# Drafting Partnership and LLC Agreements for the New Partnership Audit Rules

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July 13, 2018



## Partnership Audit Rules Regimes

- **Tax Equity and Fiscal Responsibility Act (TEFRA)**
  – Tax years ending on or before December 31, 2017
  – Adjustments made and collected at the partner level
- **Bipartisan Budget Act (BBA)**
  – Tax years beginning on or after January 1, 2018
  – Adjustments made and collected at the partnership level
  – New rules are designed to make partnership audits more efficient for the IRS

## Potential Issue with BBA Regime

- In 2018, partnership X has partners A and B. In that year, X understates income.
- In 2019, B sells all of her partnership interest to C. In this year, the IRS audits X and makes an adjustment at the partnership level. If adjustment is made at the partnership level, A and C bear the cost.
- B has a windfall. She gained the advantage of the understatement of income in 2018 and did not bear the cost of the adjustment in 2019.


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## Other Notable BBA Issues

- Partners no longer have statutory rights to notification of, or participation in, the audit process.
- A "partnership representative" designated by the partnership has the sole authority to act on behalf of the partnership in any proceeding relating to U.S. federal income tax.
- The actions of the partnership representative are binding on the partnership and all of its partners.

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## Risk that BBA adjustments may result in more than the "correct" amount of tax liability

- After adjustment to income is made at the partnership level, for purposes of calculating the resulting tax liability, the BBA rules assume that the highest tax rate is applicable.
- So, the partnership may end up paying more tax than would have been collected from the partners if the partners did not have to pay tax at the highest rate.


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## When Do BBA Rule Apply?

- Partnership taxable years beginning after December 31, 2017.
- Partnership may elect to have BBA rules apply to taxable years as early as those beginning after November 2, 2015.

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# Title search: Drafting Partnership and LLC Agreements for the New Partnership Audit Rules

Also available as part of the eCourse
2018 LLCs, LPs, and Partnerships eConference

First appeared as part of the conference materials for the
27th Annual LLCs, LPs and Partnerships session
"Drafting Partnership and LLC Agreements for the New Partnership Audit Rules"