

IRS SETS SHORT FUSE FOR COMMENTS, GUIDANCE ON NEW PARTNERSHIP AUDIT RULES

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Global Government Solutions Alert

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As if it wasn't going to be busy already, the Internal Revenue Service ("IRS") has set Tax Day, April 15, 2016, as the due date for comments on significant new partnership audit rules. This new law, which was enacted as part of the Bipartisan Budget Act of 2015, replaces the complicated partnership audit regime in place since the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") with procedures intended to make it easier for the IRS to audit and collect tax from partnerships and partners. IRS Notice 2016-23 invites public comments as the agency begins to develop guidance on the implementation of the new rules, providing an opportunity for stakeholders to shape the partnership audit procedures outside of the legislative process.

The new audit rules take effect for partnership tax years beginning after December 31, 2017, so the IRS is wasting no time in beginning to prepare regulatory guidance. IRS Chief Counsel William Wilkins recently said that the IRS is aiming to issue proposed rules based on stakeholder feedback "less than a year" from now.

The audit provisions of the Bipartisan Budget Act make sweeping changes to the existing TEFRA regime, seeking simplification that could result in disparate effects on partners. For example, the new rules generally provide that adjustments resulting from a partnership audit will be assessed at the partnership level in the year the audit is completed — not the tax year to which the audit relates. This could have a disproportionate impact on current partners who have joined the partnership since the year being examined. Any additional tax due as a result of an adjustment will be calculated at the highest tax rates.

An exception to the general rule described above allows partnerships to make an irrevocable election to pass the audit adjustments through to their partners by issuing adjusted

Form K-1s; these adjustments will be taken into account by the partners on their tax returns for the tax year in which the audit was completed. In addition, partnerships with 100 or fewer partners may elect out of the above treatment by making an annual election on the partnership tax return that includes a list of all the partners and undertaking to notify all partners of the election.

Another significant provision of the new audit rules grants the IRS expanded "math error" authority, which gives the agency greater latitude to make changes to partner returns that are inconsistent with the partnership return — without conducting an audit.

The IRS has requested comments on the following specific issues of interest relating to the new rules:

- Matters relating to the "election out" of the new rules for partnerships with 100 or fewer partners.
- Designation of the "partnership representative," a role similar to that of the "tax matters partner" under TEFRA, with expanded authority to bind the partnership.

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- Determination of the amount of any imputed underpayment of tax resulting from an audit adjustment and issues relating to modifications of such imputed underpayments.
- How an audit adjustment that does not result in an imputed underpayment should be taken into account by the partnership.
- The alternative election to pass the audit adjustments through to partners by issuing adjusted Form K-1s.
- How a partnership makes an administrative adjustment request to be taken into account in the year the request is made, and the effect of such a request.
- The effect of audit adjustments on the basis of the partners in their partnership interests and the basis of the partnership in its assets.
- The rules for consistent filing of partner returns.
- The effect of bankruptcy and the treatment under the new partnership audit rules where a partnership ceases to exist.
- Procedural matters.
- Any other issues relative to the implementation of the new partnership audit rules.

Comments are due to the IRS by April 15, 2016, although given the short time frame provided in the notice, the IRS has indicated it will accept comments submitted beyond the due date. Please contact any member of the K&L Gates Tax Policy Team if you have any questions or would like to consider submission of comments. These new rules are likely to change the tax costs for partners in significant ways, and now is the time to ensure the IRS is aware of concerns and has input regarding appropriate resolution of those concerns.

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