” provision in section 6241(11) to address two matters:

1) The centralized partnership audit regime will not apply where an adjustment during the examination of a person other than the partnership requires a change to a partnership-related item. Specifically, the new regime will not apply where:
   - The examination being conducted is of a person other than the partnership;
   - A partnership-related item must be adjusted, or a determination regarding a partnership-related item must be made, as part of an adjustment to a non-partnership-related item of the person whose return is being examined; and
   - The treatment of the partnership-related item on the return of the partnership under section 6031(b) or in the partnership’s books and records was based in whole or in part on information provided by, or under the control of, the person whose return is being examined.

2) Partnerships with a QSub as a partner generally cannot elect out of the new audit regime

Administrative Practice Committee will be drafting comments, due by Feb. 22, 2019
International Tax Guidance
International Tax Guidance: Coordination with Withholding Rules

- **Scope of Centralized Partnership Audit Regime**
  - Determination that partnership withheld incorrect amount under Chapter 3 or 4 is determined outside centralized partnership audit.
    - **Example:** Partnership should have withheld at a 30% rate on amounts allocable to a foreign partner but erroneously withheld at a 15% rate. The adjustment to increase the withholding tax liability is not determined in a centralized partnership audit, but as part of the Form 1042 examination.
  - Determination that partnership underreported an item subject to withholding can be determined by adjusting partnership’s withholding tax liability or in centralized partnership audit.
    - **Example:** Partnership underreported dividend income and therefore withheld less than it should have on dividend income allocated to a foreign partner. IRS can assess and collect the under-withheld amount without a partnership audit. If IRS later audits the partnership, dividend income allocable to the foreign partner would be disregarded in calculating the imputed underpayment.
● If Partnership Pays the Imputed Underpayment

› Partnership is treated as having paid the amount required to be withheld with respect to the adjustment under Chapter 3 or 4.

› If the IRS has already collected the Chapter 3 or 4 tax attributable to an adjustment to an amount subject to withholding, the adjustment is disregarded for purposes of calculating the imputed underpayment.
Creditable Foreign Tax Expenditures – Imputed Underpayment

- CFTEs are grouped together and placed into subgroups based on the separate category of income to which the CFTE relates under Section 904(d) (general category income, passive category income)

- Reallocations from one category to another category or one partner to another are not netted
  - Adjustments that do not result in an imputed underpayment are taken into account in the adjustment year
  - Decrease in CFTE’s is treated as a decrease in credits and increases the imputed underpayment on a dollar-for-dollar basis
Reallocation of CFTEs Example. IRS determines $400 of passive category CFTEs should have been general category. The partnership adjustment is a $400 decrease to passive CFTEs and a $400 increase to general category CFTEs.

- Both adjustments are in the CFTE grouping but are not netted.
- $400 increase to general category CFTEs is an adjustment that does not result in an imputed underpayment and is taken into account in the adjustment year.
- $400 decrease to passive category CFTEs results in a $400 imputed underpayment.

<table>
<thead>
<tr>
<th></th>
<th>Passive Category CFTEs</th>
<th>General Category CFTEs</th>
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</thead>
<tbody>
<tr>
<td>Original Return</td>
<td>$400</td>
<td>$0</td>
</tr>
<tr>
<td>As Adjusted</td>
<td>$0</td>
<td>$400</td>
</tr>
<tr>
<td>Amount of Adjustment</td>
<td>($400)</td>
<td>$400</td>
</tr>
</tbody>
</table>
The technical corrections added section 6241(12) to provide that shareholders of CFCs and PFIC owners are treated as partners for purposes of the partnership audit regime.

Until guidance comes out, it is unclear what this means for taxpayers. Results differ if the government treats the CFC or PFIC like a DE or if it treats them more like a partnership. In the former case, there is no opportunity for the entity to pay the tax and avoid identifying its owners. In the latter case, the CFC or PFIC could pay the tax.
Partnership Agreement
Drafting Considerations
Partnership Agreement Drafting Considerations

● General

› When drafting and reviewing a partnership agreement, it is important to consider potential conflicts of interest and have notice and process provisions in place

  o The potential for conflicts exist when a partnership representative is also a partner.

  o Each direct and indirect partner and the partnership itself could have competing interests in a partnership audit

  o The partnership agreement could impose some level of fiduciary duty on the partnership representative or the possible replacement of the partnership representative if it appears that there is a conflict of interest

● Election out

› A partnership that qualifies to elect out of the partnership audit regime may want to require that in its partnership agreement and require its partners to provide the necessary information to the partnership to make that election
Partnership Agreement Drafting Considerations

- Partnership representative
  - The partnership should carefully consider who will serve as the partnership representative and designated individual, if applicable, and whether to name that person(s) in its partnership agreement.
  - The partnership agreement should specify how a partnership representative is selected and how a replacement partnership representative is chosen.
  - The partnership agreement may require that the partnership representative give notice to some or all of the partners of certain specific events (e.g., correspondence with the IRS).
    - The details of the notice will depend on the relationship between the partners.
    - The partnership representative should at least be required to give notice of the commencement of an audit and when any assessment has been made.
Partnership representative (cont.)

- The partnership agreement may contain provisions limiting the authority of the partnership representative
  - For instance, the partnership agreement could require that some percentage of the partners must agree to certain actions to be taken by the partnership representative, such as settling an audit or extending the statute of limitations
  - Partnerships should consider whether to have a separate agreement for terms and conditions of its relationship with the partnership representative.
Pull-In Modification:

- Partnerships may want to clarify that the partnership representative has the power to utilize the pull-in modification procedure in their partnership agreements.
- Partnerships also may want to require the pull-in modification procedure in certain situations (e.g., when there is more than a de minimis adjustment amount) in their partnership agreements. Consider leaving a way for the PR to get an exception if facts and circumstances warrant.
• Push-Out Election
  › Partnerships may want to clarify that the partnership representative has the power to make a push-out election in their partnership agreements
  › Partnerships also may want to require a push-out election in their partnership agreements. Consider leaving a way for the PR to get an exception if facts and circumstances warrant
  ○ Requiring the push-out election could be beneficial when the adjustment year partners are materially different than the reviewed year partners
Partnership Agreement Drafting Considerations

- Other Considerations
  - Indemnity of partnership representative
  - Allocations and capital accounts
IRS Implementation – Where Do Things Stand?
Questions?
Appendix
Schedule B-2

Election out of the Centralized Partnership Audit Regime

Part I
List of Eligible Partners

<table>
<thead>
<tr>
<th>Name of Partner</th>
<th>Taxpayer Identification Number (TIN)</th>
<th>Type of Eligible Partner</th>
</tr>
</thead>
<tbody>
<tr>
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</table>

Part II
List of S Corporation Shareholders (For each S corporation partner, complete a separate Part II and separate Part V, if needed)

<table>
<thead>
<tr>
<th>Name of S Corporation Partner</th>
<th>Name of Shareholder</th>
<th>Shareholder TIN</th>
<th>Type of Person</th>
</tr>
</thead>
<tbody>
<tr>
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</tbody>
</table>

Part III
Total Number of Schedules K-1 Required to be Issued. See instructions.

1. Total of Part I and all Parts IV Schedules K-1 required to be issued by the partnership.
2. Total of Part II and all Parts V Schedules K-1 required to be issued by any S corporation partners.

Note: If line 1 is more than 100, the partnership cannot make the election under section 6221(b).

For Department of State Forms, use the Instructions for Form 1120.