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TO: CLIENTS AND THEIR ADVISORS
RE: A NEW LANDSCAPE FOR PARTNERSHIP AUDITS AND DUE DILIGENCE

In November 2015, Congress repealed the existing framework for audits of partnership (or LLC) tax returns, commonly referred to as "TEFRA". In a nutshell, those provisions allowed the IRS to conduct an audit of a partnership's income tax return (Form 1065) and enter into an agreement with the designated "tax matters partner" of the partnership as to what changes should be made. The IRS would then send a bill to each partner for the additional tax actually due as a result of the partner's share of the changes being incorporated into the partner's previously filed income tax return.

The new statutes (effective in 2018 or earlier if elected by a partnership), make several changes that have a significant impact on partners and partnerships going forward. Certain small partnerships can elect out of the new regime.

- A new "Partnership Representative", who need not be a partner, has authority to deal with the IRS. Only the partnership and the Partnership Representative receive notice of IRS proceedings.

- When changes are made or agreed upon with the IRS, the default outcome is that the partnership itself is billed for the additional income tax due, using the highest income tax rate. If all partners cooperate within prescribed time periods, they can elect to amend their own income tax returns and pay the tax at the partner level using the actual tax rate or tax-exempt status of each partner.

- There is a timing difference because the year being audited is likely several years before the year in which the audit concludes and any additional tax would be billed to the partnership in the future year. Thus, a current partner could bear the tax cost of the audit changes for a year in which he or she was not a partner and received no income from the partnership.

- Various defenses, such as reasonable cause for the non-imposition of penalties, are now evaluated at the partnership level and the determination made at that level cannot easily be challenged by a partner who feels his or her circumstances are different.

The implications of this new law are quite broad. For example, a prospective purchaser of a partnership interest will now be economically concerned with possible changes to prior year partnership income tax returns. Partners will want to contractually require notices, reimbursement, indemnification and procedural consent rights among themselves. Any new partnership agreement should be drafted to incorporate the new provisions, and any existing partnership should have its agreement reviewed.

Our office is available to assist you or your clients in exploring retirement planning issues as well as our other areas of specialization, including tax dispute resolution; tax collection defense; tax preparation; international tax planning and compliance; business structuring; estate planning and administration; guardianship and Medicaid planning; charitable planning, and tax-exempt organizations.