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Partnership Audit Regulations

Cross References

- REG-136118-15, June 14, 2017

The Bipartisan Budget Act of 2015 replaced the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) procedures for auditing partnership returns beginning in 2018. The IRS recently issued proposed regulations dealing with the new partnership audit procedures. The following is a summary of provisions contained in the new regulations.

Partnership audit regime. Beginning in 2018, any adjustment made during a partnership audit to items of income, gain, loss, deduction, or credit of a partnership and any partner's distributive share of those adjusted items is assessed and collected at the partnership level. Any penalty, addition to tax, or additional amount that relates to an adjustment made during a partnership audit is also determined at the partnership level.

Election out of centralized partnership audit regime. A partnership can elect out of the centralized partnership audit regime if it has 100 or fewer partners during the year and all partners are eligible partners. Eligible partners include individuals, C corporations, eligible foreign entities, S corporations, or the estate of a deceased partner. A partnership has 100 or fewer partners if it is required to furnish 100 or fewer K-1s during the year. Unlike the TEFRA rules, a husband and wife are not treated as a single partner for purposes of this 100 or fewer partner rule.

By electing out of the centralized partnership audit regime, the IRS must assess and collect additional taxes and penalties at the partner level rather than the partnership level. The proposed regulations detail the procedures for which a partnership can make such election. It is expected that the Form 1065 instructions will also contain the details on how to make such election.

Consistency rule. A partner's treatment of each item of income, gain, loss, deduction, or credit attributable to a partnership must be consistent with the treatment of those items on the partnership return, including treatment with respect to the amount, timing, and characterization of those items. The IRS may assess and collect tax resulting from a partner inconsistently reporting items. The partner may not request an abatement of that assessment. This rule does not apply to items that the partner properly identifies on a statement as being treated inconsistently with the partnership return under the inconsistent treatment rules of IRC section 6222 [see Prop. Reg. §301.6222-1(d) for details].

Partnership representative. The proposed regulations provide rules for how a partnership designates a partnership representative and the authority of that representative. It is expected that the Form 1065 instructions will also contain the details on how to designate a partnership representative.

Imputed underpayment and modification of imputed underpayment. In general, an adjustment at the partnership level may result in an imputed underpayment. The partnership must then pay the imputed underpayment in the adjustment year. The proposed regulations address calculations and modifications of an imputed underpayment and the treatment of adjustments that do not result in an imputed underpayment.

Election for alternative to payment of imputed underpayment. The proposed regulations contain instructions for how a partnership can elect to have the partners pay the imputed underpayment rather than the partnership. If the partnership makes a valid election, the partners and not the partnership are liable for the tax, penalties, additions to tax, and additional amounts plus interest resulting from the imputed underpayment.

Administrative adjustment requests. The proposed regulations contain instructions for how a partnership may file and administrative adjustment request (AAR) with respect to one or more items of income, gain, loss, deduction, or credit, and any partner's related distributive share for a partnership tax year. In general, the partnership and not individual partners may make an AAR.