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IRS Issues Temporary Regulations on Early Election into New Partnership Audit Procedures

Making good on its promise to deliver guidance, on Aug. 4 the IRS issued temporary regulations that spell out the circumstances under which partnerships can elect into the new partnership audit regime that was enacted by Congress at the end of 2015.

The IRS rules for auditing partnerships were completely revamped pursuant to the Bipartisan Budget Act of 2015 (BBA) that was signed into law by President Obama on Nov. 2, 2015. The BBA repeals the previous partnership audit rules enacted under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and those applicable to elective large partnerships. All partnerships and entities that have elected to be taxed as partnerships will be subject to these new rules unless they make an annual election to opt out of these rules. The major impact of this new law is that any tax liability that results from an adjustment on a partnership return will be imputed directly to the partnership rather than its partners/members. The IRS will look to collect the liability (tax, interest, and penalties) directly from the partnership. Therefore, current partners of the partnership may be on the hook for taxes attributable to a previous year in which they may not have been partners.

The new audit framework does not apply to tax years beginning before Jan. 1, 2018, absent an affirmative election. Tax practitioners had sought certainty from the IRS on how partnerships might make an early election into the new rules for tax years ending after the legislative enactment and until 2018. According to the temporary regulations, an early election can only be made within 30 days of a partnership receiving notice from the IRS that the partnership's return has been selected for examination. A partnership can make the election by sending a written statement to the IRS

employee who sent the notice stating that the partnership is electing to have the BBA audit provisions apply. The statement must be dated and signed by the tax matters partner or a partner with authority to sign the partnership return for the examination year, made under penalties of perjury. The statement must include relevant information about the electing partnership (name, TIN, tax year) as well as information about the signing individual (name, TIN, address, and telephone number). Importantly, the temporary regulations require that the statement include representations that the partnership is not insolvent (or does not anticipate insolvency), is not currently in bankruptcy (or does not anticipate bankruptcy), and has sufficient assets to pay any potential imputed underpayment arising from an examination. The statement must also designate the partnership representative.

Once an election has been made, it cannot be revoked without consent from the IRS. This irrevocable election feature also prevents a partnership from using the small partnership exception under new section 6221(b) to elect out of the new rules. The regulation states that an election is not valid if it frustrates the purposes of the BBA to collect an imputed underpayment, and no extension of time to make the election is permitted.

The temporary regulations outline several situations that prevent a partnership from electing into the BBA audit procedures. For example, a partnership cannot already have acted to apply any of the TEFRA partnership procedures to the partnership return for the tax year at issue, such as filing an administrative adjustment request or filing an amended partnership return.

Takeaways

The temporary regulations explain the limited circumstances in which partnerships can choose to apply the new BBA audit procedures to partnership tax years beginning from Nov. 2, 2015, to Dec. 31, 2017. IRS concern over ultimate payment of a partnership adjustment after examination requires a partnership making the early election to represent it has the financial means to do so. Partnerships will need to closely work with their tax advisers in determining if an early election to apply the BBA procedures would be beneficial if a notice of selection is received, or how the new partnership audit rules would impact their partnership agreement structure.

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