

## TOP FIVE THINGS TAX MATTERS PARTNERS SHOULD DO WHEN RECEIVING AN FPAA

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As discussed in a prior [Client Alert](#), the IRS is ramping up enforcement efforts and focusing on partnerships. As a result, partnerships may soon receive IRS notices adjusting the partnership's return. Due to the time it takes to select a tax return for audit and conduct the audit, these upcoming notices are likely to be for pre-2018 tax years when the partnership was subject to the complex TEFRA procedural rules. Under those procedures, the notice is a notice of Final Partnership Administrative Adjustment (FPAA), and the partnership is generally represented by the Tax Matters Partner (TMP). The FPAA is the equivalent of a notice of deficiency for partnerships, but only partnership items are adjusted and no deficiency is proposed. Because the FPAA triggers the time period for filing suit to contest the partnership adjustments, this Client Alert highlights the top five things a TMP should do when receiving an FPAA.

### WHAT IS TEFRA?

The TEFRA rules are complex procedural rules enacted in 1982 to create a unified procedure to determine the tax treatment of partnership items at the partnership level, rather than the individual partner level. While the TEFRA rules addressed a real and serious administrative problem, the TEFRA rules did not allow for the assessment and collection of the tax from the partnership, which created new administrative complexities.

As a result, Congress repealed and replaced TEFRA in the Bipartisan Budget Act of 2015 (BBA), and the BBA rules are generally effective for tax years beginning after December 31, 2017. Commentators now focus on BBA procedural issues, but many partnerships now under audit or in litigation are still subject to the TEFRA rules. For example, when the recent conservation easement settlement offer was released for pending Tax Court cases (discussed in this [Client Alert](#)), commentators speculated about issues with the offer that arise under the BBA procedures. However, none of the pending cases are subject to the BBA procedures—they are all subject to the TEFRA procedures.

### TOP FIVE THINGS A TMP SHOULD KNOW WHEN IT RECEIVES AN FPAA

When the IRS issues an FPAA, the clock starts running on the time period to file suit to contest the adjustments. The TMP needs to be prepared, so it can evaluate its options and act quickly. Here are the top five things a TMP should do when receiving an FPAA:

- 1. Within 45 days, evaluate procedural options if the partners never received formal notice of the audit.** The IRS is required to notify partners of the beginning of an administrative proceeding (NBAP) at least 120 days before issuing the FPAA. However, the failure to provide that notice does not invalidate the FPAA. Instead, it opens up other procedural options that need to be considered within 45 days of receiving the FPAA.

2. **Within 90 days, evaluate where to file suit.** The TMP has 90 days to file suit in the Tax Court, the district court in which the partnership's principal place of business is located, or the Court of Federal Claims. If the TMP does not file suit within 90 days, another partner can file suit within the next 60 days. Because the TMP is also a notice partner, if the TMP fails to file suit within 90 days, it can file suit in its capacity as a notice partner within 150 days after the FPAA is mailed.
3. **Within 90 days, evaluate the deposit requirement.** If suit is filed in district court or the Court of Federal Claims, the partner filing suit must deposit with the IRS the amount by which its tax liability would increase if its return were made consistent with the partnership return as adjusted by the FPAA. The deposit is based on only the potential increased tax liability, not interest and penalties. Thus, if the TMP files suit in district court or the Court of Federal Claims, the TMP must deposit the amount by which its tax liability would increase if the FPAA were upheld. The IRS's position is that the deposit must cover tax increases for all affected years, not only the tax year that is the subject of the suit. Two decisions of the Court of Federal Claims adopted the IRS's position, but then a later decision of the Court of Federal Claims reached the opposite result. Thus, there is some uncertainty as to the required amount of the TMP's deposit.

A pass-through filing partner is required to deposit an amount based on the potential tax liability of all indirect partners who own interests through the pass-through partner. The IRS requires the deposit amount to include the total impact on the tax liability of indirect partners, even if some of the changes to the indirect partner's tax liability stem from a direct interest or an interest in a separate pass-through intermediary and not the pass-through partner filing suit. The Court of Federal Claims has agreed with this interpretation. No other court has addressed the issue. This can be a significant issue when the TMP is a pass-through partner owned by the other partners, as it essentially results in a full-payment rule. One possible solution is to have a notice partner that is not a pass-through partner file suit. However, the TMP then loses control of the suit, absent an agreement with the filing partner.

4. **Before filing suit, consult the partnership agreement.** Partnership agreements frequently impose restrictions on the TMP's ability to file suit. The TMP should consult the partnership agreement before filing suit to make sure it obtains the required approvals and otherwise complies with the partnership agreement.
5. **After filing suit, notify the partners.** After filing suit, the TMP is required to provide notice to the other partners. If suit is filed in Tax Court, the Tax Court Rules require the notice to be sent after receiving the Notification of Receipt of Petition from the court and within 30 days after filing the petition. The notice must include the docket number and the date the petition was served on the IRS Commissioner. There is a significant backlog at the Tax Court due to the pandemic closure, making it difficult to comply with the notice requirement. We recommend providing notice within 30 days of filing suit and following up with the partners after the Notification of Receipt of Petition is received from the Tax Court with the docket number and date the IRS Commissioner was served.

If suit is filed in district court or the Court of Federal Claims, notice must be provided within 30 days after filing suit. There are no rules expressly requiring that the notice include the docket number and the date the petition was served on the IRS Commissioner, although we recommend the notice include this information. Because petitions filed in district court and the Court of

Federal Claims are filed electronically, there is no delay in receiving the docket number as there is currently in the Tax Court.

## WE ARE AVAILABLE TO HELP

Thompson & Knight attorneys have significant experience in assisting taxpayers in partnership audits and litigation subject to the complex TEFRA procedural rules. 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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