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In our previous newsletter, we went over the elimination of the position of Tax Matters Partner, and its replacement of Partnership Representative. In this memo, the second in a multi-part series, we intend to introduce you to the ways in which Partnerships can avoid being drawn into CPAR (Centralized Partnership Audit Regime).

Recap: The New Regime

In an effort to increase the efficiency of Partnership examinations, the Bipartisan Budget Act of 2015 repealed the previous rules regarding the auditing of partnerships: the TEFRA partnership audit rules and the electing large partnership audit rules. Although the new rules will be implemented in tax years beginning or after January 1st, 2018, taxpayers can now elect to be subject to the rules now. Under the new rules under IRC §6221(a), at the end of an exam, rather than having the Auditors assess the increase of tax at the Partner level, the new rules will levy the tax at the Partnership level. While these changes are beneficial to the IRS, taxpayers will be at a disadvantage. However, there are ways out of this.

Opting Out

While these changes are beneficial to the IRS, taxpayers will be at a disadvantage. However, there are currently four ways out of this.

<u>Method #1 Electing Out</u>

Under §6221(b) taxpayers can elect out of this if the following prerequisites are met:

1. The partnership must make an election out of the new provisions.
2. The partnership issued less than 100 K-1s for the year.
3. Each of the Partners must be an "allowed partner" which is either an individual, any Foreign Entity that would be treated as a C Corporation, if it was a domestic entity, C Corporation, S Corporation* or an Estate of a deceased Partner.
4. The election must be made on the timely filed return and include the name and identification number of each partner and inform said partners that this election has been made.

*Although S Corporations are allowed, the total number of shareholders in the S Corporation rather than the S Corporation itself will count against the 100 K-1 limit.

Method #2 Filing Amended Returns

If the Partnership does not elect out of the new rules or if it is unable to, in the case of an Audit, the Partners can pre-empt the Final Partnership Adjustment by filing amended returns for the year(s) in question to include their share on the underreported income on their personal returns. This amount amended will reduce the amount owed by the partnership and allows the tax to be computed at the partner's individual level, rather than the top rate.

Method #3 Pull In

An alternative to amending the tax returns, is the pull-in procedure. The partners of the reviewed year would pay the tax that would be due if the taxpayer filed an amended return, update their tax carryovers and other attributes for later years, and provide the IRS with the support behind those calculations, all without filing an amended return. Payment is due by the end of 270 days after the date of the notice of proposed partnership adjustment is mailed.

Method #4 Push-Out Election

The final method is the Push-Out Election. After receiving the Final Partnership Adjustment, the Partnership can opt to push out the understatement to the current year as additional income albeit subject to a 2% higher interest rate. This includes former partners who previously owned a partnership interest in the partnership during the year of audit. In the case of partnerships with high partner turnover and who are unable to elect out of these rules, this is the best option as it will ensure that the former partners are responsible for their share of the tax.

Questions? Let's talk.