

Congress looks to fix new partnership audit rules

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Introduction

What might change?

Comment

Introduction

The Bipartisan Budget Act of 2015 fundamentally changed the rules by which partnerships and entities taxed as partnerships interact with the Internal Revenue Service (IRS) in an audit or litigation (for further details please see "[Congress enacts new tax examination and collection regime for partnerships](#)"). The Bipartisan Budget Act repealed the 30-year-old Tax Equity and Fiscal Responsibility Act of 1982 partnership audit regime, creating uncertainty within the partnership tax community. Many practitioners have since expressed concern that the Bipartisan Budget Act partnership audit rules are unclear and unworkable, and impose 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 to provide technical corrections to the Bipartisan Budget Act partnership audit rules (along with technical corrections to other provisions in the code). The Tax Technical Corrections Act has bipartisan support, may pass in early 2017 and embodies Congress's response to concerns regarding the new partnership audit rules.

What might change?

Tiered structures (upper-tier partners)

The Tax Technical Corrections Act addresses concerns regarding the 'push-out' method when a partnership, dealing with an imputed underpayment, pushes out adjustments to partners which themselves may be partnerships. Under the 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 authorised the treasury secretary to issue regulations relating to certain special situations – expressly defined to include foreign partnerships – carving them out of the new regime or applying additional or distinct rules to them.

Pull-in method

The Tax Technical Corrections Act adds one further option to the Bipartisan Budget Act'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 Tax Technical Corrections Act clarifies that where a partner elects to file an amended return or follows

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the 'pull-in' procedure, the statutes of 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 Tax Technical Corrections Act clarifies that items of a different character (eg, 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 Tax Equity and Fiscal Responsibility Act rules.⁽²⁾

Partnership-related items

The Tax Technical Corrections Act 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 Bipartisan Budget Act rules is broader than the prior Tax Equity and Fiscal Responsibility Act rules and covers items described as partnership items, affected items and computational items under the Tax Equity and Fiscal Responsibility Act.

Congress may enact some technical corrections to the Bipartisan Budget Act 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.

Comment

Clients should review their partnership agreements to ensure that those agreements take into consideration the new concepts reflected in the Bipartisan Budget Act and Tax Technical Corrections Act. The Tax Technical Corrections Act makes clear that the Bipartisan Budget Act 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.

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Endnotes

(1) Senate Finance Committee member John Thune (R-SD) 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 (December 8 2016).

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

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