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

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

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I. Overview

The Bipartisan Budget Act of 2015 (the "BBA")[1] (as corrected and clarified by the Protecting Americans from Tax Hikes Act of 2015, the Tax Technical Corrections Act of 2016 and the Tax Technical Corrections Act of 2018)[2] repealed and replaced the 1982 Tax Equity and Fiscal Responsibility Act ("TEFRA") and electing large partnership ("ELP") rules with a new regime for partnership audits and adjustments focused on partnership-level assessments and collections (the "Centralized Audit Rules"). The Centralized Audit Rules became effective for partnership tax years beginning after 2017, although partnerships could elect to have the entity-level assessment apply earlier (for tax years beginning after November 2, 2015). The new rules are expected to increase partnership audit rates and the related tax assessments.

The Centralized Audit Rules require partnership-level resolution of all items of partnership income, deduction, gain, loss or credit. The statute of limitations for adjustments is determined exclusively at the partnership-level (i.e., the partner's statute of limitations will not be taken into account). The Centralized Audit Rules replace the tax matters partner with the "partnership representative," which represents the partnership in the audit and has the sole authority to act on behalf of the partnership. The partnership representative binds both the partnership and the partners, and the partners do not have the right to participate in the proceeding or receive notice of the proceedings from the IRS.

The default rule is that the tax deficiency arising from a partnership-level adjustment is assessed against and collected from the partnership in the year when the audit or judicial review is completed (the "adjustment year"). Because the tax is assessed against and collected from the partnership in the adjustment year, the current year partners bear the economic burden of the tax, not the partners in the partnership for the year under audit (the "reviewed year").

The tax deficiency is referred to as the "imputed underpayment." The underpayment is "imputed" because the partnership is not a taxpayer. The tax is assessed at the highest rate applicable to individuals. The partnership may request that the imputed underpayment be reduced in certain circumstances to more accurately reflect the tax positions of its partners. The imputed underpayment may also be reduced to the extent that the reviewed-year partners file amended returns or equivalent statements under an alternative pull-in procedure or enter into closing agreements and pay the tax. If the partnership does not want to pay the entity-level tax, the partnership can elect to "push-out" the adjustments to the reviewed-year partners. In that

[1] Pub. L. No. 114-74.
[2] Pub. L. No. 114-113, div. Q.

case, the partnership will issue adjusted partner statements (the equivalent to amended K-1s) to the reviewed-year partners. The partners will then take the tax from the audit year and any intervening years into account on their individual returns in the year in which they receive the adjusted partner statements.

The BBA had many deficiencies and open issues regarding how the new rules would be administered. The Tax Technical Corrections Act of 2016 addressed some of the deficiencies and open issues in the BBA. The IRS also released administrative guidance to address the open issues. On January 18, 2017, the IRS released unofficial proposed regulations on the new partnership audit rules, which were subsequently withdrawn in response to the Trump administration's regulatory freeze on new regulations. The proposed regulations were released again on June 13, 2017 with only a handful of changes from the version released in January ("June NPRM").[3] The proposed regulations addressed many of the holes in the statute and attempt to balance fairness to taxpayers with ease of IRS administration. On November 30, 2017, the IRS published proposed regulations regarding rules relevant in the international tax area.[4] On December 19, 2017, the IRS released proposed regulations allowing the push-out election to be made through tiers and addressing some of the open procedural issues from the June NPRM.[5] On January 2, 2018, the IRS published final regulations on the election out of the partnership audit regime.[6]

The Tax Technical Corrections Act of 2018 addressed some of the deficiencies and open issues in the BBA (the "2018 Technical Corrections").[7] On August 9, 2018, Treasury released final regulations on the designation and authority of the partnership representative.[8] On August 13, 2018, the IRS withdrew proposed regulations and reproposed the regulations to reflect the 2018 Technical Corrections. This Article summarizes the administrative aspects of the new rules and identifies what taxpayers can do now that the rules are in effect.[9]

II. Partnership Audits

a. Scope of the Audit

As originally enacted, the Centralized Audit Rules applied to "items of income, gain, loss, deduction, or credit," and it was unclear whether the scope of the Centralized Audit Rules was narrower than TEFRA. The 2018 Technical Corrections clarified that the Centralized Audit

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[3] 82 Fed. Reg. 27334 (Jun. 14, 2017).
[4] 82 Fed. Reg. 56765 (Nov. 30, 2017).
[5] 82 Fed. Reg. 60134 (Dec. 19, 2017).
[6] 82 Fed. Reg. 28398 (Jan. 2, 2018).
[7] Pub. L. No. 115-141.
[8] 83 Fed. Reg. 39331 (Aug. 9, 2018).
[9] This article does not address the proposed regulations on the impact of the Centralized Audit Rules on capital accounts and basis that were released on February 2, 2018. *See* 83 Fed. Reg. 4868 (Feb. 2, 2018).

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