

Dallas Bar Association–Family Law Section

May 9, 2018



New Partnership Audit Rules: What They Mean to Family Lawyers



Charles D. Pulman, J.D., LL.M., CPA
Matthew L. Roberts, J.D., LL.M.

Copyright © Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P. All rights reserved.

Overview of PAR

- The Bipartisan Budget Act of 2015 (BBA) signed into law on 11/02/15.
- Proposed Regulations issued on 6/14/17, 11/30/17, 12/19/17 and 2/2/18.
- Final Regs. on Opt Out Election issued 1/2/18.
- Tax Technical Corrections Act of 2018 (TTCA).
- Sections 6221 to 6241.

Application

- Returns filed for partnership taxable years beginning after 12/31/17 unless the partnership has made a valid opt-out election.
- Any entity taxed as a partnership for federal income tax purposes, e.g., limited partnerships and LLCs.
- Centralized system of audit, assessment, and collection of tax at partnership level.

The Partnership Representative

- Sole authority to act on behalf of the partnership, including examination, elections and judicial proceedings.
- Partners may not participate in or contest examination or participate in judicial proceedings.
- Partners bound by all decisions of partnership representative.
- Due Process concerns.

Opt-Out Election

- Partnerships with 100 or fewer partners can opt-out.
- Eligible partners are individuals, C corps, foreign entities treated as C corps for U.S. tax purposes, S corps (regardless of SH identity), and estates of deceased individuals.
- If a valid opt-out election is made, deficiency proceedings conducted at the partner level to adjust items, resolve issues, and assess and collect any tax.
- Opt-out election is valid unless the IRS determines the election is invalid.

PAR Notices

- IRS issues three notices:
 - Notice of Administrative Partnership Proceeding (NAP) – Audit Begins.
 - Notice of Proposed Partnership Adjustment (NOPPA) – Adjustments Proposed.
 - Notice of Final Partnership Adjustment (FPA) – Adjustments Final.

Scope of PAR

- Any adjustment to a “partnership-related item,” which is defined in Section 6241(2) as “any item or amount with respect to a partnership which is relevant in determining a partner’s tax liability.”

Key PAR Terms

- Adjustment Year:
 - The tax year the court decision is final;
 - The tax year in which the Administrative Adjustment Request (AAR) is made; or
 - The tax year in which FPA is made.
- Reviewed Year: The year audited by the IRS.
- Imputed Underpayment (IU): Amount of tax arising out of audit adjustments, computed by netting certain adjustments multiplied by the highest tax rate applicable to individuals or C corps for the Reviewed Year.
- Tax imposed on a partnership with certain modifications and exceptions.

Notice of Proposed Partnership Adjustment (NOPPA)

- Sets forth the underlying adjustments to the partnership's return.
- Must be mailed before three (3) years after the latter of the following:
 - Date partnership return for taxable year is filed;
 - Return due date for such taxable year; and
 - Date on which partnership filed AAR for such taxable year.

Modification Procedures

- Partnership may request modification of Imputed Underpayment subject to IRS acceptance.
- Amended Returns and Pull-In.
- Tax-exempt partners.
- Modification of applicable highest rate.
- Passive losses of publicly-traded partnerships.
- Other modifications approved by IRS.

Amended Returns and Pull-In

- Reviewed Year partner(s) files amended return based on share of adjustments and pays any tax, interest and penalties related to the Reviewed Year and other affected years.
- In lieu of filing an amended return, a Reviewed Year partner pays the tax that would be paid under an amended return – “Pull-In”.
- Reduces tax owed by partnership.
- Optional per Partner.

Notice of Final Partnership Adjustment (FPA)

- Sets forth Imputed Underpayment Amount.
- Three options:
 - Accept the adjustments, which will be assessed at the partnership level; or
 - File a petition with the U.S. Tax Court, U.S. District Court, or U.S. Court of Federal Claims; and
 - Make Push Out Election under either above option.

The Push Out

Alternative to Partnership Payment (The “Push Out”)

- The Reviewed Year partners pay tax on their share of adjustments.
- Additional tax paid with tax return for year election made or later.
- A “push out” election is revocable only with IRS consent. Section 6226(a).
- Higher interest rate (+2%) and 3.8% NII Tax apply to tax owed.
- Partnership Representative makes election.
- Applies to all partners – mandatory.

Tier Push Out

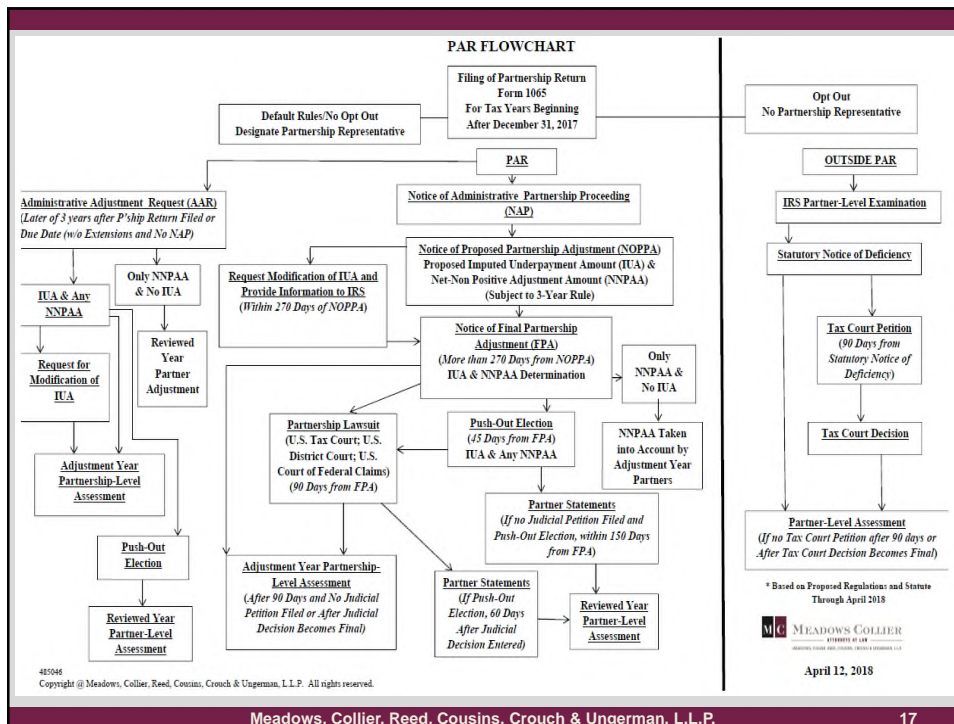
- If the audited partnership (“P1”) makes a Push Out election and P1 has a pass-through partner (“P2”), P2 can also make a Push Out election to P2’s partners (“Affected Partners”).
- The Push Out election may be made by each pass-through partner in the chain of ownership of the interest in P1.

Partnership “Ceases to Exist”

- If the IRS determines that a partnership “ceases to exit,” the Imputed Underpayment is assessed against “former partners”.
- Former partners are persons who were partners in the Adjustment Year or prior final return year of the partnership.
- “Ceases to exits” means the partnership ceases to carry on business or does not have the ability to pay, in full, any amount due by the partnership.

Failure to Pay

- If the Imputed Underpayment is not paid by the partnership within ten (10) days after notice and demand (and no push out election):
 - Each Adjustment Year partner or former partner can be assessed directly by the IRS a tax equal to that partner’s “proportionate share” of the Imputed Underpayment; or
 - S corporations and its shareholders are treated as partnerships and partners.



Family Manual

- Either one or both of the parties will be solely or equally “responsible for all federal income tax liabilities of the parties from the date of marriage through December 31, ____ and shall timely pay any deficiencies, assessments, penalties, or interest due thereon, and shall indemnify and hold **[name of party B]** and **[his/her]** property harmless therefrom.”

Base Facts

- *H is 40% LP in SPFLP, Ltd.*
- *In 2019, H & W divorce.*
- *In 2021, IRS audits 2018.*
- *In 2022, IU of \$500,000 on SPFLP, Ltd.; \$200,000 to LP interest.*
- *AID – Tax liabilities: H pays pre-divorce years.*
- *H & W file joint return for 2018.*

Case One – Prior Law

- Pre-Tax Audit Regime
 - LP interest to W.
 - Tax assessed by IRS against H & W for 2018.
 - H pays \$200,000 tax per IRS Notice.
 - Pre-Divorce year tax liability.

Case Two – New Law

- LP interest to H under AID.
- SPFLP assessed and pays IU amount in 2022.
- H bears economic loss.
- Consistent with AID intent.

Case Three – New Law

- LP interest to W under AID.
- SPFLP assessed and pays IU amount in 2022.
- W bears economic loss.
- Does H indemnify W – whose tax liability?
- SPFLP makes capital call to W for IU – does H indemnify W – is there tax liability of parties?

Case Four – New Law

- LP interest to W under AID.
- SPFLP makes Push Out Election of IU adjustments.
- Additional tax reported on and paid with H's 2022 tax return.
- Is there a tax liability of the parties pre-divorce?

Case Five – New Law

- LP interest $\frac{1}{2}$ to H and $\frac{1}{2}$ to W.
- SPFLP assessed IU amount in 2022.
- SPFLP fails to pay.
- IRS assesses tax against H and W in 2023.
- Does H indemnify W? – Is this pre-divorce tax liability of H and W?

Case Six – New Law

- LP interest to W.
- SPFLP assessed IU amount in 2022 for 2018.
- SPFLP and W requests H file amended return for 2018.
- Is amended return signed by H & W?
- If amended return – H pays tax?
- If no amended return – SPFLP pays tax?

Case Seven – New Law

- LP interest to W.
- SPFLP assessed IU amount in 2022.
- SPFLP and W request H pay tax under “Pull-In”.
- H refuses to do so.
- Can W exercise “Pull-In” even though not named partner in 2018?

Charles D. Pulman

Partner



phone (214) 749-2447
toll-free (800) 451-0093
fax (214) 292-2347
cpulman@meadowscollier.com

Mr. Pulman's practice concentrates on tax planning, real estate, and corporate. His tax planning practice includes federal, state, and international tax planning for businesses and individuals seeking to minimize tax obligations while accomplishing objectives. His real estate practice includes representing clients in the purchase and disposition of improved and unimproved property, development of property, structuring ownership entities, tax-free and like-kind exchanges, and negotiation of all types of loans. Mr. Pulman's corporate practice involves representing clients in the acquisition and disposition of businesses, mergers, and business entity planning including partnerships, limited liability companies, and corporations.

Mr. Pulman is Board Certified in Tax Law by the Texas Board of Legal Specialization. He is a Certified Public Accountant and has a LL.M. in Taxation from NYU.

Mr. Pulman frequently speaks on a number of tax topics. He is active in numerous charitable, political, and civic organizations.

Mr. Pulman was admitted to practice in Texas in 1976.

Matt L. Roberts

Associate



phone (214) 749-2409
toll-free (800) 451-0093
fax (214) 747-3732
mroberts@meadowscollier.com

Mr. Roberts practices in the areas of Income Tax Litigation, Estate and Gift Tax Litigation, White Collar and Government Regulatory Litigation, and State Tax Planning and Litigation. Mr. Roberts' practice also includes both domestic and international Income Tax and Business Planning. He represents individuals, estates, partnerships, closely-held businesses, and large corporations in all states of a tax dispute, including IRS examinations, administrative appeals, and litigation in U.S. Tax Court, Federal District Court, and the Court of Federal Claims.

Mr. Roberts' practice also concentrates on resolving white collar criminal investigations and representing taxpayers in disputes with the Texas Comptroller of Public Accounts and other state tax agencies.

Mr. Roberts was admitted to practice law in Texas in 2015 and in Mississippi in 2011. He was admitted to practice before the United States Tax Court in 2012. From 2012-2015, Mr. Roberts was an Attorney-Advisor for The Honorable Chief Judge Michael B. Thornton, United States Tax Court in Washington, DC.

DISCLAIMER

The information included in these slides is for discussion purposes only and should not be relied on without seeking individual legal advice.

490876