

The New Partnership Audit Rules: The Beginning of a New Era

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Overview

- Background – How did we get here?
- Overview of the New Partnership Audit Rules
- Audits
 - › Scope of the Audit
 - › Partnership Representative (Designation, Resignation and Revocations)
 - › Notice and Participation Rights of Partners
 - › Statute of Limitations

Overview

- Assessment and Payment
 - › Calculation of the Imputed Underpayment
 - › Modifications of the Imputed Underpayment
 - › Push-Out Election
 - › Partnership Fails to Pay
- Planning Considerations
 - › Election In
 - › Election Out
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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

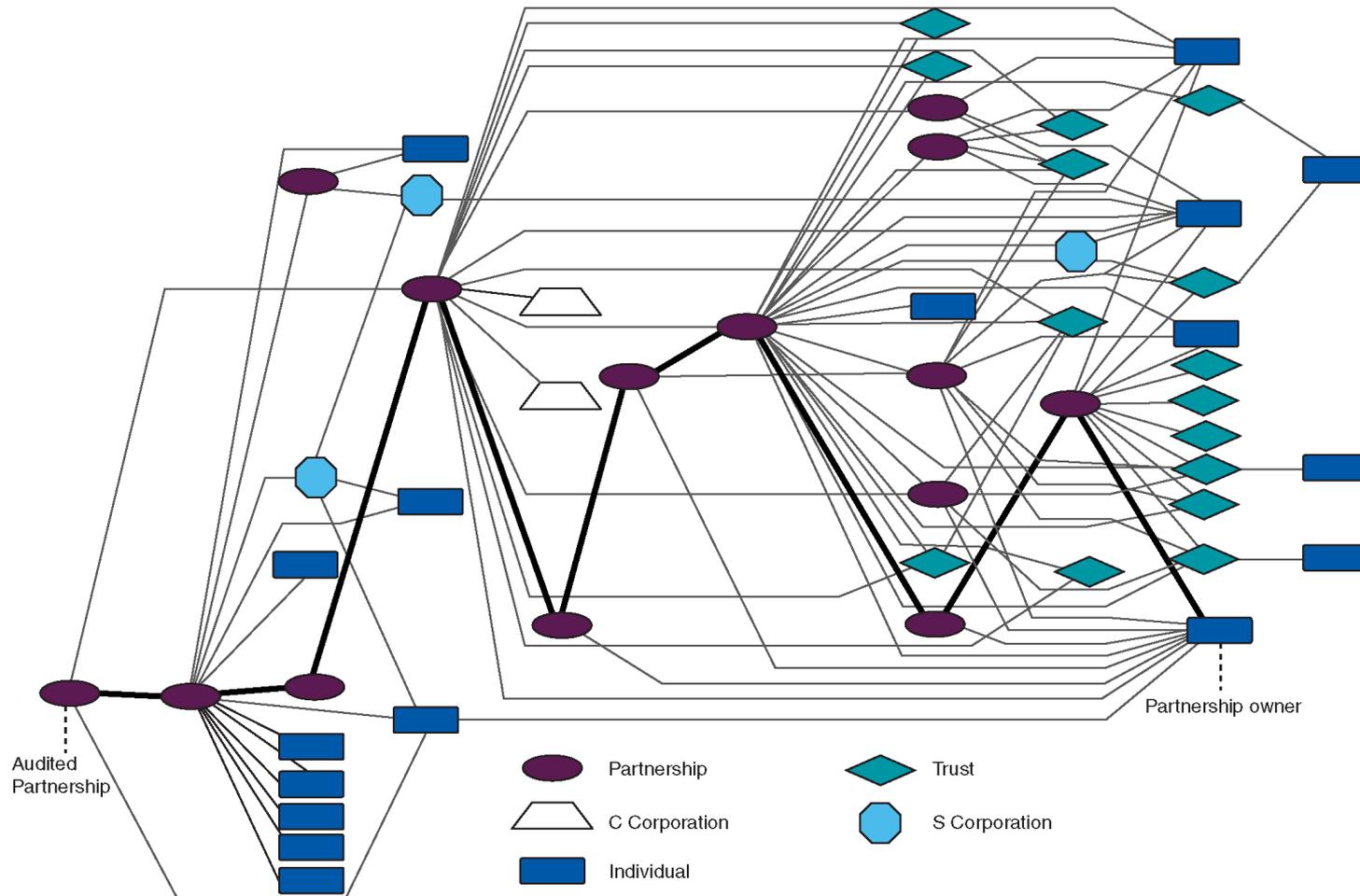
How did we get here?

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.

How did we get here? The Challenges of TEFRA



Source: GAO analysis of IRS documentation. | GAO-14-732

Bipartisan Budget Act of 2015 (“BBA”): Overview

- **Audits and Litigation:** Requires partnership-level resolution of all items of partnership income, deduction, gain, loss or credit (like TEFRA).
- **Assessment and Collection.** Default rule is that the partnership is assessed tax on the imputed underpayment in the year the adjustments are finally determined (the adjustment year).
 - › Partnership is generally assessed tax at the highest rate applicable to individuals, although the imputed underpayment may be modified to some extent to reflect the tax positions of the reviewed-year partners.
 - › The imputed underpayment is reduced to the extent reviewed-year partners file amended returns and pay the tax.
 - › Partnership can elect to push-out the adjustments to the reviewed-year partners.
- **Simplified Administrative Procedures.** Replaced tax matters partner with partnership representative and eliminated partner notice and participation rights.

BBA: Overview

- Effective for tax years beginning after 2017 (although partnerships may elect to have entity-level assessments apply earlier)
- New rules are expected to increase partnership audit rates and the related tax assessments.
 - › Joint Committee on Taxation estimates the net revenue effect is \$9.325 billion of additional revenue over 8 years.

BBA: Overview

- BBA had many deficiencies and open issues regarding administration of the new rules.
 - › PATH Act of 2015 included a few corrections and clarifications.
 - › Tax Technical Corrections Act of 2016 was introduced in December 2016 would have addressed some of the open issues. Status is unclear.
 - › Proposed Regulations
 - IRS released a 277 page Notice of Proposed Rulemaking on January 18, 2017
 - Withdrawn on January 20, 2017 as a result of the regulatory freeze
 - Released again on June 13, 2017 with very few changes

Scope of the Partnership Audit

- Under the statute, the partnership audit applies to “items of income, gain, loss, deduction, or credit of a partnership” “a partner’s distributive share thereof”, and any penalties or additions to tax that relate to an adjustment of such an item.
 - › Statute appeared to be more narrow than TEFRA’s scope that applied to “partnership items.”

Scope of the Partnership Audit

- Proposed Regulations broadly define the scope of a partnership proceeding to include all items and information related to or derived from the partnership including:
 - › 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-level proceeding 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.

Scope of the Partnership Audit

- **Practice Tip:** The broad scope of the partnership proceeding means that certain defenses that are specific to partners (such as in the context of a disguised sale by the partner to the partnership or penalty defenses) will need to be raised in the partnership proceeding. However, only the partnership representative is entitled to participate in the partnership proceeding. Partners may want to provide in the partnership agreement that the partnership representative will consult with the partners to identify any defenses and raise such defenses in the partnership proceeding.

Partnership Representative

- BBA replaces the tax matters partner in TEFRA with the “partnership representative”
- 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 may not be limited by state law or agreement (including the partnership agreement)

Who can be the Partnership Representative?

- In order to be the partnership representative, the person must have (1) a substantial presence in the United States; and (2) the capacity to act.
 - › 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:
 - › can 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.
- **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.
 - › This means that in a multi-year audit the partnership may have a different partnership representative for each year under audit.
 - › Partnership cannot change the partnership representative until the IRS issues a notice of administrative proceeding or the partnership files an AAR.
 - Avoids unnecessary paperwork to process changes that have no impact because the partnership is not under audit.

Resignation 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 resigning partnership representative **may** designate a successor, but is not required to in order for the resignation to be effective.
 - › If the partnership representative does not designate a successor, the partnership has 30 days to designate a successor or the IRS will designate one.

Revocation of the Partnership Representative

- Partnership can revoke a designation of the partnership representative.
 - › This is an exception to the general rule that the partnership representative has the sole authority to act on behalf of the partnership.
 - The revocation must be signed by a general partner for the year in which the designation was in effect (i.e., the reviewed year).
 - If each general partner eligible to sign is no longer a partner or lacks the capacity to act, another partner may sign.
 - › Revocation must include a statement under penalties of perjury that the partner is authorized by the partnership to revoke the designation.
 - › Partnership **must** designate a successor in order for the revocation to be effective.

IRS Designation of the Partnership Representative

- IRS may select **any person** to serve as the Partnership Representative and will consider the following factors:
 - › Whether there is a suitable partner for the reviewed year or the time the designation 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
- Once designated, the partnership cannot revoke the designation without the IRS's consent.

Audit - Notice of Partnership Proceedings

- IRS must mail to the partnership and partnership representative:
 - › Notice of selection for examination
 - Election in must be made within 30 days of receipt
 - › Notice of any administrative proceeding (NBAP) initiated at the partnership level
 - › Notice of any proposed partnership adjustment (NOPPA)
 - If the IRS does not issue a NOPPA, it may not issue an FPA and it may not make any assessments.
 - The IRS may rescind a NOPPA with the partnership's consent.

Audit - Notice of Partnership Proceedings

- IRS must mail to the partnership and partnership representative:
 - › Notice of any final partnership adjustment (FPA)
 - IRS must wait 270 days after the NOPPA (or longer, if period extended) to see if partnership submits a request to modify the imputed underpayment :
 - › If not, the FPA is issued in the next 60 days (or up to three years after partnership return is due or filed, whichever is later)
 - › If so, the FPA is issued in the next 270 days (or up to three years after partnership return is due or filed, whichever is later)
 - › If an FPA is issued, the limitations period is suspended during the 90-day period in which the partnership may file a petition for judicial review, and if filed, until the court decision becomes final, plus one year.

Statutes of Limitations

- Only partnership-level statute of limitations relevant
 - › A partner's statute of limitations is no longer taken into account, unless the partnership elects out of the new rules
 - › Except partners may not file an amended return to pay tax and reduce the imputed underpayment unless partner statute of limitations for assessments is open
- **Unanswered Question:** Is the IRS able to open the statute of limitations by issuing a NOPPA?

Audit - Partner Participation Rights

- Unlike under TEFRA, partners do not have the right to participate in the proceedings or receive notice of the proceedings from the IRS.
- All partners are bound by a final resolution in the partnership proceeding.

Imputed Underpayment Computation

Step 1 – Group Adjustments: Adjustments placed in one of four groupings

- › Reallocation
- › Credit
- › Residual
- › Creditable Expenditures (Reserved)

Residual grouping further put into subgroupings based on character, etc. so items of different character are not netted

Step 2 – Net Groups and Subgroups: Items in same group or subgroup are netted (except that offsetting amounts in reallocation group are not netted). Net positive amounts aggregated.

- › **Net Non-Positive Amount** (i.e., taxpayer favorable adjustment) in residual or reallocation group is NOT an imputed underpayment.
 - Taken into account in the adjustment year as a decrease in income or an increase in loss

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 credits. This is the imputed underpayment.

Imputed Underpayment Computation

	Original Return	As Adjusted	Amount of Adjustment
Ordinary Income	\$300	\$500	\$200
Depreciation Deduction	(\$100)	(\$70)	\$30
Subtotal Ordinary Subgroup			\$230
Long-Term Capital Gain	\$125	\$200	\$75
Long-Term Capital Loss	(\$75)	(\$25)	\$50
Subtotal Long-Term Capital Subgroup			\$125
Total Aggregate Net-Positive Adjustments			\$355
Tax Credit	\$5	\$3	\$2

Step 1: Group adjustments.

- Ordinary income and depreciation deduction in one subgroup
- LTCG and LTCL in a separate subgroup
- Tax credit

Step 2: Net subgroups. Aggregate net positive adjustments.

Step 3: Compute Imputed Underpayment ($\$355 \times 40\% = \$142 + \$2 \text{ credit} = \underline{\$144}$)

Imputed Underpayment Computation

Net Non-Positive (Taxpayer Favorable) Adjustment

	Original Return	As Adjusted	Amount of Adjustment
Ordinary Income	\$300	\$100	(\$200)
Depreciation Deduction	(\$100)	(\$70)	\$30
Subtotal Ordinary Subgroup			(\$170)
Long-Term Capital Gain	\$125	\$200	\$75
Long-Term Capital Loss	(\$75)	(\$25)	\$50
Subtotal Long-Term Capital Subgroup			\$125
Total Aggregate Net-Positive Adjustments			\$125

Step 1: Group adjustments.

- Ordinary income and depreciation deduction in one subgroup
- LTCG and LTCL in a separate subgroup

Step 2: Net subgroups

- Ordinary: (\$170) Net non-positive (taxpayer favorable) adjustment that does not result in an imputed underpayment. Reduces income in adjustment year.
- Capital: \$125

Step 3: Compute Imputed Underpayment ($\$125 \times 40\% = \50)

Imputed Underpayment Computation

Reallocation

IRS determines \$30 of ordinary income and \$70 of depreciation allocated to B should have been allocated to A. The partnership adjustment is a net \$40 increase allocated to B and a corresponding \$40 decrease allocated to A.

	A	B
Original Return	\$0	(\$40)
As Adjusted	(\$40)	\$0
Amount of Adjustment	(\$40)	\$40

Step 1: Group adjustments – reallocation group.

Step 2: Do not net offsetting amounts because in reallocation group.

–\$40 net decrease of income to A is a net non-positive amount (taxpayer favorable) and therefore not an imputed underpayment. Taken into account in adjustment year by partnership and allocated to A or successor to A's interest (or, if no successor, among adjustment year partners per distributive shares)

–\$40 net increase to B is the total netted partnership adjustment.

Step 3: Compute Imputed Underpayment ($\$40 \times 40\% = \16)

Imputed Underpayment Computation

- **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 non-positive (taxpayer favorable) adjustments
 - If multiple imputed underpayments designated by the IRS, the partnership may separately elect to push out each imputed underpayment
 - Partnerships may request that the IRS create multiple imputed underpayments, but the IRS is not required to do so

Example: IRS determines 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 of Imputed Underpayment

- **Types of Modification**

Seven Types of Modifications that the IRS will Consider:

1. Amended Return
2. Tax-Exempt Partner
3. Rate Modification (Corporate or individual partner)
4. Passive Losses of PTPs
5. Multiple Imputed Underpayments (requests regarding the number and composition of imputed underpayments)
6. RIC or REIT Deficiency Dividend
7. Closing Agreement

The IRS also allows a partnership to request a modification not listed above.

IRS approval required.

Note: Partnership representative may provide information to the IRS to reduce the imputed underpayment during the audit, but after the NOPPA is issued, the formal modification procedures and timelines apply – 270 days unless extended or waived.

Modification of Imputed Underpayment

- Amended Returns (Reviewed-Year Partners)
 - › Partners who were partners during the reviewed year file amended returns taking into account their distributive share of partnership adjustments and pay the applicable tax.
 - Partner must file amended returns for all years with respect to which any tax attribute is affected by the adjustments and pay any tax due.
 - › Partnership reduces the imputed underpayment by the tax attributable to the partners who filed amended returns.
 - › Reduction in imputed underpayment is based on the partners' distributive shares of partnership adjustments.

Modification of Imputed Underpayment

- Amended Returns – Proposed Regulations
 - › To file an amended return to pay tax, partner's statute of limitations for assessments must be open.
 - If not, cannot file an amended return but other modification alternatives are still available (e.g., a closing agreement).
 - Partner can file amended returns for refunds relating to partnership adjustments at anytime.
 - › Partnership representative must provide affidavits from each partner that partner filed amended returns and paid tax due.
 - › After filing amended return, partner cannot file additional amended returns with respect to partnership adjustments unless partner receives IRS permission.
 - › In a reallocation adjustment, all partners affected must file amended returns unless partner takes the relevant adjustment into account by some other type of modification.

Modification of Imputed Underpayment

- Amended Returns – Proposed Regulations
 - › **Pass-Thru Partners.** 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.** Indirect partners can file amended returns.
 - › **Open Issue:** Can a partner that holds its partnership interest through a disregarded entity file an amended return?

Modification of Imputed Underpayment

- Amended Returns – Technical Corrections
 - › Amended return procedure is not available to indirect partners (per Joint Committee Technical Explanation)
 - Proposed Regulations allow indirect partners to file amended returns
 - › In the case of a reallocation adjustment, all partners affected must file amended returns.
 - Proposed Regulations allow other types of modifications

Modification of Imputed Underpayment

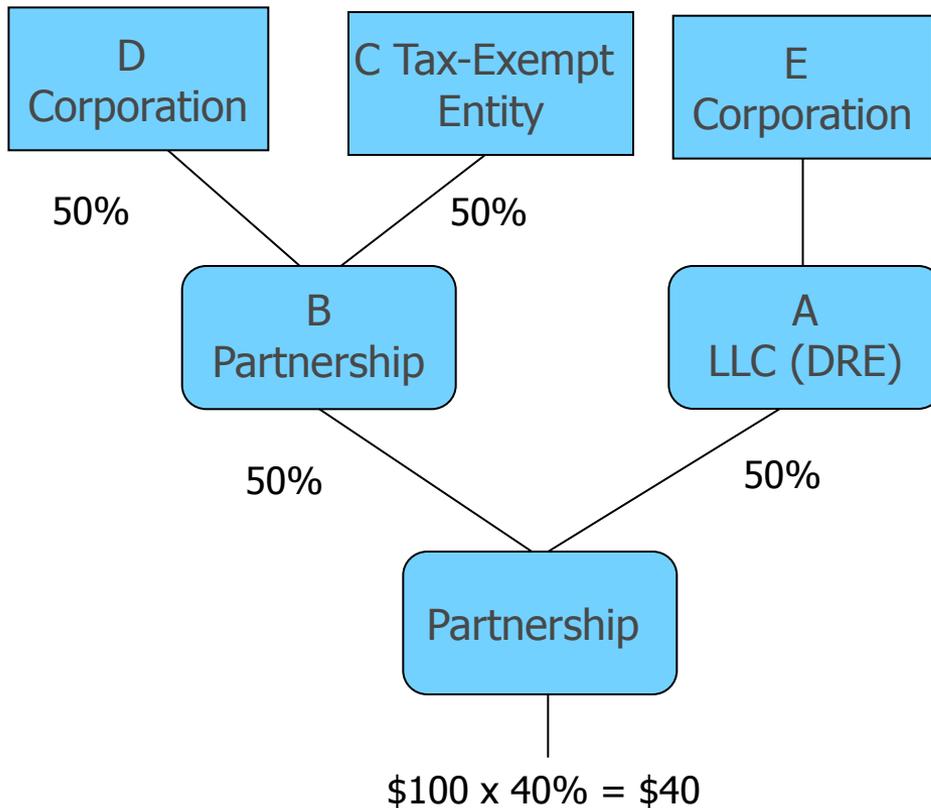
- Modification Requests and Submission of Documents and Evidence
 - › **Who?** Only the partnership representative may request a modification and the modification must be approved by the IRS
 - › **When?** Within 270 days of the NOPPA
 - 270-day period can be extended by agreement
 - 270-day period can be waived by agreement of the parties (e.g., if partnership wants to litigate the adjustments)

Modification of Imputed Underpayment

- Modification Requests and Submission of Documents and Evidence
 - › **How?** IRS may set forth procedures in forms and instructions to request and substantiate a modification
 - Partnership must substantiate modifications to satisfaction of IRS
 - Partnership representative must provide detailed description of the structure, allocations, ownership and ownership changes, and partners (including any indirect partners, if relevant)
 - Documents and information based on facts and circumstances and type of modification requested
 - › Necessary documents and information may include tax returns, partnership operating documents, certifications

Modification of Imputed Underpayment

Example – Multiple Modifications (Amended Return and Tax-Exempt Entity)

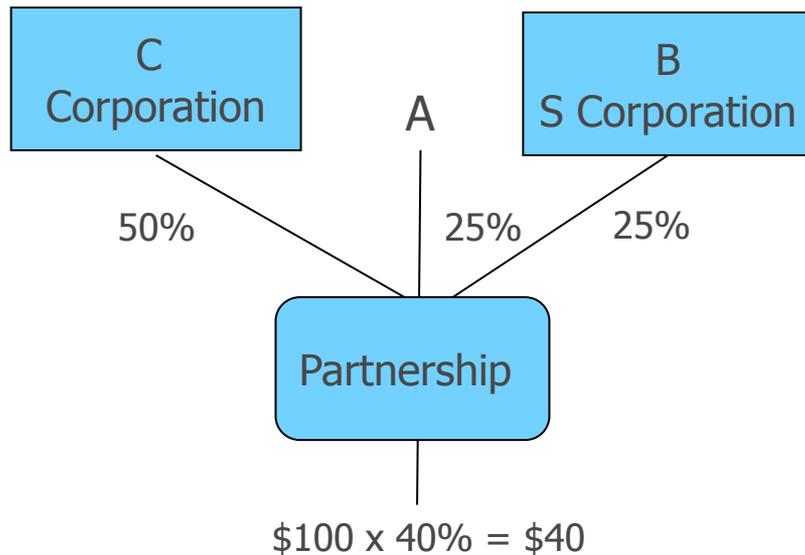


NOPPA shows \$100 increase in ordinary income resulting in \$40 imputed underpayment.

- 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?
 - Proposed regulations: Yes
 - Technical Corrections: No
- A cannot file an amended return reporting A's share because A is a disregarded entity.
- Open issue whether E can file an amended return since A is not a pass-through partner.
- B **can** file an amended return reporting B's share.

Modification of Imputed Underpayment

Example – Rate Modification (Capital Gains)



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 \times 35\% = \17.50
 - A's share = $\$25 \times 20\% = \5
 - B's share = $\$25 \times 20\% = \5
- Total tax burden reduced from \$40 to \$27.50.

Assessment and Payment

- After the modification process, IRS will issue a FPA.
- Default rule – The partnership pays the tax.
 - › This means current-year partners bear the economic burden for the tax, not reviewed-year partners.
 - › Partnership can make a **push-out election** to push-out the adjustments to the reviewed-year partners.

The Push-Out Election

- Partnership must furnish statements (equivalent of amended K-1s) to reviewed-year partners.
- A reviewed-year partner pays the tax on its “reporting-year return” which is the year in which it receives the statement from the partnership reflecting the adjustments.
 - › **Example:** If a partnership makes a push-out election and properly furnishes statements to its partners on August 1, 2020, an individual partner would pay the tax on the adjustments on his or her 2020 return due April 15, 2021.
 - › Tax is the amount that would have been paid if the adjustments had been correctly reported initially less the amount actually paid.
 - › Adjustments include the audit year and any intervening year with tax attributes affected by the audit year.
- Cost of the election is that partner must pay “hot interest” on the underpayment (federal short-term rate plus five percentage points).

The Push-Out Election

Timing of Election. Partnership must make the election within 45 days of the date the FPA was mailed.

- Statement must be attached to the FPA and include the name, address and TIN of the partnership, audit year, imputed underpayment, and each reviewed-year partner's name, address and TIN.
- Under BBA it was unclear whether a partnership that makes a push-out election could still seek judicial review. Proposed Regulations clarify that the push-out election does not impact partnership's ability to challenge FPA in Tax Court.
 - › **Example:** If the FPA is mailed June 1 the push-out election must be made by July 16 and the petition must be filed in Tax Court by August 30. The partnership will have to furnish the statements on or before 60 days after the court decision becomes final.
 - › If the partnership does not want the push-out election to apply after the conclusion of the court proceeding, the partnership can request IRS consent to revoke the election.

The Push-Out Election

Statements Furnished to Reviewed-Year Partners

- In order for the push-out election to be valid, the partnership must properly furnish statements (equivalent of amended K-1s) to the reviewed-year partners reflecting their share of partnership adjustments
- Statements must be furnished within **60 days** of when the adjustments become final.
- Statement must include the partner's name, address and TIN, share of any adjustments (in audit year or any intervening year), modifications attributable to the partner, the safe harbor amount and the date the statement is furnished.
- Partnership must mail the statement to the current or last known address of the partner and—if a statement is returned—undertake reasonable diligence to identify the reviewed-year partner's correct address.
 - › Proposed Regulations do not address what happens if the partnership fails to properly furnish the required statement to the partner

The Push-Out Election

Statements Furnished to Reviewed-Year Partners

- **Safe Harbor Amount.** Partner can elect to pay a safe harbor amount in lieu of computing the correct amount of tax for the reviewed year and any intervening years.
 - › Partnership calculates and includes safe harbor amount in statement furnished to reviewed-year partners.
 - › The safe harbor amount is calculated like the imputed underpayment except based only on the partner's share of the partnership adjustments.
 - Modifications due to the partner filing an amended return or entering into a closing agreement will reduce the safe harbor amount.
 - All other modifications are not taken into account.
 - › The safe harbor amount provides a simplified means for a partner to take into account its share of the adjustments.
 - › Election to pay the safe harbor amount is made on the return for the reporting year.

The Push-Out Election in Tiers

- Under the BBA, it was unclear whether pass-through partners would be able to push-out adjustments to their owners instead of paying tax on the adjustments at the first tier.
 - › Technical Corrections would allow pass-through partners to push-out adjustments to their partners.
 - › Proposed Regulations do not and note that this approach presents significant administrative concerns. Proposed Regulations request comments on how the IRS might administer the push-out election in tiered structures.

Comparison of Partnership's Options under Proposed Regulations

	Partnership Pays (Default)	Modifications	Push-Out Election
Who bears the economic burden?	Current-Year Partners	To the extent modified by amended returns or closing agreement, reviewed-year partners.	Reviewed-Year Partners
Requirements	N/A	Partnership Representative must request modification and substantiate within 270 days after NOPPA issued. IRS must agree.	Election must be made within 45 days of date FPA is issued and statements furnished to partners within 60 days of when adjustments are finally determined.
Treatment of Tiers	N/A	Modifications may be based on Indirect Partners and Indirect Partners and Pass-Through Partners may file amended returns.	Not available for Upper-Tiers

What if partnership can't pay?

- If Partnership Cannot Pay:
 - › Proposed Regulations
 - If a partnership terminates, dissolves or otherwise lacks the ability to pay an imputed underpayment, the IRS can determine the partnership “ceases to exist.”
 - If IRS determines a partnership “ceases to exist,” the partnership is no longer liable for the imputed underpayment. Instead, the adjustment-year partners are liable for the tax on their share of the partnership adjustments.
 - › Partners are severally, but not jointly, liable for the imputed underpayment.

What if partnership can't pay?

- If Partnership Cannot Pay:
 - › Technical Corrections
 - If a partnership fails to pay an imputed underpayment within 10 days of notice and demand, the interest rate on the underpayment will increase by 2% and the IRS may assess and collect adjustment against adjustment-year partners for their proportionate shares.
 - › Partners are severally, but not jointly, liable for the imputed underpayment.
 - › Same result as Proposed Regulations but prescribed procedure.

Planning Considerations: Election In

- The BBA permits a partnership to make an “early election” into the new partnership audit regime, but does not provide details on how such an election would be made.
- The temporary regulations issued on August 5, 2016 provide further clarity on this election. According to the regulations, the election can only be made after the partnership has received notice from the IRS that a partnership tax return for a qualifying taxable year has been selected for audit.
 - › Once made, the election can only be revoked with the consent of the IRS.
 - › The partnership needs to designate a partnership representative.
 - › Early election requires representations regarding the solvency of the partnership and that no filing for bankruptcy protection is expected.
 - › The temporary regulations do not address the question whether the “push out election” is available if an early election is made.

Planning Considerations: Election Out

- 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
 - 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
 - A partnership, trust (including a grantor trust), disregarded entity, nominee or agent are not eligible partners
 - An S corporation is an eligible partner even if its shareholders would not be eligible partners if direct partners

Planning Considerations: Election Out

Examples – Counting Partners for Election Out

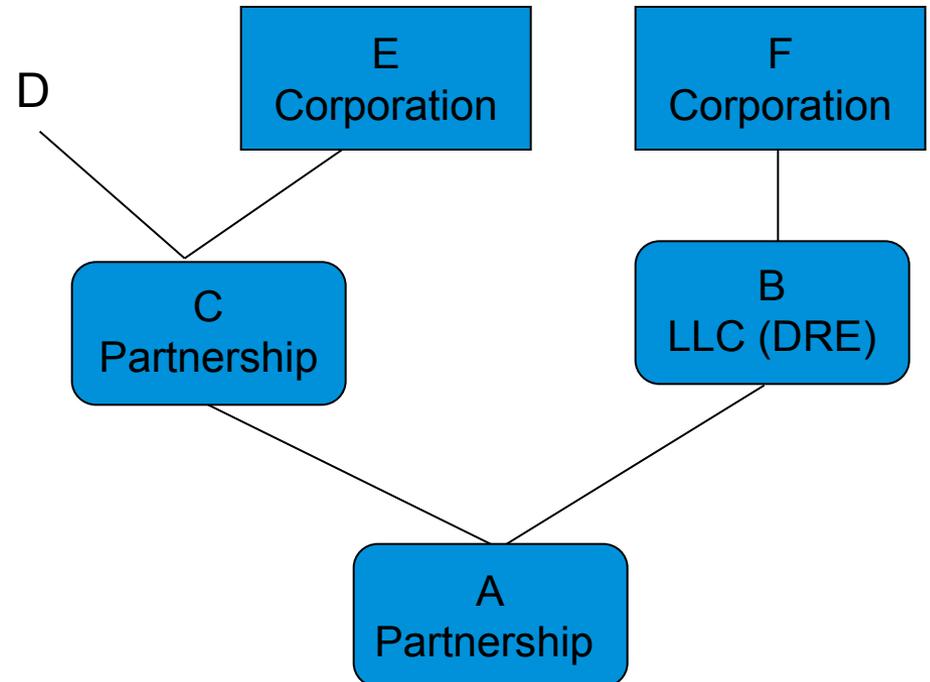
- Partnership has 98 partners at the beginning of the year. Partners A, B and C sell their interest during the year. Partnership is required to furnish 101 K-1s for the year. Partnership cannot elect out.
- Partnership has 51 partners, 50 partners that are individuals and an S corporation. S corporation has 50 shareholders during the tax year. 101 K-1s are issued (51 to the direct partners plus 50 to the S corporation shareholders). Partnership cannot elect out.

Planning Considerations: Election Out

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.

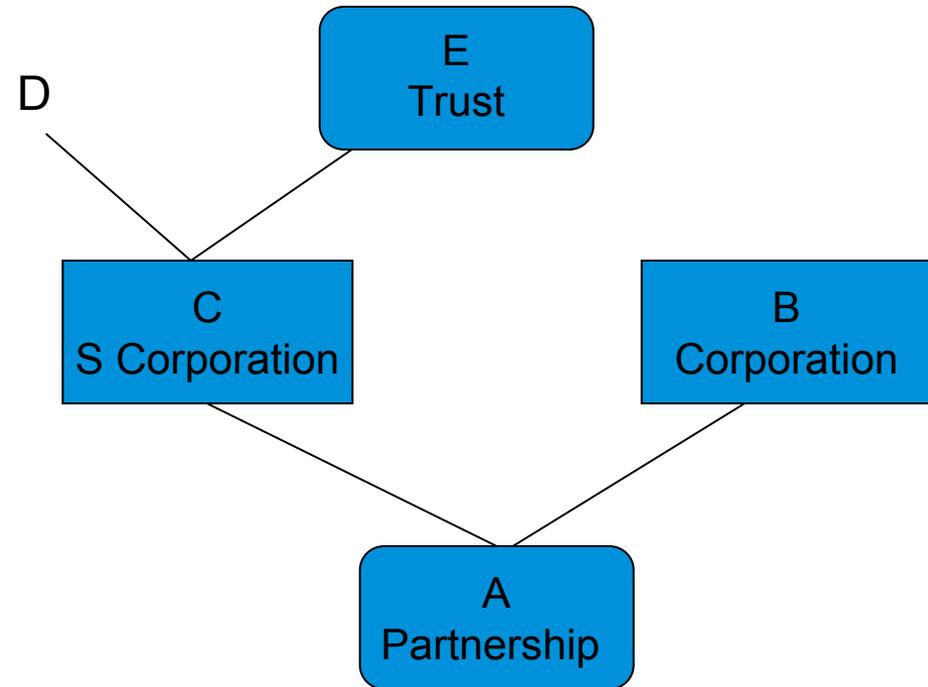
Conclusion: Corporation must be a direct partner to be an eligible partner for election out. Individual D cannot hold her partnership interest through a pass-through entity to be an eligible partner for election out.



Planning Considerations: Election Out

Eligible Partners Example

- C is an eligible partner even though C's shareholder E would not be an eligible partner if it held a direct interest in A.
- B is an eligible partner.
- A can elect out.



Planning Considerations: Election Out

- **How to elect out?**

- › Election is made on a timely filed partnership return (Form 1065).
- › 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.
- › Partnerships must notify each partner of the election out within 30 days of the election.

- **Should eligible partnerships elect out?**

- › If they do, the IRS must make determinations at the partner level (same as pre-TEFRA where a partnership with 99 partners can have 99 separate audits and 99 different results).
- › General consensus among practitioners is to elect out if possible.
 - For this reason, IRS is reluctant to expand election out, and proposed regulations decline to expand the list of eligible partners to include pass-through partners or disregarded entities.

Drafting Considerations: Partnership Representative

Draft/Amend Partnership Agreements to Appoint Partnership Representative

- Current practice is to include a “Partnership Representative” provision in the TMP section.
- Standards for designating the Partnership Representative and revoking a designation.
- Scope of the Partnership Representative provision will depend on who you represent (i.e., total authority v. partner consent)
- Key Issues: notice to partners, duty to inform or consult, extension of the statute of limitations, settlements, litigation, modifications of the imputed underpayment, push-out election.
- Decisions to pay tax or make a push-out election? Must partners approve? Which partners? What threshold? De minimis payments? Other considerations?
- Indemnification of Partnership Representative?

Drafting Considerations: Partnership Representative

Partnership Representative Provision (Simple)

With respect to tax years beginning after December 31, 2017, the partnership representative of the Partnership pursuant to Code Section 6223(a) shall be _____, or any Partner or other person with a substantial presence in the United States designated by the General Partner in the manner prescribed by the Internal Revenue Service.

Drafting Considerations: Partnership Representative

Partnership Representative Provision (Complex)

(a) For tax years beginning on or before December 31, 2017: The Tax Matters Member, with the approval of a majority of the Board of Managers, may elect (at such time and in such form and manner as the Internal Revenue Service may prescribe) for the amendments to Sections 6221-6241 made by Section 1101 of the Bipartisan Budget Act of 2015 (H.R. 1315) to apply to any return of the partnership filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

(b) With respect to tax years beginning after December 31, 2017, the partnership representative of the Company pursuant to Section 6223(a) of the Internal Revenue Code shall be any Member or other person with a substantial presence in the United States designated by the Board of Managers in the manner prescribed by the Internal Revenue Service. (Any person who is designated as the partnership representative is referred to herein as the “Partnership Representative”). The Partnership Representative is authorized to take such actions and to execute and file all statements and forms on behalf of the Company which may be permitted or required by the applicable provisions of the Internal Revenue Code or Treasury Regulations issued thereunder, provided that the Partnership Representative may file suit only with the approval of a majority of the Board of Managers. The Partnership Representative shall have the sole authority to act on behalf of the Company under Subchapter C of Section 63 of the Internal Revenue Code (relating to IRS partnership audit proceedings) and in any tax proceedings brought by other taxing authorities, and the Company and all Members shall be bound by the actions taken by the Partnership Representative in such capacity. The Partnership Representative shall be reimbursed by the Company for all expenses incurred in connection with all examinations of the Company’s affairs by tax authorities, including resulting Proceedings, and is authorized to expend Company funds for professional services and costs associated therewith. If an audit results in an imputed underpayment by the Company as determined under Section 6225 of the Internal Revenue Code, the Partnership Representative, with the approval of a majority of the Board of Managers, may make the election under Section 6226(a) of the Internal Revenue Code within 45 days after the date of the notice of final partnership adjustment in the manner provided by the Internal Revenue Service. If such an election is made, the Company shall furnish to each Member of the Company for the year under audit a statement reflecting the Member’s share of the adjusted items as determined in the notice of final partnership adjustment, and each such Member shall take such adjustment into account as required under Section 6226(b) of the Internal Revenue Code and shall be liable for any related interest, penalty, addition to tax, or additional amount.

Drafting Considerations: Transactions and Partnership Agreements

- Transfer/ownership restrictions to preserve ability to elect out – require C corporation partners to own interest directly
- Tax due diligence in partnership interest acquisition/contribution is even more important
 - › Economic burden of imputed underpayment may be borne by adjustment year partners
 - › Identify uncertain tax positions and options to mitigate risk
 - › Will acquiring partners require a push-out election?
 - › Indemnification by former partners if partnership pays the tax
 - › Confirmation that the partnership will not elect into the new rules early
 - › Ability to amend partnership agreement as future guidance is issued
- Need to identify arrangements that may be treated as partnerships and subject to partnership audit rules (constructive partnerships, joint operating agreements, etc.)

Drafting Considerations: Transactions and Partnership Agreements

- Require partners to take actions to reduce imputed tax liability?
 - › Require partners to file amended returns if statute is open
 - › Provide information to partnership representative to modify the imputed underpayment/privacy concerns
- Lender requirements – require a push-out election?