

Client Alert

Treasury Department Issues Temporary Regulations on Electing into the New Partnership Audit Rules

August 23, 2016 – The Treasury Department recently issued temporary regulations that detail how partnerships may make an early election into the new partnership audit rules. Under the new partnership audit regime, the IRS may assess and collect federal tax underpayments at the partnership level, commencing with partnership taxable years that begin on or after January 1, 2018. The temporary regulations permit partnerships (and limited liability companies taxed as partnerships) to make a written election into the new regime within 30 days after receiving notice from the IRS that an eligible partnership tax return (i.e., a partnership return for taxable years beginning after November 2, 2015 and before January 1, 2018) has been selected for examination.

Consequently, partnerships and their partners need to become familiar with how the new partnership audit rules have changed the federal tax audit process and partners' rights to participate in such process. Some of the key provisions of the new regime include:

- The new rules introduce the role of the “partnership representative,” replacing the “tax matters partner.” Unlike a tax matters partner, a partnership representative need not be a partner but must have a “substantial presence” in the United States. In addition, the new rules have eliminated the concept of a “notice partner.” The partnership representative has sole authority to act on behalf of the partnership and bind the partners with respect to audit and adjustment proceedings.
- The default assessment and collection process will be conducted at the partnership level, however a partnership may elect to shift responsibility for an underpayment to its partners. Pursuant to such election, the partnership would issue amended Schedule K-1s that take into account each partner's share of the underpayment.
- The new rules allow partnerships with 100 or fewer partners to elect out of the rules with a timely filed return, however not all such partnerships are eligible. For example, partnerships with partnerships as partners are not eligible, and it is not yet clear how the election out applies in the case of partnerships with partners that are certain foreign entities, grantor trusts, or disregarded entities.

Under the temporary regulations, a partnership making an early election must designate the partnership representative and make certain representations regarding the partnership's solvency and sufficiency of assets. The new partnership audit rules are complex and implementing the provisions will require the IRS to issue detailed Treasury regulations or other guidance. If you have any questions about the new partnership audit regime or the temporary regulations, please contact your primary attorney at Morrison Cohen LLP or any of our Tax attorneys who are carefully monitoring these changes:

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