Ethical Considerations Arising Out of the BBA Partnership Audit Rules

Friday, January 31, 2020 | 3:10 PM Eastern

2020 Midyear Tax Meeting
Panelists

• Matthew Cooper, Managing Director, Deloitte Tax LLP (Moderator)
• Emily Lesniak, Special Counsel, IRS Office of Chief Counsel (Procedure & Administration)
• Sheri Dillon, Partner, Morgan, Lewis & Bockius LLP
• Rochelle Hodes, Principal, Crowe LLP
• Alice Harbutte, Managing Director, Ernst & Young LLP
BBA Overview

- On November 2, 2015, Congress enacted the Bipartisan Budget Act of 2015 ("BBA"), which is generally effective starting with 2018 tax years.
- The BBA repealed the partnership examination procedures under the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), and created a new partnership audit regime.
- The BBA contains one set of partnership-level audit rules that will apply to all partnerships, subject to an election out for certain eligible partnerships.
- The IRS will examine a partnership’s return for a particular year.
- Any adjustments will be taken into account by the partnership, and the partnership will pay the tax, penalties, and interest resulting from the adjustments in the year the audit or judicial review is completed, unless the partnership elects to flow those adjustments out to the partners for the year under audit.
- Partnership Representative replaces Tax Matters Partner.
Key Terms/References

**Imputed Underpayment** – net adjustments x highest tax rate +/- credit groupings

**6225 Payment** – the default rule where the partnership pays the imputed underpayment

**6226 Election** – partnership election to push out the imputed underpayment to reviewed-year partners

**Partnership Representative** – binds the partnership and the partners

**Reviewed Year** – the partnership tax year under examination

**Adjustment Year** – the year in which the adjustment is made or becomes final

**Election Out for Certain Partnerships** – annual option for eligible partnerships

**Election In** – early application of the BBA to electing partnerships
Relevant ABA Model Rules

• 1.1 - Competence
• 1.2 – Scope Of Representation And Allocation Of Authority Between Client And Lawyer
• 1.3 – Diligence
• 1.6 – Confidentiality of Information
• 1.7 – Conflict of Interest: Current Clients
• 1.8 – Conflict of Interest: Specific Rules
• 1.9 – Duties to Former Clients
• 1.10 – Imputation of Conflicts of Interests: General Rule
• 1.13 – Organization as a Client
• 1.16 – Declining or Terminating Representation
• 2.1 - Advisor
Relevant Circular 230 Provisions

• § 10.21 – Knowledge of client’s omission

• § 10.22 – Diligence as to accuracy

• § 10.29 – Conflicting Interests
Who is the Client?
• Partnership?
• Partnership Representative?
• Partners?

• What does engagement letter say?
• What does partnership agreement say?
• What does state law say?
• Who signs the Form 2848, Power of Attorney and Declaration of Representative? Instructions say: “For matters related to the centralized partnership audit regime, the partnership representative must sign the Form 2848.”
Partnership Representative In General
• Possesses the sole authority to act on behalf of the partnership during IRS BBA examinations and civil litigation
• All partners are bound by the acts of the partnership representative
• Unlike TEFRA, statute does not require partnership representative to provide notice of IRS BBA exam activities to other partners
• Partners have no statutory or regulatory right to participate in any IRS exam or appeal (what about litigation?)
• Will be designated by IRS if not selected by the partnership
Who can be a Partnership Representative?

- Treas. Reg. § 301.6223-1(b): Does not need to be a partner; just needs to be a person with a “substantial presence” in the United States
- Designated individual if partnership representative is an entity.
- Annual election generally made on return (special changing/resignation procedures in place)
- Can a tax attorney be a partnership representative?
  - Pros
  - Cons
  - Other considerations?
Hypo

• Practitioner represents BBA Partnership in an IRS examination of 2018 tax year. The IRS is focusing on a transaction and has informally indicated that items from the transaction will be disallowed and a penalty imposed.

• Partnership Representative, a partner in BBA Partnership, orchestrated the transaction and obtained a tax opinion from other attorneys in Practitioner’s firm, which was addressed to Partnership and advised that the transaction would withstand scrutiny.

• The other partners now regret the transaction and have a strained relationship with Partnership Representative.

• Partnership Representative leaves BBA Partnership in 2020, but BBA Partnership does not take action to revoke PR status.
Hypo cont.

• During the examination, Partnership Representative repeatedly advises Practitioner not to share IDRs and status updates with other partners, notwithstanding partnership agreement requires communication and majority vote of partners on major decisions of partnership.

• In 2021, the IRS issues a Form 5701 proposing adjustments and penalties.

• Practitioner submits a response to the Form 5701 asserting a reasonable cause defense on behalf of Partnership.
Hypo cont.

• Potential Issues:
  • Can Practitioner represent Partnership during the examination?
  • Who is authorized to make all decisions as to strategy, including how to resolve matter with IRS and what modifications/elections to make regarding any potential liability?
  • Did Partnership Representative and/or Practitioner have obligation to notify partners of status of IRS exam?
  • What if Partnership Representative is a U.S. CPA or attorney?
Hypo cont.

• Potential Issues:
  • What if Partnership Representative unilaterally decides to agree to unfavorable settlement, including penalties, and does not elect to push-out adjustments to partners?
  • What actions should BBA partnership take to prevent this from occurring in future?
  • What potential issues if Partnership Representative filed AAR in 2020 reversing the transaction (and pushing out adjustments to partners) before IRS opened up examination?
  • What do IRS employees do when they identify potential conflicts?
ABA Model Rules to Consider

• Rule 1.1 (Competence): A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

• Rule 1.2 (Scope of Representation): A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

• Rule 1.3 (Diligence): A lawyer shall act with reasonable diligence and promptness in representing a client.
  • Comment: A lawyer should pursue a matter on behalf of a client . . . and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor. A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf.

• Rule 1.6 (Confidentiality): A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by another rule.
ABA Model Rules to Consider

• Rule 1.7 (Conflict – Current Client): Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

  (1) the representation of one client will be directly adverse to another client; or

  (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

• Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

  (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

  (2) the representation is not prohibited by law;

  (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

  (4) each affected client gives informed consent, confirmed in writing.
ABA Model Rules to Consider

• Rule 1.9 (Conflict – Former Client): (a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

• (b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

   (1) whose interests are materially adverse to that person; and

   (2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

• Also cannot generally use information to the disadvantage of the former client or reveal information relating to the representation.
ABA Model Rules to Consider

• Rule 1.13 (Organization as Client):
  • A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
  • Proceed as reasonably necessary in the best interest of the organization, and refer matter to highest authority in the organization, unless not necessary in the best interest of organization to do so.
  • In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

• Rule 1.16 (Declining or Terminating Representation): A lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if the representation will result in violation of the rules of professional conduct or other law.

• Rule 2.1 (Advisor): A lawyer shall exercise independent professional judgment and render candid advice. In doing so may refer not only to law, but also to moral, economic, social and political factors.
Relevant Circular 230 Provisions

• § 10.21 – Knowledge of client’s omission: If you know that a client has not complied with the tax law or has an error on a return:
  • Inform the client promptly, and
  • Advise the client of the consequences

• § 10.22 – Diligence as to accuracy: Exercise due diligence in:
  • Preparing returns and other documents for the IRS
  • Determining correctness of information that you provide to the IRS
  • Determining correctness of information that you provide to your client

• § 10.29 – Conflicting Interests: Providing the service to one client will harm another client, or significant risk that service to one will be materially limited by responsibilities to another or your own interest. Service may proceed if:
  • Can provide competent and diligent service,
  • The representation is not prohibited by law, and
  • Each affected client provides written consent
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