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HEADLINE: #1 2015 TNT 208-1 POTENTIAL PARTNERSHIP AUDIT CHANGES IN THE BUDGET ACT. (Release Date: OCTOBER 27, 2015) (Doc 2015-23804)

ABSTRACT: A partnership proposal in the budget bill released October 27 would create a single, streamlined set of partnership audit rules, repealing the rules from the 1982 Tax Equity and Fiscal Responsibility Act and electing large partnership (ELP) rules.

SUMMARY: Published by Tax Analysts(R)

A partnership proposal in the budget bill released October 27 would create a single, streamlined set of partnership audit rules, repealing the rules from the 1982 Tax Equity and Fiscal Responsibility Act and electing large partnership (ELP) rules.

Streamlining partnership audits has been a focus of legislative efforts and executive proposals over the past few years. Most recently, House Ways and Means Committee member James B. Renacci, R-Ohio, offered his Partnership Audit Simplification Act of 2015 (H.R. 2821), which was nearly identical to the proposal in former Ways and Means Chair Dave Camp's Tax Reform Act of 2014 (H.R. 1).

Former Sen. Carl Levin introduced legislation in December 2014 designed to make it easier to audit large partnerships by assessing tax liabilities at the partnership level and eliminating the requirement to notify all partners before an audit.

The Obama administration included new simplified partnership procedures in its 2015 revenue proposals. "The common theme among these proposals, and reflected in the Budget Act, is a shift in the payment of tax from those persons who were partners for the year under audit and received the tax benefit from the tax item at issue, to the partnership and its current partners," said Mary A. McNulty of Thompson & Knight LLP.

Practitioners said that although the result in the budget agreement is imperfect, it reflects comments about the prior proposals. "Hopefully there will be future opportunities to continue to iron out remaining aspects that are not needed to accomplish the policy goal of greater tax compliance," said Jeffrey D. DeBoer of the Real Estate Roundtable in a statement. Monte Jackel of Jackel Tax Law noted that the changes aren't limited to large partnerships, and that the rules could apply more broadly than it appears, "but on the other hand, it sets up the mechanism for auditing these partnerships and making adjustments that can be enforced."

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Streamlining partnership audits has been a focus of legislative efforts and executive proposals over the past few years. Most recently, House Ways and Means Committee member James B. Renacci, R-Ohio, offered his Partnership Audit Simplification Act of 2015 (H.R. 2821 (Doc 2015-14422)), which was nearly identical to the proposal in former Ways and Means Chair Dave Camp's Tax Reform Act of 2014 (H.R. 1 (Doc 2014-29326)). (Prior coverage (Doc 2015-15375). Related coverage (Doc 2015-23774). Bipartisan Budget Act of 2015 (Doc 2015-23743).)

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The Obama administration included new simplified partnership procedures in its 2015 revenue proposals (Doc 2015-2512). "The common theme among these proposals, and reflected in the Budget Act, is a shift in the payment of tax from those persons who were partners for the year under audit and received the tax benefit from the tax item at issue, to the partnership and its current partners," said Mary A. McNulty of Thompson & Knight LLP.

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The proposals effectively apply the current ELP rules to most partnerships, including partnerships with a limited liability company, a trust, or another partnership as a partner. McNulty noted that the bill did not adopt a suggestion from practitioners that would have expanded the application of the ELP rules at the first-tier level for passthrough partners, rather than at the partnership entity level. "That approach would have addressed the complex computational problems present in multi-tiered partnerships but been a less draconian approach than the entity-level assessment approach in the Budget Act," she said. Partnerships with 100 or fewer qualifying partners could opt out of the new rules.

Under the bill, the tax matters partner rules would be replaced with a simplified partnership representative provision that allows a partnership to designate either a partner or non-partner to be the representative with the sole authority to act on behalf of the partnership for purposes of partnership audit and judicial proceedings. McNulty said this is a practical solution that gives partnerships much more flexibility regarding who can be chosen.

The proposed statute of limitations for assessments would look only at when the partnership's return was filed and extensions between the IRS and the partnership, rather than taking into account partners' individual statutes of limitation. The statute of limitations for filing partnership refund claims would be based solely on when the partnership return was filed but could not be extended by agreement.

"Complexities remain in the streamlined provisions in the Budget Act, particularly regarding the computation of the imputed underpayment and determining who pays," said McNulty. The bill presents several alternatives for potential payers, including the partnership, the partnership and the partners who file amended returns for the reviewed year, all partners in the reviewed year for which the partnership files adjusted K-1s, and the former partners of a partnership that ceases to exist.

Unlike with prior proposals, partners would not be subject to joint and several liability for any liability determined at the partnership level. "While the Budget Act is taxpayer favorable and much welcomed, further proposals may be needed to ensure payment of a partnership's entire tax liability," said McNulty.

Partnerships Created by Gift

A second proposal in the bill would clarify that Congress did not intend for the family partnership rules to provide an alternative test for whether a person is a partner in a partnership, and that the generally applicable principles of law apply. Jackel said the issue stems from the opinion in *Castle Harbour (TIFD III-E Inc. v. U.S., 660 F.Supp.2d 367 (2009) (Doc 2009-22285))*. This provision is tangentially related to the partnership audits provision in that it also addresses how to collect tax more efficiently from large partnerships, he said.

Steven R. Schneider of Goulson & Storrs PC agreed that the change was prompted by *Castle Harbour*. "They're putting [section 704(e)] back solely in the gift context, to where it was likely originally intended," he said.