

Understanding the New Partnership Audit Rules

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Mary A. McNulty, Thompson & Knight LLP, Dallas, TX
Todd D. Keator, Thompson & Knight LLP, Dallas, TX

Thompson & Knight 
ATTORNEYS AND COUNSELORS

Overview

- Summary of New Partnership Audit Rules
- Open Issues
- Drafting Considerations in Partnership Agreements and Other Agreements

Bipartisan Budget Act of 2015 – “BBA”

- Congress repealed and replaced the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) and electing large partnership (ELP) rules with a new regime for partnership adjustments and audits that is focused on partnership-level assessments and collections.
- **Game changer that is going to force most partnerships to amend partnership agreements to take into account the potential partnership entity level assessments.**
- IRS requested comments in Notice 2016-23. State Bar of Texas Tax Section provided comments on April 26, 2016.

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Highlights of BBA

- Effective Date: Applies to returns filed for partnership taxable years beginning after December 31, 2017;
- TEFRA and ELP rules repealed (and partners no longer have rights to participate in tax audits or litigation – i.e., no more “notice partners” concept);
- New rules apply to all partnerships unless the partnership elects out;
- Tax on “imputed underpayments” is assessed **and collected** at the partnership level (unless the partnership makes an election to push out the tax liability to its partners);
- “Tax Matters Partner” is replaced with new “Partnership Representative” (who need not be a partner).

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Purpose of BBA – Replace TEFRA

- **TEFRA – Key elements:**
 - Audit process determined at partnership level (instead of multiple audits at individual partner level);
 - IRS interacts with “tax matters partner” (who must be a partner);
 - Resulting deficiencies flow through to partners;
 - Collection efforts at partner level, which proved administratively burdensome with large partnerships with tens of thousands of partners (such as MLPs), especially where IRS attempted to collect very small amounts from thousands of partners (cost outweighed collections).
- IRS did not have the resources or capability to audit large partnerships and multi-tiered partnerships due to complexity of allocating adjustments to ultimate partners and assessing tax.
- Result was that IRS audited less than 1% of large partnerships and collected very little tax from these audits.

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BBA – Key Benefits

- Benefits of BBA over TEFRA:
 - Easier for IRS to audit partnerships and collect tax;
 - No right to notice/participation in audits by individual partners;
 - Statutory default is to collect tax at partnership level; thus, burden of passing adjustment through to the partners shifts from the IRS to the partnership.
- Congress estimates partnership audits under the new rules will generate approximately \$10 billion in tax revenue.

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