

CENTRALIZED PARTNERSHIP AUDIT REGIME NOW EFFECTIVE

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The Now Effective Centralized Partnership Audit Regime for Partnership Taxable Years Beginning After December 31, 2017

THOUGHT
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JAMES USSEGLIO, Tax Principal

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BACKGROUND

The Bipartisan Budget Act of 2015 (BBA)¹, which was enacted into law on November 2, 2015, made significant changes to the rules governing federal partnership tax audits with respect to returns filed for partnership taxable years beginning after December 31, 2017. Since its original date of enactment, the BBA has been amended by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act)² on December 18, 2015 and the Technical Corrections Act of 2018 (TTCA)³ on March 23, 2018.

The BBA repealed and replaced the partnership tax audit procedures that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)⁴ and the audit rules applicable to electing large partnerships with a new centralized partnership audit regime (hereinafter referred to as either the "Regime" or "Centralized Partnership Audit Regime").⁵ In general, the new Regime will be the exclusive method by which the Internal Revenue Service (IRS) may audit a partnership and determine, assess, and collect any tax due (and penalties and interest) at the partnership level, subject to various elections. Previously, the IRS could audit a partnership, but could only assess and collect at the partner level.

ELECTION TO APPLY THE NEW RULES BEFORE 2018

The BBA provides that a partnership may elect to have the new Regime apply (other than the election out of the new Regime under section 6221(b)⁶) to any of its partnership returns filed for a partnership taxable year beginning after November 2, 2015 and before January 1, 2018.⁷ In general, this election may only be made within 30 days of the date the IRS first notifies a partnership in writing that its return has been selected for examination.⁸ However, beginning January 1, 2018, a partnership that has not been issued a notice of selection for examination may make this election for an eligible taxable year for the purpose of filing an Administrative Adjustment Request (AAR) under section 6227.⁹

¹ P.L. 114-74.

² P.L. 114-113.

³ P.L. 115-141.

⁴ P.L. 97-248.

⁵ See new subchapter C of chapter 63 of the IRC (sections 6221-6241).

⁶ All references to "section" or "§" are to the Internal Revenue Code (IRC) of 1986, as amended, or the U.S. Treasury Regulations promulgated thereunder.

⁷ BBA, section 1101(g)(4); §301.9100-22(a). See also IRS Form 7036.

⁸ §301.9100-22(b).

⁹ §301.9100-22(c).

SCOPE OF THE NEW CENTRALIZED PARTNERSHIP AUDIT REGIME

Section 6221(a) provides the scope of items that are subject to adjustment under the new Regime. This section provides that any adjustment to a “partnership-related item,” defined as any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person under chapter 1, without regard to whether or not such item or amount appears on the partnership’s return and including an imputed underpayment and any item or amount relating to any transaction with, basis in, or liability of, the partnership, and any partner’s distributive share of any such item or amount¹⁰, shall be determined, and any tax attributable thereto shall be assessed and collected, at the partnership level. The applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item shall also be determined at the partnership level.

Examples of partnership-related items include the character, timing, source, and amount of the partnership’s income, gain, loss, deductions, and credits¹¹; the amount and character of partnership liabilities and any changes to those liabilities from the preceding tax year¹²; any item or amount relating to an election under section 754¹³; and partnership allocations and any special allocations¹⁴.

Taxes not covered by the new Regime include taxes imposed by chapter 2 (tax on self-employment income), chapter 2A (unearned income Medicare contribution), chapter 3 (withholding tax on nonresident aliens and foreign corporations), or chapter 4 (withholding tax for certain foreign accounts). However, any partnership adjustment determined under the income tax shall be taken into account for purposes of determining and assessing tax under these chapters of the IRC to the extent that the partnership adjustment is relevant to such determination.¹⁵

ELECTING OUT OF THE NEW FEDERAL REGIME

The new Centralized Partnership Audit Regime applies to all partnerships with partnership taxable years beginning after December 31, 2017 for any partnership required to file a return under section 6031(a).¹⁶ However, eligible partnerships may elect out of the new Regime for any partnership taxable year.¹⁷ Partnerships that elect out of the new Centralized Partnership Audit Regime are subject to the pre-TEFRA audit rules under which the IRS must separately assess tax with respect to each partner under separate partner-level deficiency proceedings.

¹⁰ IRC §6241(2)(B); Prop. Reg. §301.6241-6.

¹¹ Prop. Reg. §301.6241-6(d)(1).

¹² Prop. Reg. §301.6241-6(d)(5).

¹³ Prop. Reg. §301.6241-6(d)(8).

¹⁴ Prop. Reg. §301.6241-6(d)(9).

¹⁵ IRC §6241(9)(A); Prop. Reg. §301.6241-7(a).

¹⁶ IRC §6241(1).

¹⁷ IRC §6221(b); §301.6221(b)-1(a).

For a partnership to be eligible to elect out, two conditions must be met. First, a partnership must be required to furnish 100 or fewer statements under section 6031(b) (Schedules K-1) for the taxable year.¹⁸ For partnerships that have an S corporation as a partner, the number of statements (Schedules K-1) required to be furnished by the S corporation partner to its own shareholders are taken into account to determine the number of statements furnished by the partnership for purposes of section 6221(b)(1)(B).¹⁹ Second, a partnership must only have eligible partners. Eligible partners are individuals, C corporations, foreign entities that would be treated as C corporations if they were domestic, S corporations, and estates of deceased partners.²⁰ Partners that are partnerships, disregarded entities, trusts (including revocable trusts, grantor trusts, and nongrantor trusts), and nominees are not eligible partners for purposes of electing out of the new Regime.²¹

An eligible partnership may elect out of the new Centralized Partnership Audit Regime on a timely filed return (including extensions) for a taxable year.²² A partnership making such election must disclose to the IRS certain information about each partner.²³ Additionally, a partnership making this election must notify each partner of the election within 30 days of making the election in the form and manner determined by the partnership.²⁴

THE PARTNERSHIP REPRESENTATIVE

A partnership subject to the new Regime must designate a partnership representative who shall have sole authority to act on behalf of the partnership for the partnership taxable year.²⁵ A partnership representative can be any person, including a non-partner, that has a substantial presence in the United States. If an entity (including a disregarded entity) is designated as the partnership representative, the partnership must appoint a designated individual to act on the entity's behalf.²⁶ The designation of a partnership representative is made on the partnership's return filed for the partnership taxable year and is made separately for each taxable year. A designation for one taxable year is not effective for any other taxable year.²⁷ Special rules apply with regards to partnership representative or designated individual resignations, revocations and determinations that a designation of a partnership representative is not in effect.²⁸

The partnership and all partners are bound by the actions of the partnership and the partnership representative and by any final decision in a proceeding brought under the new Regime. For example, a settlement agreement entered into by the partnership representative on behalf of the partnership binds the partnership and its partners.²⁹ Furthermore, the partnership representative has sole authority to act on behalf of the partnership in any examination and such authority may not be limited by state law, partnership agreement, or any other document or agreement.³⁰

¹⁸ IRC §6221(b)(1)(B); §301.6221(b)-1(b)(1).

¹⁹ IRC §6221(b)(2)(A)(ii); §301.6221(b)-1(b)(2)(ii).

²⁰ IRC §6221(b)(1)(C); §301.6221(b)-1(b)(3)(i).

²¹ §301.6221(b)-1(b)(3)(ii).

²² IRC §6221(b)(1)(D)(i); §301.6221(b)-1(c)(1).

²³ See IRC §6221(b)(1)(D)(ii) and §301.6221(b)-1(c)(2). See also Schedule B-2 (IRS Form 1065).

²⁴ See IRC §6221(b)(1)(E) and §301.6221(b)-1(c)(3).

²⁵ IRC §6223(a); §301.6223-1(a).

²⁶ §301.6223-1(b).

²⁷ §301.6223-1(c).

²⁸ See IRC §6223(a) and §§301.6223-1(d), (e) and (f). See also IRS Form 8979.

²⁹ IRC §6223(b); §301.6223-2(a).

³⁰ §301.6223-2(d).

IMPUTED UNDERPAYMENT AND MODIFYING THE IMPUTED UNDERPAYMENT

Section 6225(a) provides the general (or default) rules that if partnership adjustments made by the IRS result in an imputed underpayment, the partnership must pay an amount equal to such imputed underpayment in the “adjustment year³¹.” If the adjustments do not result in an imputed underpayment, such adjustments must be taken into account by the partnership in the adjustment year.³²

An “imputed underpayment” (the amount owed by the partnership) is calculated by multiplying the total netted partnership adjustment by the highest rate of federal income tax in effect for the “reviewed year”³³ under section 1 or 11 (currently 37 percent). The product of that amount is then increased or decreased by any adjustment made to the partnership’s credits. If the result of this summation is a net positive adjustment, the resulting amount is the imputed underpayment, and if it results in a net non-positive amount, the result is an adjustment that does not result in an imputed underpayment.³⁴ The proposed regulations provide detailed rules for the grouping and netting of partnership adjustments (including those due to reallocation or recharacterization) and possible limitations on such adjustments that are taken into account in determining the amount of an imputed underpayment of a partnership.³⁵

A partnership may request modification of an imputed underpayment to correct the potential overstatement of the imputed underpayment calculation to that closer to the actual amount of tax due had the partnership and partners reported the partnership adjustments properly. A partnership may also request modification with respect to a partnership adjustment that does not result in an imputed underpayment.³⁶ All information required to be submitted to the Secretary under the modification procedures must be submitted within 270 days following the date the notice of proposed partnership adjustment (NOPPA) is mailed under section 6231 by the IRS unless such period is extended with the consent of the Secretary.³⁷ Any modification of the imputed underpayment shall be made only upon approval of the requested modification by the Secretary.³⁸

Section 6225(c) and the proposed regulations thereunder³⁹ provide the types of modification of an imputed underpayment the IRS will consider if requested by the partnership, including but not limited to modification based on “reviewed year partners”⁴⁰ filing amended returns with payment of any tax due, modification based on the status of its tax-exempt partners, modification based on a rate of tax lower than the highest applicable tax rate, and modification based on applicable income tax treaties. Additionally, the IRS may consider other requests for modification if not specifically listed.⁴¹

³¹ As defined under IRC §6225(d)(2) and Prop. Reg. §301.6241-1(a)(1) as including the partnership taxable year in which a notice of final partnership adjustment (FPA) is mailed under section 6231.

³² Prop. Reg. §301.6225-1(a)(1); Prop. Reg. §301.6225-3.

³³ As defined under IRC §6225(d)(1) and Prop. Reg. §301.6241-1(a)(8) as meaning the partnership taxable year to which a partnership adjustment relates.

³⁴ IRC §6225(b)(1); Prop. Reg. §301.6225-1(b)(1); Prop. Reg. §301.6225-1(f)(1).

³⁵ See IRC §6225(b) and Prop. Reg. §301.6225-1(b).

³⁶ IRC §§6225(c)(1), (9); Prop. Reg. §301.6225-2(a).

³⁷ IRC §6225(c)(7); Prop. Reg. §301.6225-2(c)(3). See also IRS Form 8980.

³⁸ IRC §6225(c)(8); Prop. Reg. §301.6225-2(c)(4).

³⁹ Prop. Reg. §301.6225-2(d).

⁴⁰ As defined under Prop. Reg. §301.6241-1(a)(9) as meaning any person who held an interest in a partnership at any time during the reviewed year.

⁴¹ Prop. Reg. §301.6225-2(d)(10).

THE “PUSH-OUT” ELECTION

Section 6226 provides an alternative to the general rule under section 6225(a)(1) that a partnership must pay the imputed underpayment. Under this section, a partnership may elect to “push-out” the responsibility to its reviewed year partners for payment of the partnership tax assessment. This election would require the reviewed year partners to take into account their share of the partnership adjustments that relate to the imputed underpayment and pay any tax, penalties and interest⁴² due as a result of those adjustments.⁴³ A partnership making a valid election under this section is no longer liable for the imputed underpayment to which the election applies.⁴⁴ Any adjustments that do not result in an imputed underpayment that are associated with an imputed underpayment for which an election is made are not taken into account by the partnership in the adjustment year but instead are included with each reviewed year partners’ share of adjustments.⁴⁵

A partnership may only make an election under section 6226 within 45 days of the date the FPA was mailed by the IRS.⁴⁶ Additionally, the partnership must furnish statements to its reviewed year partners with respect to the partner’s share of the adjustments and file those statements with the IRS within 60 days after the date the partnership adjustments are finally determined.⁴⁷ A reviewed year partner must pay any additional chapter 1 tax for the partner’s taxable year which includes the date the statement was furnished to the partner that results from taking into account the aggregate of the correction amounts reflected in the statement.⁴⁸ Special rules apply with regards to partnerships and S corporations in tiered structures that receive statements under section 6226(a)(2).⁴⁹

ADJUSTMENTS TO TAX ATTRIBUTES AND COORDINATION WITH CERTAIN INTERNATIONAL TAX RULES

Proposed regulations address how and when partnerships and their partners adjust tax attributes to take into account partnership adjustments under both sections 6225 and 6226.⁵⁰ The proposed regulations provide rules for adjusting tax basis and book value of a partnership’s property, partners’ bases in their partnership interests, partners’ capital accounts, and other tax attributes.

Proposed regulations also address how certain international tax rules operate in the context of the new Regime, including rules relating to the withholding of tax on foreign persons, the treatment of creditable foreign tax expenditures and foreign tax credits, and issues related to treaties and reductions to the rate of tax on foreign persons.⁵¹

⁴² IRC §6226(c)(2)(C) by substituting 5 percent for 3 percent for the underpayment rate under IRC §6621(a)(2)(B).

⁴³ Prop. Reg. §301.6226-1(b).

⁴⁴ IRC §6226(a); Prop. Reg. §301.6226-1(a).

⁴⁵ Prop. Reg. §301.6226-1(b)(2).

⁴⁶ IRC §6226(a)(1); Prop. Reg. §301.6226-1(c)(3).

⁴⁷ IRC §6226(a)(2); Prop. Reg. §301.6226-2(a); Prop. Reg. §301.6226-2(b); Prop. Reg. §301.6226-2(c).

⁴⁸ IRC §6226(b)(1); Prop. Reg. §301.6226-3(a).

⁴⁹ See IRC §6226(b)(4); Prop. Reg. §301.6226-3(e).

⁵⁰ See Prop. Reg. §§301.6225-4, 301.6226-4, 1.704-1, 1.705-1, and 1.706-4.

⁵¹ See Prop. Reg. §§301.6225-1(b)(3), 301.6225-2(d)(9), 301.6226-2(g)(3), 301.6226-3(f), 301.6227-2(b)(3), and 301.6241-7(a)(2) and (b), among other sections.

ADMINISTRATIVE ADJUSTMENT REQUESTS

Under the new Regime, a partnership may file an AAR to request a change to the amount of one or more partnership-related items reported on a partnership return that has already been filed with the IRS.⁵² Any such adjustments will generally be determined and taken into account for the partnership taxable year in which the administrative adjustment request is filed.⁵³ If the adjustments result in an imputed underpayment, the partnership must take the adjustments into account under rules similar to the rules of section 6225 (other than sections 6225(c)(2), (c)(7), and (c)(9)), unless the partnership makes an election under rules similar to the rules of section 6226 (determined without regard to the substitution described in section 6226(c)(2)(C)). If the adjustments do not result in an imputed underpayment, such adjustments must be taken into account by the reviewed year partners.⁵⁴ A partnership may apply limited modifications to the amount of any imputed underpayment reported on an AAR without seeking approval from the IRS.⁵⁵

A partnership may not file an AAR more than three years after the later of the date on which the partnership tax return for such year is filed or the last day for filing the partnership return for such year (determined without regard to extensions). Generally, in no event may a partnership file an AAR after a notice of an administrative proceeding with respect to that taxable year is mailed under section 6231.⁵⁶

If you would like to discuss these matters further, contact [Jim Usseglio](#) at 800.244.7444.

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⁵² IRC §6227(a); Prop. Reg. §301.6227-1(a); Prop. Reg. §301.6227-1(b). See also IRS Forms 8082 and 1065X.

⁵³ IRC §6227(b).

⁵⁴ IRC §§6227(b)(1), (2); Prop. Reg. §301.6227-1(a).

⁵⁵ Prop. Reg. §301.6227-2(a)(2).

⁵⁶ IRC §6227(c); Prop. Reg. §301.6227-1(b).