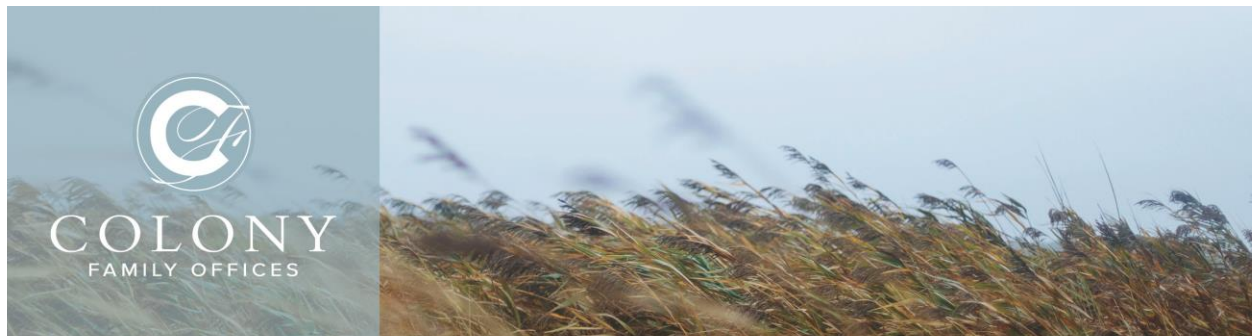

NEW RULES APPLICABLE TO ENTITIES TAXED AS PARTNERSHIPS

March 2019

Final regulations governing the selection, designation and power of partnership representatives were issued on August 6, 2018. On December 21, 2018, the Treasury and the IRS issued final regulations addressing other aspects of IRS partnership audits. If your family owns a family limited partnership or other entity taxed as a partnership, such as a limited liability company (or an S corporation that has made an election to be taxed as a partnership), these rules could apply to you and may necessitate changes to existing organizational documents.

Partnerships and limited liability companies that have not yet reviewed their agreements should take steps now to comply with the new rules and regulations or risk compliance issues should they be selected for audit. Furthermore, partnerships and limited liability companies should take steps now to identify a partnership representative.

Here are some helpful reminders for companies on the status of the new partnership audit rules and regulations now that 2018 has come and gone.

Partnership Representative Regulations

One of the biggest changes to the partnership rules was the creation of the partnership representative as the replacement for the tax matters partner, or TMP, who acted on behalf of the partnership under prior law if the partnership were audited. The new partnership representative has far more authority to act on behalf of the partnership, including the power to bind the partnership and all partners to any audit determinations. With the substantial increase in authority, a partnership must be careful deciding who, or what, should serve as its partnership representative.

Unlike prior law, which required a partner (or member in the limited liability company structure) to serve as the TMP, any individual or entity may be selected as the partnership representative. The individual or entity can come from outside of the partnership. A partnership can even select itself as its own partnership representative. If an entity is chosen as the partnership representative, a "designated individual" must be selected from within the entity to work with the IRS in the event of a partnership audit.

Regulations: Centralized Audit Regime

In August of 2018, the IRS issued new proposed regulations to address centralizing partnership audits. The new centralized partnership audit regime was enacted as part of the Bipartisan Budget Act of 2015 ("BBA"). The new audit procedures are effective for taxable years beginning after December 31, 2017 (§§6221 –6241). These rules provide an easier way for the IRS to collect underpayments of tax from partnerships and partners by generally requiring payment at the partnership level. Prior law required the IRS to instead pursue individual partners to satisfy underpayments of tax following a partnership-level audit adjustment.

Opting Out of the BBA Regime

Under the BBA, all partnerships are subject to the new audit/collection rules unless they qualify for an exception applicable to certain so-called "small partnerships." Even if an exception applies, the partnership must affirmatively elect out on that year's Form 1065. There are strict eligibility requirements to opt out of the regime, focusing on the number and type of partners in the partnership. Each eligible partnership should carefully consider whether it wishes to be bound by the BBA partnership audit process or to opt out.

Important Reminders

Partnerships should start thinking about logical choices for who, or what, to select as a partnership representative. The designation is required on all future Form 1065 filings. Should a partnership fail to select a partnership representative, the IRS does have the ability to select one on the partnership's behalf. Partnerships that still have not reviewed their partnership agreements in light of the new BBA regime should take proactive steps to ensure compliance with the new rules and regulations. Otherwise, they face substantial risk should they be selected for audit.

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