

Drafting Partnership and LLC Agreements for the New Partnership Audit Rules

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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



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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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