New Partnership Representative Rules: Considerations in Amending Existing Agreements

The Bipartisan Budget Act of 2015 ("BBA") introduced a centralized partnership audit regime to repeal and replace the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). The BBA streamlined partnership audits (including limited liability companies taxed as partnerships, collectively referred to as "partnerships") by providing for the assessment and collection of tax at the partnership level.

The BBA also replaced the tax matters partner with the "partnership representative," who will represent the partnership in an audit or IRS examination and has the sole authority to act on the partnership's behalf with respect to federal income tax matters. The partnership and its partners are bound by the actions (or lack of actions) of the partnership representative, and the partners do not have any rights to participate in any audit proceedings or receive notice from the IRS. Unless a partnership is able to elect out of the BBA procedures, each year the partnership must designate a partnership representative and, if applicable, a designated individual (discussed below) on its Form 1065, U.S. Return of Partnership Income. If a partnership fails to designate a partnership representative, the IRS may appoint a partnership representative for the partnership. Due to the significant changes to the partnership audit regime effected by the BBA, existing partnerships should amend their partnership agreements (or limited liability company agreements, if applicable, collectively referred to as "partnership agreements") to conform to the procedures under the BBA.

Partnership Agreement Considerations

In addition to appointing a partnership representative on its Form 1065, each partnership should appoint a partnership representative in its partnership agreement. The partnership representative can be an individual or an entity, including a disregarded entity or the partnership itself. However, if the partnership designates an entity (including the partnership itself) as its partnership representative, the partnership must also designate an individual to act on the entity's behalf (the "designated individual"). Partnerships should also consider providing a mechanism in the partnership agreement for replacing a partnership representative in the event the partnership representative resigns or is removed.

While general indemnity provisions are often built into partnership agreements for agents, officers, and directors of the partnership, partnerships should also include specific indemnification language to afford the partnership representative and, if applicable, the designated individual, a certain level of protection from claims made by the partnership, current partners, and former partners.

Contractual limitations on the partnership representative's authority in the partnership agreement can benefit the partnership and its partners by ensuring that the partnership representative is acting in a manner that best serves the interests of the partnership and its partners. Partnerships should consider imposing limitations on the partnership representative's power to enter into settlement agreements, file

suit, extend the statute of limitations, and make elections and invoke certain procedures under the BBA, including the push-out election and pull-in procedure. While the IRS is not bound by any contractual limitations imposed on the partnership representative in the partnership agreement, clearly defining the scope of the partnership representative's authority can provide additional protections for the partnership and the partners.

Partners with controlling interests in a partnership generally prefer language in the partnership agreement that provides the maximum authority to appoint and control the partnership representative with minimum oversight by minority partners. For example, a controlling majority partner may be able to amend the partnership agreement to require that the partnership representative secure the majority partner's consent before making any elections or taking any other action under the BBA procedures. Partners in minority positions, in contrast, generally prefer including notice and consultation requirements so that they can provide input on certain decisions made by the partnership representative. Finally, the partnership agreement should include a survival provision that allows the partnership representative provision to survive the partnership's termination, the termination of the partnership agreement, and any partnership interest transfer or disposition. Each partnership structure is unique, and the amendment to the partnership agreement should be crafted in a manner that is specific to the partnership's needs and considers the partnership's size, operations, type of management, and types of partners, among other factors.

Required Partnership Agreement Amendment

The American Institute of Certified Public Accountants ("AICPA") recently issued guidance for preparing Form 1065 for the 2018 tax year. The AICPA guidance advised accountants to confirm that partnerships have amended their partnership agreements to appoint a partnership representative before signing a Form 1065. Thus, partnerships should be aware that accounting firms may require that partnerships amend their partnership agreements prior to a return preparer signing a Form 1065. Practitioners generally agree that it is in everyone's best interest to have a partnership agreement designating (and indemnifying) a partnership representative and, if applicable, a designated individual, prior to the due date of the Form 1065. Accordingly, partnerships should plan to amend their partnership agreements to avoid any difficulties and delays as filing deadlines approach, to avoid unnecessary penalties associated with late filings.

Thompson & Knight has significant experience drafting amendments to partnership agreements that include partnership representative provisions specific to the individual needs of each partnership. Amendments can be prepared quickly and efficiently to account for the general requirements of the BBA and the various specific business needs of each partnership. If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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