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IRS NEW PARTNERSHIP AUDIT RULES

As you prepare and gather the 2017 tax data, I strongly encourage you to take this opportunity to review and modify your partnership agreements to be in compliance with the IRS new partnership audit rules. The new rules enacted by The Bipartisan Budget Act of 2015 (BBA) introduced new tax terms and concepts, and are applicable to partnership tax years beginning on or after January 1, 2018. To read a summary of important provisions under the new audit rules, please see our previous memo - Changes to IRS Partnership Audit Rules.

What Should Partnerships Do To Prepare?

1. Elect out of the BBA – This opt-out election is made annually on a timely-filed tax return, and is only available to partnerships with less than 100 partners and in which no partner is itself a partnership, disregarded entity, trust, nominee, or estate of an individual other than a deceased partner. If the partnership elects out, any audit must be conducted at the partner level, partner by partner, under the audit procedures applicable to each partner.

2. Amend the partnership agreement to address the following issues covered by the BBA –

   Governance: Under the Act, the Partnership Representative (PR) has the sole authority to act on behalf of the partnership; the partnership and all partners are bound by actions taken by the PR. If no PR is designated, the IRS has the authority to designate one. Hence, any desired restrictions on the PR's authority must be set forth in the partnership agreement in addition to the designation and removal of the PR.

   Economics: In an event of an audit, the BBA requires the IRS to assess and collect from the partnership an imputed underpayment calculated using the highest tax rate for the year under the audit. To avoid having unfavorable audit consequences imposed on current partners, the partnership agreement can require reviewed-year partners to file amended returns or provide a detailed adjustment statement to shift the tax liability back to the reviewed-year partners.

To comply with the new law, we suggest partnerships and partners review and modify the indemnification and tax procedure provisions of the partnership agreements to incorporate new terms and concepts discussed above. Please do not hesitate to contact us if you have any questions regarding the BBA or how its various provisions may impact your partnership. You may view a copy of this and other FBD memos on our website under PUBLICATIONS - http://www.fbco.com/publications/Client memos.

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