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Tax Notes

The New Partnership Tax Audit Rules: Are You Prepared for Change in 2018?

By Alan S. Kufeld, CPA and Adam Everard, MST

A major shift has occurred in how the IRS will handle partnership tax examinations in the future. The IRS has created new centralized procedures for the audit, assessment, and collection of tax. Partnerships may now be assessed tax at the partnership level for IRS tax examinations as opposed to the tax assessment taking place at the individual partner's level. The rules apply to all partnerships and will go into effect in 2018. This legislation was enacted under the Bipartisan Budget Act of 2015 and will repeal the longstanding partnership audit rules of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

What does the new legislation mean for your partnership?

Significant Change

Under the new partnership audit rules, any imputed underpayment of taxes will be assessed at the top corporate or individual tax rate at the partnership level. Importantly, the IRS will assess the partnership in the year of the adjustment — when the examination ends — as opposed to the year being reviewed. This could create a rift among current and former partners if not properly addressed in your partnership agreement. Take, for instance, a partner who was in the partnership as of the review year, but exited the partnership prior to the year of adjustment. Assuming the examination resulted in the partnership being assessed an imputed underpayment — under the new rules — it is possible that the exiting partner would not have a tax liability because he or she exited the partnership before the year of adjustment. If not properly addressed, existing and new partners could assume the tax liability of the former partner.

Sole Point Person

To assist with closing examinations more swiftly and efficiently, the new law stipulates that partnerships appoint a person to serve as the partnership representative. This role is very different from the role of the tax matters partner under the repealed TEFRA rules. Under the new rules, the partnership representative now has sole authority to act on behalf of the partnership and his/her actions are binding on the partners. Under the previous TEFRA rules, each partner was granted more authority and had notice rights for IRS-related matters. Accordingly, the shift toward a partnership representative for IRS matters should cause partnerships to rethink operating partnership agreements. The selection of the partnership representative should be approached with care and caution.

Opt-Out Details

The new rules generally apply to all partnerships. However, partnerships that satisfy certain requirements and have 100 or fewer partners may elect out of the new regime annually. Interestingly, a partnership may <u>not</u> opt out of the new audit rules if any of its partners are partnerships or trusts. If a partnership opts out, any adjustments resulting from an examination could flow to each partner individually, as the rules stipulate under TEFRA. Partnerships electing to opt out of the new rules must follow cumbersome procedural requirements each year.

Care should be taken when drafting or revising partnership agreements to address the maximum number of partners and types of partners allowed in the partnership.

Contact Us

For more information on the impact of the new partnership audit rules on your partnership, please contact Alan S. Kufeld, CPA, Partner at akufeld@pkfod.com or your PKF O'Connor Davies' tax advisor.

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