Anchin Alert

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There's a new sheriff in town: the not-so-new IRS Consolidated Partnership Audit Regime ("CPAR")

Action needed by March 15, 2019 (however, implementation may require a considerable amount of time)

On January 01, 2018, the CPAR (promulgated under the Bipartisan Budget Act of 2015) went into effect. Two sets of related regulations were issued in August 2018. As a result, there is the potential for a federal entity level tax if an election out of the CPAR is not made with each year's federal partnership tax return. Under the CPAR default regime, tax will be assessed on the partnership in the year that the partnership tax examination or audit becomes final - not the reviewed year (the year under audit). As such, the tax assessed may not be equitable due to partner ownership shifts in subsequent years. The goals of the new regime are two-fold: to increase the IRS collection efficiency and to reinvest resources into increasing the number of partnership audits.

Since almost all partnerships and their partners will be effected, this alert summarizes some of the key issues that you will need to consider.

Question: Why should our partnership be concerned with the CPAR if we can elect out?
Answer: To elect out, the partnership cannot have even one ineligible partner and must have 100 or less eligible partners. However, electing out may not be what is best for the partnership and its partners.

Question: What partners are eligible vs. ineligible to make the election?
Answer: Eligible partners include individuals, "C" Corporations, any foreign entity that would be classified as a "C" Corporation if it were a domestic corporation, "S" Corporations and Estates of deceased partners. Both LLC's and trusts are considered to be *ineligible* partners to make an effective election out – this includes even disregarded entities such as single member LLC's and grantor trusts. This may make almost all family partnerships ineligible to elect out of the CPAR.

Question: If it turns out we have no ineligible partners, is the 100 count straightforward?
Answer: Unfortunately, this isn't simple math as the count is based upon the election out notice requirements (how many notices of the election out must be transmitted to partners). For example, joint ownership counts as two partners and for an S corporation partner, you have to count both the entity and look through to the number of underlying shareholders, e.g. – an S corporation with 10 shareholders counts as 11 notices.

Question: If we have less than 101 eligible partners and can elect out, is it a simple procedure?
Answer: For the election to be valid there are onerous compliance disclosure requirements to be submitted with the partnership return. The election must be made on a timely filed return and each partner must be notified of such. Additionally, the partnership return must include a schedule showing each partner's name, taxpayer identification number (EIN or SSN) and federal tax classification (individual, S Corp, etc.). This must include the relevant information for all shareholders of an S corporation partner. *Presumably the S corporation has the authority to disclose that information to the partnership.*

Question: If our partnership is eligible, is there any downside to electing out of the CPAR?
Answer: Unfortunately, you are now in the wild, wild, west of the (Pre-TEFRA) audit procedures. It could be that a partner or, multiple partners gets audited instead of the partnership. As a result, you will need to supply the partner(s) and/or their accountants with your supporting tax data to justify what was reflected on the returns and hence the K-1's. That may be a lot of work and the partnership may not be fully comfortable releasing such information. Also, different items may be challenged in different partner audits. Lastly, partners may not be happy dealing with or paying their professionals to handle the audit of their share of partnership items reported to them on the K-1.

Question: What happens if the partnership is ineligible or chooses not to make the election out?
Answer: There are two options:

Default Regime (option 1) where the partnership will pay the tax, interest and penalties (if applicable) in the year that the final adjustment notice is issued and allocates those adjustments and partnership level tax underpayments to the partners in that year. The tax is calculated at the highest individual rate unless the partnership can demonstrate allocations to C corp. partners or that lower rates may apply to either the income items or partners, e.g. – long term capital gains or passive activity losses.

Push Out Election (option 2) where the partnership elects to push out the adjustments to the partners in the return under audit (the "reviewed year").

The IRS wants all partnerships to be in the default regime and be the remitter instead of having to chase down partners. If instead, the partnership makes the Push Out election, there will be an additional cost as the interest rate will be 2 percentage points higher than under the default regime.

Question: For the default regime and Push Out Election, is the compliance simpler and election easier?
Answer: First, in order for the partnership to deal with not having made the election out of the CPAR, a Partnership Representative ("PR") must be designated on each tax return. The PR is a new designation and takes the place of the old tax matters partner ("TMP"). All dealings by the IRS will be with this person. If not properly designated, the IRS can designate such if the partnership doesn't cure this defect within 30 days of IRS notification. Second, the Push Out election must be made within 45 days after receiving the final partnership adjustment notice. In order to be effective for the return under audit, the entity has to amend its partnership agreement so as to designate a PR by March 15th of the year following the reviewed year.

Question: Is there any real difference between the new PR vs the old TMP?
Answer: This is the root of the issue. Here, the IRS only wants to deal with the PR who will have the sole authority to act and such actions on behalf of the partnership will be binding upon it. As such, the partnership agreement and/or, separate PR agreement will need to specify what authority the person has, logistics on resignation, successor, etc. plus removal if the person becomes disgruntled or, incapacitated.

Question: Who can be a PR and what are their concerns?
Answer: *Anyone* with a substantial presence in the United States can be a PR, i.e. – it doesn't have to be a partner or, even an employee. It can also be an entity (even a disregarded entity) but, an individual still must be designated. The issues that come up will be that if one partner is better off in default vs push out, then at least one other partner is worse off. The PR will have a fiduciary responsibility and even partners, e.g. – independent trustees, managing members of LLC partners may also have a fiduciary duty that the default regime is in contrast with. Hence, it can be a recipe for disaster or at least, litigation. Therefore, clear guidelines as to what will be done and when with some flexibility, may alleviate both the litigation concerns and reticence that someone may have in taking on the PR responsibilities. Also, Directors & Officers ("D&O") insurance may be insisted on for the PR to accept the position.

Question: What other issues should the partnership or partners consider or be concerned with?
Answer: Every partnership is different and none of these amendments will be cookie-cutter or straight forward. Under the CPAR, you may want to consider having a percentage threshold that if the adjustment is below such, then the partnership will be in the default regime. If above the threshold, then the partnership will make the push out election. This may ease concerns with changes within the partners both coming and going or percentage fluctuations between years.

Question: Why does this need to be addressed by March 15, 2019?
Answer: For calendar year partnerships, agreements need to be amended by March 15th of the following year to be retroactively effective to January 1st of the prior year.

Question: Shouldn't our corporate attorney be able to provide us with the amendment that we need?
Answer: First, this may take significant time to determine what the partnership prefers in the agreements regarding the restrictions on the PR and potential quantifications regarding the default regime or push out election. Additionally, you will need time to get sign-offs to the amendment and an agreement with the PR. Finally, most attorneys will not have experience in dealing with the new CPAR. It could be that even a relatively small partnership may need months to address all of the issues and find a competent attorney familiar with the regime. If they have time by then that is.

For more insight on these regulations, please contact your Anchin Relationship Partner or a member of Anchin's Tax Department.

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