



November 2016

## Quick Guide: Overview of New Partnership Tax Audit Rules

The new partnership tax audit rules apply to multi-member LLCs and other entities treated as partnerships for federal income tax purposes.

The rules are effective for tax years beginning after December 31, 2017.

- > The precise mechanics remain in flux with many clarifications still to come.

Potential for tax to be imposed at the partnership level.

Partnership representative replaces the tax matters partner.

- > Partnership examinations are managed at the partnership level by a partnership representative who has the power to bind the partnership and its partners during an audit.

Partnerships with 100 or fewer partners can elect out of the new audit rules if all partners of the partnership are one of the following:

- > An individual, a C-Corp, a foreign entity that would be treated as a C-Corp if it were domestic, an S-Corp or an estate of deceased partner, but not a partnership.

# DIRECT PARTNERSHIP INCOME TAX LIABILITY

## CAUTION – DEFAULT RULE:

Absent an election, the partnership may be liable for underpayment of taxes in a given year.

TO AVOID THIS RESULT CONSIDER:

### Alternative 1: Partners amend returns

If partners of an audited partnership file amended returns reflecting the final partnership adjustment and pay their allocable share of the adjustment, the partnership gets an offsetting reduction in its direct liability.

### Alternative 2: Election to push out underpayment liability (the “push out method”)

The push out method allows a partnership to pass on the liability for additional taxes to partners and thus avoids entity level liability.

Partnership must make this election within 45 days of a final partnership adjustment.

Partnership must furnish to each reviewed year partner and to the IRS a statement of the partner’s share of any adjustment to income, gain, loss, deduction, or credit as determined by the final partnership adjustment.

## New Partnership Tax Audit Rules Checklist

### Formation Considerations

- Is the partnership eligible to opt out of the new regime?
- Can a new partnership be structured so as to remain eligible for electing out?

It must have less than 100 partners, each of which is either an individual, a C-Corp, or an S-Corp, but not a partnership.

For example, by maintaining less than 100 partners and not using a tiered structure.

### Partnership Representative Considerations

**How is a partnership going to choose the partnership representative?**

Existing operating agreements can be amended to deem the tax matters partner as the partnership representative or change rules on how a partnership representative is selected.

Partnership representative does not have to be a partner, but must have a substantial presence in the U.S.

If partnership does not designate a partnership representative, the IRS has the authority to designate one on behalf of the partnership.

**What authority will the partnership representative have to act on behalf of the partnership?**

Does the partnership representative have the authority to make any elections on behalf of the partnership?

Can the partnership representative require partners to amend their returns?

## Audit Considerations

**Should the partnership elect to apply the push out method?**

Election must be made within 45 days following a final partnership adjustment.

Partnership must furnish to each reviewed year partner and to the IRS a statement reflecting each partner's share of the final partnership adjustment.

**Should the partnership require the partners to file amended returns?**

In some cases it may be easier for the partnership to pay the underpayment directly and seek indemnification from the partners.

## Indemnification Considerations

**Who is liable for the imputed underpayment when the partnership pays the tax or incurs expenses during a partnership audit?**

Should the partnership indemnify its partners or should the partners indemnify the partnership?

The Board may have authority to allocate the tax burden among the partners as offsets to future distributions.

**How is indemnification handled when partners sell their interest in the partnership?**

Operating agreement should address specifics of any indemnification obligations.

This *GT Alert* was prepared by **Alejandro Ruiz**, **Noam Lipshitz** and **David Dalton**. Questions about this information can be directed to the following members of the Tax Audits and Litigation Group:

- > [Alejandro Ruiz](mailto:ruiz@gtlaw.com) | +1 415.655.1318 | [ruiz@gtlaw.com](mailto:ruiz@gtlaw.com)
- > [Noam Lipshitz](mailto:lipshitzn@gtlaw.com) | +1 954.768.5209 | [lipshitzn@gtlaw.com](mailto:lipshitzn@gtlaw.com)
- > [David Dalton](mailto:daltond@gtlaw.com) | +1 415.655.1297 | [daltond@gtlaw.com](mailto:daltond@gtlaw.com)
- > [Scott E. Fink](mailto:finks@gtlaw.com) | +1 212.801.6955 | [finks@gtlaw.com](mailto:finks@gtlaw.com)
- > [Barbara T. Kaplan](mailto:kaplanb@gtlaw.com) | +1 212.801.9250 | [kaplanb@gtlaw.com](mailto:kaplanb@gtlaw.com)
- > [G. Michelle Ferreira](mailto:ferreiram@gtlaw.com) | +1 415.655.1305 | [ferreiram@gtlaw.com](mailto:ferreiram@gtlaw.com)
- > [Courtney A. Hopley](mailto:hopleyc@gtlaw.com) | +1 415.655.1314 | [hopleyc@gtlaw.com](mailto:hopleyc@gtlaw.com)
- > Or your [Greenberg Traurig](#) attorney

<b>Amsterdam</b> + 31 20 301 7300	<b>Denver</b> +1 303.572.6500	<b>Northern Virginia</b> +1 703.749.1300	<b>Tallahassee</b> +1 850.222.6891
<b>Atlanta</b> +1 678.553.2100	<b>Fort Lauderdale</b> +1 954.765.0500	<b>Orange County</b> +1 949.732.6500	<b>Tampa</b> +1 813.318.5700
<b>Austin</b> +1 512.320.7200	<b>Houston</b> +1 713.374.3500	<b>Orlando</b> +1 407.420.1000	<b>Tel Aviv<sup>^</sup></b> +03.636.6000
<b>Berlin<sup>-</sup></b> +49 (0) 30 700 171 100	<b>Las Vegas</b> +1 702.792.3773	<b>Philadelphia</b> +1 215.988.7800	<b>Tokyo<sup>⌘</sup></b> +81 (0)3 4510 2200
<b>Berlin-GT Restructuring<sup>-</sup></b> +49 (0) 30 700 171 100	<b>London<sup>*</sup></b> +44 (0)203 349 8700	<b>Phoenix</b> +1 602.445.8000	<b>Warsaw<sup>~</sup></b> +48 22 690 6100
<b>Boca Raton</b> +1 561.955.7600	<b>Los Angeles</b> +1 310.586.7700	<b>Sacramento</b> +1 916.442.1111	<b>Washington, D.C.</b> +1 202.331.3100
<b>Boston</b> +1 617.310.6000	<b>Mexico City<sup>+</sup></b> +52 55 5029.0000	<b>San Francisco</b> +1 415.655.1300	<b>Westchester Count</b> +1 914.286.2900
<b>Chicago</b> +1 312.456.8400	<b>Miami</b> +1 305.579.0500	<b>Seoul<sup>∞</sup></b> +82 (0) 2.369.1000	<b>West Palm Beach</b> +1 561.650.7900
<b>Dallas</b> +1 214.665.3600	<b>New Jersey</b> +1 973.360.7900	<b>Shanghai</b> +86 (0) 21.6391.6633	

*This Greenberg Traurig Alert is issued for informational purposes only and is not intended to be construed or used as general legal advice nor as a solicitation of any type. Please contact the author(s) or your Greenberg Traurig contact if you have questions regarding the currency of this information. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a service mark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. <sup>-</sup>Greenberg Traurig's Berlin office is operated by Greenberg Traurig Germany, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. <sup>-</sup> Berlin - GT Restructuring is operated by Köhler-Ma Geiser Partnerschaft Rechtsanwälte, Insolvenzverwalter. <sup>\*</sup>Operates as Greenberg Traurig, LLP. <sup>\*\*</sup>Greenberg Traurig is not responsible for any legal or other services rendered by attorneys employed by the strategic alliance firms. <sup>+</sup>Greenberg Traurig's Mexico City office is operated by Greenberg Traurig, S.C., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. <sup>∞</sup>Operates as Greenberg Traurig LLP Foreign Legal Consultant Office. <sup>^</sup>Greenberg Traurig's Tel Aviv office is a branch of Greenberg Traurig, P.A., Florida, USA. <sup>⌘</sup>Greenberg Traurig Tokyo Law Offices are operated by GT Tokyo Horitsu Jimusho, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. <sup>~</sup>Greenberg Traurig's Warsaw office is operated by Greenberg Traurig Grzesiak sp.k., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. Certain partners in Greenberg Traurig Grzesiak sp.k. are also shareholders in Greenberg Traurig, P.A. Images in this advertisement do not depict Greenberg Traurig attorneys, clients, staff or facilities. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. ©2016 Greenberg Traurig, LLP. All rights reserved.*