

## Congress Looks to Fix New Partnership Audit Rules

December 14, 2016

The Bipartisan Budget Act of 2015 (“BBA”) fundamentally changed the rules by which partnerships, and entities taxed as partnerships, interact with the Internal Revenue Service (“IRS”) in an audit or litigation. We outlined these significant changes to the partnership audit rules in a prior [Alert](#). The BBA repealed the 30 year-old TEFRA partnership audit regime, creating uncertainty within the partnership tax community. ***Many practitioners have since expressed concern that the BBA partnership audit rules are unclear, unworkable and create significant administrative burdens on taxpayers.***

In an attempt to clarify and introduce practicality to the new rules, Congress introduced the Tax Technical Corrections Act of 2016 (“TTCA”) to provide technical corrections to the BBA partnership audit rules (along with technical corrections to other provisions in the Code). The bill is unlikely to pass before the end of the year due to Congress’ limited legislative schedule in December.<sup>1</sup> Even so, the TTCA has bipartisan support, may pass in early 2017, and embodies Congress’ response to practitioners’ concerns regarding the new partnership audit rules.

### What Might Change?

Tiered Structures (Upper Tier Partners). The TTCA addresses concerns regarding the “push-out” method when a partnership, dealing with an imputed underpayment, pushes out adjustments to partners who themselves may be partnerships. Under the Congressional amendments, the “push-out” election would apply to pass-through partners up through the tiers. Pass-through partners would be subject to new information reporting and disclosure requirements in connection with any lower-tier partnership’s “push-out” election. Upper-tier partnerships would be obliged to file reports that could include, for example, identifying information for an upper-tier partnership’s own partners and other information that would facilitate assessment and collection from those upper-tier partners.

Foreign Partnerships. Foreign partnerships may be subject to a different set of rules. Congress has authorized the Secretary to issue regulations relating to certain special situations—expressly defined to include foreign partnerships—carving them out of the new regime and/or applying additional or distinct rules to them.

Pull-in Method. The TTCA adds one further option to the BBA’s menu of procedural alternatives. The new “pull-in” procedure provides a simplified means for modifying the imputed underpayment that does not require the reviewed year partners to file amended returns. Rather, the reviewed year partners pay the tax that would be due with amended returns, make binding changes to their tax attributes for subsequent years, and provide the IRS with information to substantiate that the tax was correctly paid. With respect to the statute of limitations, the TTCA clarifies that, where a partner elects to file an amended return or follows the “pull-in” procedure, the statutes of

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<sup>1</sup> Senate Finance Committee member John Thune, R-S.D., stated that it was unlikely any tax corrections would pass this year. See Senate Approves HRA Expansion; Tax Corrections Bill on Hold, 2016 TNT 236-4 (Dec. 8, 2016).

limitations for that partner's affected tax year do not bar the assessment of any additional tax or preclude the partner from seeking any refund due.

Imputed Underpayment. The TTCA clarifies that items of a different character (e.g., capital or ordinary) are not netted together in determining the amount of the imputed underpayment. This clarification addresses concerns raised by practitioners that the imputed underpayment could be significantly more or less than the cumulative amount that the reviewed-year partners would have to pay if the adjustment were allocated to them, as required by the TEFRA rules.<sup>2</sup>

Partnership-related items. The TTCA creates a new term called "partnership-related items" which includes "any item or amount" with respect to the partnership that is relevant in determining the income tax liability of any person, without regard to whether the item or amount appears on the partnership's return and including an item or amount relating to any transaction with, basis in, or liability of the partnership. This change confirms that the scope of the BBA rules are broader than the prior TEFRA rules and cover items described as partnership items, affected items, and computational items under TEFRA.

Congress may enact some technical corrections to the BBA partnership audit rules in the New Year. The rules are likely to include some of the provisions discussed above, but some items may have to be addressed by regulations.

## What Should Partnerships Be Thinking About In This Environment?

Clients should review their partnership agreements to ensure that those agreements take into consideration the new concepts reflected in the BBA and TTCA. The TTCA makes clear that the BBA partnership audit rules are here to stay. Although the final structure may still be under construction, the fundamental concepts can and should be embedded in or anticipated by the terms of partnership agreements. We will continue to monitor the TTCA and any further proposed legislation and will update clients as necessary.

For the latest developments on the new partnership audit rules, please visit [www.partnershiprepresentative.com](http://www.partnershiprepresentative.com) or contact a member of [Caplin & Drysdale's](#) partnership tax team:

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<sup>2</sup> See Comments on Bipartisan Budget Act of 2015 Partnership Audit Procedures, American Bar Association (June 6, 2016).



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