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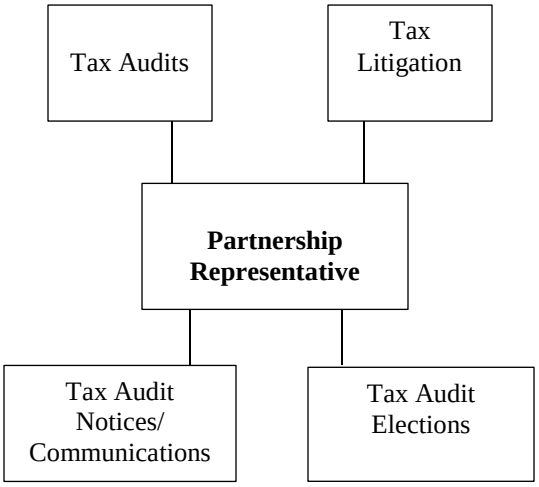
## I. "WHAT ME WORRY"[1]

### A. Overview.

1. The New Audit Rules. The new partnership audit rules (the "new audit rules") were enacted to address the perceived problems audits created by the TEFRA regime. They will likely result in more partnership tax audits and more tax revenues collected from partnership and partners. For purposes of this paper, all references to partnerships and partners include limited liability companies taxed as partnerships for federal tax purpose and their members treated as partners for federal income tax purpose.

The audit rules are extremely complicated and will require more elaborate partnership provisions than required under the TEFRA regime. Partnership advisors will need to spend substantial time with their clients explaining the new audit rules and the decisions that need to be made before amending partnership agreements to problems created by these rules.

2. The Partnership Representative. The partnership representative is the central figure in the new audits rules. The partnership representative is given the sole authority to make elections and to represent and to bind the partnership (and the partners) in all administrative and court proceedings involving adjustments to the partnership's federal income tax return. The partnership representative's authority to deal with the IRS, Chief Counsel and Justice Department is absolute regardless of any contrary provisions of the partnership agreement or state law.




a. The new audit rules require every partnership to designate a partnership representative on its federal income tax return for each tax year beginning after December 31, 2017. For partnership tax years beginning before January 1, 2018, the pre-2018 audit rules continue to apply.

b. All notices and communications involving federal income tax audits will only be sent to the partnership representative. The partners have no right to participate in the audit.

c. The partnership representative can make an annual election out of the new audit rule.

[1] Alfred E. Neuman, the fictional mascot of Mad Magazine

3. Partnership Level Determination and Payment of Income Tax.

a. The new audit rules provide a default rule for the determination and payments of partnership related income tax:

(1) Partnership income tax audits will be conducted at the partnership level; and

(2) Any resulting income tax will be paid by the partnership and not by the partners.

b. There are two exceptions to the default rule:

(1) The "election out" by which an eligible partnership can elect to have audits conducted and tax liability paid at the partner level; and

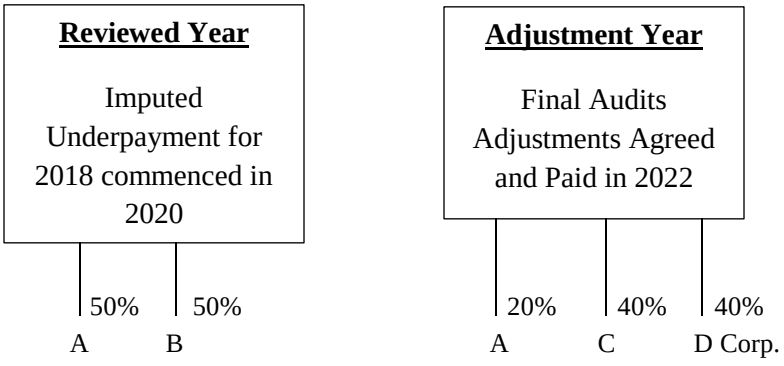
(2) The "push-out lection" by which the partnership representative requires each partner to report its share of any audit adjustments on the partner's return and to pay any result income tax liability.

c. All income tax adjustments affecting the partnership and the partners are subject to the new rules.

d. The partnership level income tax liability resulting from an IRS audit (the "imputed underpayment") including penalties and interest will be determined, assessed and collected from the partnership for the tax year in which the adjustments become final the "adjustment year" and not in the year that was audited the "reviewed year".

(1) If the partners in the two years are not the same, this rule will shift the economic consequences of paying the imputed underpayment from the reviewed year partners to the adjustment year partners.

(2) Illustration.




e. The imputed underpayment is determined by multiplying the net adjustments for the reviewed year by the highest corporate or individual income tax rate in effect for the reviewed year. To the extent the imputed underpayment income tax rate is higher than the partners' income tax rates, the overall tax paid will be higher than under the pre-2018 rules.

(1) The imputed underpayment may be reduced by certain limited modifications, if information supporting those modifications is submitted to the IRS by the partnership representative.

(2) The partnership representative may elect to shift the income tax liability resulting from the audit adjustments from the partnership to the reviewed year partners (the "push-out election"). In that case, the reviewed year partners must report the final audit adjustments on their individual return and compute and pay any resulting income tax liability.

f. All amendments or corrections of partnership returns and requests for refunds will now be addressed by an Administrative Adjustment Request (an "AAR") instead of an amended partnership tax return.

**B. Why All Partnership and LLC Agreements Should Be Amended.**

1. Timing. The partnership representative must be designated annually on the partnership income tax return starting with the first tax year beginning after December 31, 2017. The due date for calendar year 2018 partnership tax returns is March 15, 2019 or September 15, 2019 with an extension. While though it is unlikely that a post-2017 partnership return will be audited prior to 2020 or 2021, the designation of the partnership representative is required by the time the 2018 return is filed. Therefore, the provision governing the partnership representative should be in place at the time of the designation.

2. Rules Governing Partnership Representative. The new rules vest exclusive authority for partnership audits and partnership tax litigation communications, actions, representation and elections in the partnership representative. The partnership agreement should address:

(a) The designation, resignation and removal of the partnership representative;

(b) The authority, restrictions, obligations, indemnification, duties and standard of care owed by the partnership representative to the partnership and to the partners;

(c) The obligations and responsibilities owed to the partnership representative by the partnership and by the partners;

(d) The anomaly of a partnership representative who has resigned or been removed under the terms of the partnership agreement, but has not resigned or been removed for purposes of the new audit rules effective resignation or (resignation or revocation is permitted only after the commencement of an audit or the filing of an AAR); and

(e) The partnership representative's authority to incur audit and litigation costs and fees on behalf of the partnership.

3. Election Out. The partnership agreement should contain rules governing:

(a) The decision to elect out of the new audit rules;

(b) Whether ineligible partners may be admitted to the partnership; and

(c) Whether there are any penalties or other consequences if a partnership interest is transferred to an ineligible partner.

(d) If a partnership doesn't qualify for the election out, consider whether it is preferable to

operate as an S corporation; or whether the ownership by ineligible partners should be restructured.

4. Imputed Underpayments and Modifications. The partnership agreement should contain rules governing:

(a) Whether the partnership representative can direct the review year partners to file amended returns so the partnership qualifies for the "amended return modifications" to an imputed underpayment;

(b) The consequences of a partner's failure to provide the necessary modification information and certificates requested by the partnership representative; and

(c) The partnership representative's ability to request the division of a single imputed underpayment into multiple imputed underpayments.

5. Push-Out Election. The partnership agreement should contain rules for determining:

(a) When a push-out election is made; and

(b) Whether it should be made for all imputed underpayments or specific imputed underpayments.

6. Economic Distortion Provisions. The partnership agreement should contain provisions addressing:

(a) The economic distortion arising when the reviewed year partners are not the same as the adjustment year partners;

(b) The liability for the imputed underpayment when the partnership ceases to exist; and

(c) The partners' obligations to make capital contributions to pay their share of the imputed underpayment.

7. Administrative Adjustment Requests. The partners should contain rules addressing who decides when and whether to file an AAR.

## II. ELECTION OUT OF NEW PARTNERSHIP AUDIT RULES

### A. Making the Election.

1. The election out is made on a timely filed partnership tax return.[2]

2. A separate election must be made for each partnership tax year.

3. The election must include the name and taxpayer identification number of each partner S corporation shareholders for an S corporation partner and an affirmative election out statement. [3]

[2] *See* IRC § 6221(b)(1)(D)(i); Prop. Reg. § 301.6221(b)-1(c)(1).

[3] *See* IRC § 6221(b)(1)(D)(ii); Prop. Reg. §301.6221(b)-1(c)(2).

4. The partnership must notify all of the partners of the election within 30 days to make this election.[4]

**B. Eligibility to Make the Election.**

1. Eligible partnership with not more than 100 partners can elect out of the centralized audit rules in which case audits.

2. Eligible partners include individuals, C corporations, foreign entities that would be treated as C corporations if they were domestic entities, S corporations and estates of deceased partners.[5] Each shareholder of an S corporation counts toward the 100 partner limitation.[6]

3. Partnerships, trusts, any foreign entity that would not be treated as a C corporations if domestic, disregarded entities and estate of taxpayer other than deceased partners (for example a bankrupt partner's estate) are not included in the list of eligible partners. [7]

4. A partnership with ineligible partners may want to consider requiring those partners to transfer their partnership interests to eligible partners. For example, the partnership may want to prohibit the issuance of partnership interests or the transfer of partnership interests to ineligible partners.

5. The IRS has authority to issue regulations expanding the list of eligible partners, but no such provision was included in the proposed regulations.

**C. Consequences of the Election Out.**

1. The rules for a partnership level determination and payment of tax will not apply for a partnership year.

2. The IRS will be required to audit each individual partner's return for the year and collect the tax from the individual partners.

3. The partnership must nonetheless designate a partnership representative.

## III. PARTNERSHIP REPRESENTATIVE

**A. Designation.**

1. A partnership representative must be designated on the partnership's federal income tax return for each tax year beginning after December 31, 2017. Each designation is only effective only for the year made. [8]

2. The designation remains in effect until:

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[4] *See* IRC § 6221(b)(1)(c); Prop. Reg. § 301.6221(b)-1(c)(3).

[5] *See* IRC § 6221(b)(1)(C).

[6] *See* IRC § 6221(b)(2)(A)(ii).

[7] *See* IRC §§6221(b)(2)(B), (C).

[8] IRC § 6223(a); Prop. Reg. §§ 301.6223-1(a) and (c).

(a) A valid resignation;

(b) A valid revocation; or

(c) An IRS determination of no valid appointment.[9] There doesn't appear to be any requirement in the Code or the proposed regulations that the partnership representative consent to, or even be informed of, of the appointment, although the IRS might determine it is not a valid designation under those facts.

3. The partnership representative designated for the reviewed year might be different than the partnership representative designated for the adjustment year. In that case, it is the reviewed year partnership representative who receives notices and handles the audit even if not affiliated with the partnership at the time of the audit.[10]

**B. Eligibility.**

1. The partnership representative does not have to be a partner. It can be any individual or entity. If an entity is designated, the entity must designate an individual with authority to act for entity the "designated individual".[11]

2. The partnership representative must have a substantial presence in the US and the capacity to act as the partnership representative. Substantial presence means a U.S. street address and phone number, availability during normal business hours, and a U.S. taxpayer identification number.[12]

3. Capacity to act terminates upon death, a court order determining incapacity to act and serve, a court order enjoining the person from acting; incarceration; liquidation or dissolution of a designated entity; or an IRS determination of no capacity to act.[13]

4. The IRS can determine that no designation is in effect if the partnership fails to make a proper designation; the designated individual or entity does not have a US presence or lacks capacity; or there is a resignation or revocation without a designated successor.[14]

**C. Revocation and Resignation.**

1. The proposed regulations contain procedures for the resignation of a partnership representative; the revocation of the designation as partnership representative; and the appointment of a successor partnership representative. If no partnership representative is acting, the IRS has the authority to designate a partnership representative. A notice of any revocation of designation or resignation must be sent to IRS.[15]

2. The resignation of the personal representative or the revocation of a designation will not be recognized unless it is in connection with the filing of an AAR, or after the commencement of an audit for the reviewed year. An AAR may not be filed solely for the purpose of permitting the resignation of the partnership representative or the revocation of the designation.[16] The rationale for these restrictions is to avoid the unnecessary use of IRS personnel to process

[9] Prop. Reg. §301.6223-1(a).

[10] Prop. Reg. § 301.6223-1(c)(3)(1).

[11] Prop. Reg. § 301.6223-1(b)(3).

[12] IRC § 6223(a); Prop. Reg. § 301.6223-1(b)(2).

[13] Prop. Reg. § 301.6223-1(b)(4).

[14] Prop. Reg. § 301.6223-1(f)(2).

[15] Prop. Reg. §§ 301.6223-1(d), (e) and (f).

[16] Prop. Reg. § 301.6223-1(d)(2) and -1(e)(2).

resignations, revocations and designations.[17]

3. An individual partnership representative (or the designated individual for an entity partnership representative) resigns by providing written notice to the IRS and may include the designation of a successor. If no successor is designated and the failure continues for 30 days from an IRS notice of no personal representative, the IRS will designate a successor for that year.[18]

4. The revocation of the designation must be signed by a person or entity who was general partner as of the close of the year for which the designation is effective. If the revocation does not name a successor, it will not be effective.[19]

5. The resignation or revocation will be effective 30 days after the IRS's receipt of the notice designating a new partnership representative or designated individual.[20]

### D. Authority of Partnership Representative or Designated Individual.

1. The partnership representative has the sole authority to act for the partnership for federal income tax purposes with respect all matters relating to the new audit rules, including but not limited to elections under the new audit rules; matters arising from the audit; the audit proceedings, including receiving notices of the commencement of an audit and requests for information; providing information to the IRS with regards to the audit; meeting with IRS personnel to discuss and settle the audit; extending the statute of limitations for the partners and the partnership; binding the partnership and the partners to a settlement with respect to the audit matters; electing not to contest the notice of final partnership adjustments in court or to contest all or any portion of the matter in court and to choose the court forum; filing an election out; making decisions regarding the payment of the imputed underpayment; making a push-out election; entering into a closing agreement with the IRS; requesting multiple imputed underpayments; filing an ARR; and deciding whether to settle with IRS appeals or to settle litigation and whether to appeal an adverse court decision.[21]

2. The partners have no rights to participate in the audit or even to receive information regarding the audit under the new audit rules.

3. For purpose of the new audit rules, the partnership representative's authority is absolute and binding on the partnership and the partners, notwithstanding anything to the contrary in the partnership agreement or the provisions of applicable state law.[22] In other words, the IRS doesn't have to deal with anyone except the partnership representative notwithstanding any provision in the partnership agreement to the contrary. Nonetheless, the partnership agreement should be able to impose restrictions and limitations on the partnership representative actions that will give rise to contract or tort claims against the partnership representative even if such provisions are not binding on the IRS.

## IV. PARTNERSHIP ITEMS SUBJECT TO NEW AUDIT RULES

### A. Partnership Income Tax Matters.

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[17] See Preamble at 4.B (p.57)

[18] Prop. Reg. §§ 301.6223-1(d)(1) and (f)(1).

[19] Prop. Reg. § 301.6223-1(e)(1).

[20] Prop. Reg. § 301.6223-1(d)(1) and -1(e)(1).

[21] IRC § § 6223(a) and 6231(a); Prop. Reg. § 301-6223-2(c)(1) and (2); and Prop. Reg. § 6227-1(c).

[22] Prop. Reg. § 301.6223-2(c) and -2(d), Example 1; and Preamble 4.F (p. 66).

1. All income tax matters relating to the partnership's activities including the determination and amount of items of partnership income, gain, deduction and credit, and the character, timing, source and amount of those items.[23]

2. All income tax matters relating to partnership status, partnership contributions and distributions, partnership allocations, the partnership's tax bases, capital accounts and values of assets, the amount and character of partnership activities, the amount, character and allocation of partnership liabilities, partnership elections, transactions between a partnership and any partner, guaranteed payments, and partnership terminations.[24]

**B. Partner Income Tax Matters.**

1. All income tax matters relating to the partners' distributive shares including shares of partnership income, gain, deduction, and credit, and the validity of partnership allocations.

2. All income tax matters relating to the partner's interest in the partnership, including tax basis, share of liabilities, capital accounts and character of gain or loss.[25]

## V. COMPUTING AND PAYING THE IMPUTED UNDERPAYMENT

**A. The Notice of Proposed Partnership Adjustments ("NOPPA") and the Notice of Final Partnership Adjustments ("FPA").**

1. A partnership income tax audit is commencing by the IRS send an examination notice, requests for information and/or requests for meetings to the partnership representative identifying the tax year(s) being audit.

2. After the audit is completed, a NOPPA will be sent to the partnership representative. The NOPPA will include the examination report and the calculation of the imputed underpayment.[26]

3. The imputed underpayments results in the maximum amount due from the NOPPA adjustments. The imputed underpayment may be reduced by the modifications described in Section VI below.

4. After any modifications to the imputed underpayment, the IRS will send the FPA to the partnership representative. The FPA has the same effect as a notice of deficiency. It starts the 90 day period which the IRS is prohibited from assessing and collecting the imputed underpayment and during which the partnership can either pay the imputed underpayment or contests the adjustments in court.

**B. Computation of Imputed Underpayment.**

1. The imputed underpayment is determined by multiplying the total net adjustment by the highest tax rate for the reviewed year under IRC §§ 1 or 11.[27]

2. The total net adjustment is determined by first allocating the examination adjustments to the

[23] IRC § 6221(a); Prop. Reg. § 301.6221(a)-1(a).

[24] Prop. Reg. § 301.6221(a)-1(b)(1).

[25] Prop. Reg. § 301.6221(a)-1(b)(2).

[26] Code § 6231 and Prop. Reg. § 301.6225-1(a).

[27] IRC § 6225(b)(1); Prop. Reg. § 301.6225-1(c).

proper group. All adjustments are assigned to either the reallocation group; the credit group; or the residual group.

a. The reallocation group is for adjustments resulting from the reallocation of partners' distributive shares.

b. The credit group is for adjustments resulting to partnership credits.

c. The residual group is for any adjustment not assigned to credit group and reallocation group.[28]

3. The adjustments allocate to each group are further divided into subgroups. The objective of these grouping and subgrouping is to give effect to character differences, holding period differences, limitations or restrictions provided in the Code and to prevent reallocations from one partner to another from offsetting each other.[29] For example, a capital gain adjustment in the residual group will be allocated to a different subgroup than an ordinary income adjustment in the residual group. Similarly, an adjustment reallocating a depreciation deduction from Partner Ann to Partner Sue will result separate reallocation subgroup adjustment for Partner Ann and a separate reallocation subgroup adjustment for Partner Sue.

4. The adjustments within each subgroup within a group are netted together. For these purposes, any adjustment that increases gain is treated as an increase in income; any adjustment that decreases gain is treated as a decrease in income; any adjustment that increases loss is treated as a decrease in income; and any adjustment that decreases loss is treated as an increase in income. If a subgroup has a net positive adjustment it is then netted with the net positive adjustments from other subgroups in the same group to determine a net positive adjustment for the group. The net positive adjustment for each group is then netted with the net positive adjustment from the other groups to determine the total netted partnership adjustment. Net non-positive adjustments in any group or subgroup are disregarded for purposes of this calculation and do no reduce the total netted partnership adjustment.[30]

5. The IRS has the authority, to compute and the partnership representative may request separate imputed underpayments for separate groups or subgroups. Separate imputed underpayments permit the partnership representative to minimize the tax liability for the partnership and/or the partners. For example, multiple imputed underpayments would permit the partnership representative to make a push-out election for one or more specific imputed underpayments and not for the general imputed underpayment.[31]

6. If the adjustments do not create an imputed u nderpayment (for example a net overpayment) they are taken into account by the partners in the adjustment year.[32]

**C. Effect on Partners' Tax Basis and Capital Accounts.**

1. Any payment of an imputed underpayment is treated as an IRC § 705(a)(2)(B) non-deductible, non-capitalized expenditure allocable to the adjustment year Partner.[33]

2. Adjustments resulting in an imputed underpayment are treated as tax- exempt income under

[28] Prop. Reg. § 301.6225-1(d)(2).

[29] Prop. Reg. § 301.6225-1(d)(2)(v).

[30] Prop Reg. § 301.6225-1(d)(3)(ii).

[31] Prop. Reg. § 301.6225-4(f), Ex. (5) and Preamble to Proposed Regulations 5.B(ii)(p34).

[32] Prop. Reg. §§ 301.6225-1(b) and 301.6225-3.

[33] IRC § 6241(4).

705(b)(1)(B) in the adjustment year for purposes computing the partners tax bases and capital accounts in the Adjustment Year.[34]

**D. Examples for Calculating Imputed Underpayments.**

1. Example 1. Partnership reported on its 2019 reviewed year partnership return ordinary income of $300, long-term capital gain of $125, long-term capital loss of <$75>, a depreciation deduction of <$100>, and a tax credit that can be claimed by the partnership of $5. In 20211 IRS institutes an audit for the reviewed year and issues a NOPPA that determines ordinary income of $500 ($200 adjustment), long-term capital gain of $200 ($75 adjustment), long-term capital loss of <$25> ($50 adjustment), a depreciation deduction of <$70> ($30 adjustment), and a tax credit of $3 ($2 adjustment).

(a) The tax credit is in the credit grouping.

(b) The remaining adjustments are part of the residual grouping.

(c) The adjustment to ordinary income and the depreciation deduction are grouped together in an ordinary subgrouping within the residual grouping and netted with each other because they are both ordinary in character and neither is subject to differing restrictions or limitations.

(d) For purposes of netting, the decrease in the depreciation deduction is treated as an increase in income of $30 (depreciation adjustment treated as increase in income) yields $230 of additional income in the ordinary subgrouping within the residual grouping.

(e) For similar reasons, the adjustments to long-term capital gain and long-term capital loss are grouped together in a long-term capital subgrouping within the residual grouping and netted with each other. For purposes of netting, the decrease in capital loss is treated as an increase in income of $50.

(f) Thus, $75 (long-term capital gain adjustment) plus $50 (long-term capital loss adjustment) yields $125 of additional income in the long-term capital subgrouping within the residual grouping.

(g) With respect to the ordinary subgrouping, the $230 adjustment of ordinary income is a net positive adjustment for that subgrouping and is added to the $125 of additional income in the long-term capital subgrouping, for a total netted partnership adjustment $355.

(h) The total netted partnership adjustment is multiplied by 40 percent (highest tax rate in effect), which results in $142.

(i) The $142 is increased by the $2 credit adjustment, resulting in an imputed underpayment of $144.

2. Example 2. Partnership reported on its 2019 reviewed year partnership return long-term capital gain of $125 and long-term capital loss of <$75>. IRS initiates an audit with respect to the reviewed year and issues a NOPPA that determines long-term capital gain should have been reported as ordinary income of $125, resulting in an increase of ordinary income of $125 ($125 adjustment) as well as a decrease of long-term capital gain of $125 (<$125> adjustment).

(a) These adjustments are part of the residual grouping, but are in a separate subgrouping because of their different character, that is, the increase in ordinary income is part of an ordinary subgrouping and the decrease in long-term capital gain is part of a long-term capital subgrouping, both within the residual grouping.

(b) There are no other adjustments for the reviewed year.

(c) The $125 decrease in long-term capital gain is a net non-positive adjustment in the long-

[34] Preamble to Proposed Regulations 5F Notice 2016-23 Comments related to IRC Section 6225.

term capital subgrouping and as a result is an adjustment that does not result in an imputed underpayment.

(d) The $125 increase in ordinary income results in a net positive adjustment.

(e) Because the ordinary subgrouping is the only subgrouping resulting in a net positive adjustment, $125 is the total netted partnership adjustment.

(f) $125 is multiplied by 40 percent resulting in an imputed underpayment of $50.

3. Example 3. Partnership reported a $100 deduction for certain expenses on its 2019 partnership return and a $100 deduction with respect to the same expenses on its 2020 partnership return. IRS institutes an audit to partnership's 2019 and 2020 taxable years and determines that partnership improperly accelerated accrual of a portion of the expenses with respect to deduction in 2019 that should have been taken into account in 2020.

(a) Therefore, for taxable year 2019, the IRS determines that partnership should have reported a deduction of $75 with respect to the expenses ($25 adjustment) in 2019. However, for 2020, the IRS determines that partnership should have reported a deduction of $125 with respect to these expenses (<$25> adjustment). There are no other adjustments for the 2019 and 2020 partnership taxable years.

(b) The adjustments for 2019 and 2020 are not netted with each other.

(c) The 2019 adjustment of $25 is multiplied by 40 percent resulting in an imputed underpayment of $10 for partnership's 2019 taxable year.

(d) The $25 increase in the deduction for 2020 is an adjustment that does not result in an imputed underpayment. Therefore, there is no imputed underpayment for 2020.

4. Example 4. On its partnership return for the 2020 taxable year, partnership reported ordinary income of $100 million and a capital gain of $50 million. Partnership had four equal partners during the 2020 tax year, all of whom were individuals. On its partnership return for the 2020 tax year, the capital gain was allocated to partner E and the ordinary income was allocated to all partners based on their interests in the partnership.

(a) IRS initiates an audit for 2020 and determines that for 2020 the capital gain allocated to E should have been $75 million instead of $50 million and the partnership should have recognized and additional $10 million in ordinary income.

(b) In the NOPPA mailed by the IRS, the IRS may determine that there is a general imputed underpayment with respect to the increase in ordinary income and a specific imputed underpayment with respect to the increase in capital gain especially allocated to E.

## VI. MODIFICATIONS OF THE IMPUTED UNDERPAYMENT

### A. Amended Return Modifications.

1. The imputed underpayment may be reduced (modified) if a reviewed year partner files an amended return for the reviewed year reporting the partner's share of all the adjustments set forth in the NOPPA and pays the resulting tax, penalties and interest. The amended return must be for the reviewed year and any affected intervening years. The amended return must be filed within 270 days of the date the partnership received the NOPPA and the resulting additional tax paid. If these conditions are satisfied and the partnership representative provides substantiation supporting the request, the imputed underpayment will be calculated without regard to the portion of the adjustment reported on the partner's return.[35]

[35] IRC § 6225(c); Prop. Reg.§ 301.6225-2.

2. The amending partners must provide the partnership representative with an affidavit under penalty of perjury that the amended return has been filed and all taxes, interests and penalties have been paid.[36]

3. If the adjustment results from a reallocation of distributive shares of income, gain, loss, deduction or credit among the reviewed year partner, all affected reviewed year partners must file amended returns to qualify for the amended return modification.[37]

**B. Tax-Exempt Partner Modifications.**

1. The partnership representative may request a tax exempt partner modification within 270 days after receipt of the NOPPA for any portion of the imputed underpayment allocable to a tax exempt partner.

2. The partnership representative must be able to demonstrate that the tax-exempt partner would not owe tax with respect that portion of the adjustment.[38]

**C. Tax Rate Modifications.**

1. The partnership representative may request a tax rate modification within 270 days after the receipt of the NOPPA to the extent the portion of the imputed underpayment allocable to a C corporation partner would result in a lower marginal tax rate or any portion of the imputed underpayment allocable to an individual partner would qualify for a lower capital gain or qualified dividend tax rate.[39]

2. The partnership representative must be able to demonstrate that the lower marginal tax rate will apply to the partner.

3. No other tax rate modification is permitted. If a partner's tax rate would be lower if the adjustments were reported on the partner's tax return, the amended return modification is the only method for mitigating this difference.[40]

## VII. CONSISTENCY REQUIREMENT

A. Partners must treat all partnership items consistent with the partnership's treatment.[41]

B. IRS may assess and collect any underpayment of tax resulting from an inconsistency as a mathematical or clerical error, which can be assessed and collected without the normal deficiency procedures and without any request for an abatement of assessment.[42]

C. A partner can avoid the consistency requirement if the partner files a statement with the IRS identifying the

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[36] Prop. Reg.§ 301.6225-2(d)(2).

[37] Prop. Reg.§ 301.6225-2(d)(2)(vi) and (vii).

[38] IRC § 6225(c)(3).

[39] IRC § 6225(c)(4).

[40] Prop. Reg.§ 301.6225-2(d)(4).

[41] IRC § 6222(a); Prop. Reg. § 301.6222-1(a)(1).

[42] IRC §§ 6222(b) & 6213(b)(2).

inconsistency.[43]

D. The consistency rules apply even if the partnership elected out of the centralized audit rules.[44]

## VIII. PUSH-OUT ELECTION

### A. Consequences of Push-Out Election.

1. The push-out election permits the partnership to shift the responsibility for paying the imputed underpayment, penalties and interest from the partnership to the reviewed year partners.[45]

2. The push-out election requires the reviewed year partners to compute the "additional reporting year tax".

a. The additional reporting year tax is the reviewed year partners' increased tax liability, plus penalties and interest (the "aggregate adjustment amounts") resulting from including each partner's share of the adjustment in the FPA on its tax return for the reviewed year (the "correction amount for the first affected year") and each intervening year (the "correction amounts for the intervening years").[46]

b. The additional reporting year tax is then included on the reviewed year partner's tax return for the tax year that includes the date that the push-out election was furnished to the reviewed year partners (the "reporting year").[47]

c. If the correction amount for any year is negative (i.e. an overpayment), it cannot reduce any other correction amount or tax due.[48] This limitation can result in the push-out election may an overall higher income tax liability for the partners unless amended return modifications recognize the overpayments.

3. The reviewed year partner can elect to pay the aggregate additional adjustment amounts or the "safe harbor amount".[49] The safe harbor amount is essentially the reviewed year partner's share of the imputed underpayment.[50]

4. The interest rate for the additional tax due resulting from a push-out election is 2% higher than the interest rate due for the imputed underpayment.[51]

5. The push-out election is one mechanism to address the economic distortions caused by difference in the identifying or sharing ratios of the reviewed year partners and the adjustment year partners.

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[43] IRC § 6222(c); Prop. Reg. §301.6222-1(c).

[44] Prop. Reg. § 301.6222-1(a)(2).

[45] IRC § 6226; Prop. Reg. §301.6226-1.

[46] Prop. Reg. §301.6226-3(b)(2)).

[47] IRC § 6226(b); Prop. Reg. §301.6226-3(a).

[48] Prop. Reg. § 301.6226-3(b)(1).

[49] Prop. Reg. § 301.6226-3(a).

[50] Prop. Reg. § 301.6226-2(g)(2)(i).

[51] Code § 6226(c)(2).

6. The impact of the push-out election on tax basis and capital accounts is reserved in the proposed regulations, but is likely to impact those items in the same manner as the adjustments used to compute the imputed underpayment.

**B. Making the Push-Out Election.**

1. The partnership representative must file the push-out with the IRS within 45 days of the FPA (without extension).[52]

2. The partnership representative must a push-out election statement to each reviewed year partner and to the IRS not later than 60 days after the earlier of (1) expiration of time to file a petition for a court review or (2) the date the court's decision is final.[53]

3. The push-out election statement must contain each reviewed year partner's share of the adjustment items as originally reported, the changes to such items, changes to any tax attributes that could affect intervening years, each partner's share of penalties and the partner's safe harbor amount.[54]

4. The IRS will notify the partnership and the partnership representative within 30 days of a determination that a push-out election is invalid. In that case, the partnership level imputed underpayment rules apply. [55]

**C. Push-Out Election Examples.**

1. Example 1. On its partnership return for the 2020 tax year, partnership reported ordinary income of $1,000 and charitable contributions of $400. On June 1, 2023, the IRS mails a notice of final partnership adjustment (FPA) to partnership for partnership's 2020 year disallowing the charitable contribution in its entirety and asserting an imputed underpayment plus a penalty of $32 (a 20 percent accuracy-related penalty under section 6662(b)).

(a) Partnership makes a timely election under section 6226 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments.

(b) The Tax Court determines the Partnership is not entitled to any of the claimed $400 in charitable contributions and upholds the penalty of $32. The decision regarding the Partnerships' 2020 tax year becomes final on December15, 2025. The partnership adjustments are finally determined on December 15, 2025.

(c) On February 1, 2026, partnership files the statements required with the IRS and furnishes to partner A, an individual who was a partner in partnership during 2020, a required statement. A had a 25 percent interest in partnership during all of 2020 and was allocated 25 percent of all items from partnership for that year.

(d) The statement shows A's share of ordinary income reported on partnership's return for the reviewed year of $250 and A's share of the charitable contribution reported on partnership's return for the reviewed year of $100.

(e) The statement also shows no adjustment to A's share of ordinary income, but does show an adjustment of A's share of the charitable contribution, a reduction of $100 resulting in $0 charitable contribution allowed to A from Partnership for 2020.

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[52] IRC § 6226(a)(1); Prop. Reg. § 301.6226-1(c)(3).

[53] IRC § 6226(a)(2); Prop. Reg. §§ 301.6226-2(a) and (b).

[54] Prop. Reg. § 301.6226-2(e).

[55] Prop. Reg. § 301.6226-1(c)(2).

(f) In addition, the statement reports $8 as A's share of the penalty (25 percent of $32) related to the imputed underpayment resulting from the denial of the charitable contribution. The statement also shows A's safe harbor amount and interest safe harbor amount.

(g) A does not elect to pay the safe harbor amount and therefore must pay the additional reporting year tax and A's share of the penalty and interest.

(h) A computes his additional reporting year tax as follows:

(1) A determines the correction amount for the first affected year (the 2020 taxable year) by taking into account A's share of the partnership adjustment (<$100> reduction in charitable contribution) for the 2020 taxable year.

(2) A determines the amount by which his chapter 1 tax for 2020 would have increased if the $100 adjustment to the charitable contribution from Partnership were taken into account for that year. There is no adjustment to tax attributes in A's intervening years as a result of the adjustment to the charitable contribution for 2020, A's first affected year.

(3) In addition to the aggregate of the adjustment amount being added to the chapter 1 tax that A owes for 2026, the reporting year, A's tax liability for 2026 includes the $8 penalty and any interest on the correction amount for the first affected year and the penalty.

(4) Interest on the correction amount for the first affected year runs from April 15, 2021, the due date of A's 2020 return (the first affected tax year) until A pays this amount. In addition interest runs on the $8 penalty from April 15, 2021, the due date of A's 2020 return for the first affected year until A pays this amount.

(5) On his 2026 income tax return, A must report the additional reporting year tax which is the correction amount for the 2020, plus A's share of the accuracy-related penalty determined at the partnership level of ($8), and interest on the correction amount of 2020 and the penalty.

2. Example 2. The facts are the same as in Example 1, except that A makes the elections to pay the safe harbor amount and interest safe harbor amount. In addition to the safe harbor amount and the interest safe harbor amount, A must also pay the $8 penalty allocated to A on the statement. Therefore, on his 2026 income tax return, A must report the additional reporting year tax (in this case, the safe harbor amount), the penalty of $8, and the interest safe harbor amount.

3. Example 3. On its partnership return for the 2020 tax year, partnership reported an ordinary loss of $500 million. In June 1, 2023, the IRS mails an FPA to partnership for the 2020 year determining $300 million of the $500 million in ordinary loss should be recharacterized as long-term capital loss. Partnership has no long-term capital gain for its 2020 tax year.

(a) The FPA for partnership's 2020 tax year reflects an adjustment of an increase in ordinary income of $300 million (as a result of the disallowance of the recharacterization of $300 million from ordinary loss to long-term capital loss) and an imputed underpayment related to that adjustment, as well as an adjustment of an additional $300 million in long-term capital loss of 2020 which does not result in an imputed underpayment.

(b) Partnership makes a timely election under section 6226 with respect to the imputed underpayment in the FPA and does not file a petition for readjustment under section 6234.

(c) Accordingly, the adjustment year partners do not take into account the $300 million long-term capital loss that does not result in an imputed underpayment. Rather, the reviewed year partners will take into account the $300 million long-term capital loss.

(d) The time to file a petition expires on August 30, 2023 and the partnership adjustments become finally determined on August 30, 2023.

(e) On September 30, 2023, partnership files with the required statements with the IRS and furnishes required statements to all of its reviewed year partners.

(f) One partner of partnership in 2020, B (an individual), had a 25 percent interest in partnership during all of 2020 and was allocated 25 percent of all items from partnership for that year.

(g) The statements filed with the IRS and furnished to B shows B's allocable share of the ordinary loss reported on partnership's return for the 2020 taxable year as $125 million. The statement also show an adjustment to B's allocable share of ordinary loss in the amount of <$75 million>, resulting in a corrected ordinary loss allocated to B of $50 million for taxable year 2020 ($125 million originally allocated to B less $75 million which is B's share of the adjustment to the ordinary loss).

(h) In addition, the statement shows an increase to B's share of long-term capital loss in the amount of $75 million (B's share of the adjustment that did not result in the imputed underpayment with respect to partnership). The statement also shows B's safe harbor amount and interest safe harbor amount.

(i) B does not elect to pay the safe harbor amount and therefore must pay the additional reporting year tax.

(j) B computes his additional reporting year tax as follows.

(1) First, B determines the correction amount for the first affected year (the 2020 taxable year) by taking into account B's share of the partnership adjustments (a $75 million reduction in ordinary loss and an increase of $75 million in capital loss) for the 2020 taxable year. B determines the amount by which his chapter 1 tax for 2020 would have increased if the $75 million adjustment to ordinary loss and the $75 million adjustment to capital loss form partnership were taken into account for that year.

(2) Second, B determines if there is any increase in chapter 1 tax for any intervening year as a result of the adjustment to the ordinary and capital losses for 2020. B's aggregate of the adjustment amounts is the correction amount for 2020, B's first affected year plus any correction amounts for any intervening years. B is also liable for any interest on the correction amount for the first affected year and for any intervening year.

4. Example 4. On its partnership return for the 2020 tax year, partnership reported ordinary income of $100 million and a capital gain of $40 million. Partnership had four equal partners during the 2020 tax year: E, F, G and H, all of whom were individuals. On its partnership return for the 2020 tax year, the entire capital gain was allocated to partner E and the ordinary income was allocated to all partners based on their equal (25 percent) interest in partnership.

(a) The IRS initiates an administrative proceeding with respect to partnership's 2020 taxable year and determines that the capital gain should have been allocated equally to all four partners and that Partnership should have recognized an additional $10 million in ordinary income. No modifications were approved by the IRS and no penalties are imposed.

(b) On June 1, 2023, the IRS mails an FPA to Partnership reflecting the reallocation of the $40 million capital gain so that F. G. and H each have $10 million increase in capital gain and E has a $30 million reduction in capital gain for 2020. In addition, the FPA reflects the partnership adjustment increasing ordinary income by $10 million.

(c) The FPA reflects a general imputed underpayment with respect to the increase in ordinary income and a specific imputed underpayment with respect to the increase to capital gain allocated to F, G, and H. In addition the FPA reflects a $30 million partnership adjustment that does not result in an imputed underpayment that is the reduction of $30 million in capital gain with respect to E.

(d) Partnership makes a timely election under section 6226 with respect to the specific imputed underpayment relating to the reallocation of capital gain. Partnership does not file a petition for readjustment under section

6234. The time to file a petition expires on August 30, 2023.

(e) The partnership adjustments become finally determined on August 30, 2023. Partnership timely pays and reports the general imputed underpayment relating to the partnership adjustment to ordinary income.

(f) On September 30, 2023, partnership files with the required statements with the IRS and furnishes required statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA that relate to the specific imputed underpayment, that is, the reallocation of capital gain.

(g) The statement for F, G, and H each reflect a partnership adjustment of an additional $10 million of capital gain for 2020. The statements also show that each partner's safe harbor amount and interest safe harbor amount.

(h) F, G, and H elect to pay the safe harbor amount and interest safe harbor amount. The statement for E reflects a partnership adjustment of a reduction of $10 million of capital gain for 2020. The statement also reflects that E's safe harbor amount, is $0 (<$10 million> multiplied by 40 percent but not less than zero). F elects to pay the safe harbor amount, which is zero.

5. Example 5. On its partnership return for the 2020 taxable year, partnership reported a capital loss of $5 million. During an administrative proceeding with respect to partnership's 2020 taxable year, the IRS mails a notice of proposed partnership adjustment (NOPPA) in which it proposed to disallow $2 million of the reported $5 million capital loss. No penalties are imposed with respect to the $2 million adjustment.

(a) F, a C corporation partner with a 50 percent interest in partnership, received 50 percent of all capital losses for 2020. As part of the modification process F files an amended return for 2020 taking into account F's share of the partnership adjustment ($1 million reduction in capital loss) and pays the tax owed for 2020, including interest.

(b) Also as part of the modification process, F also files amended returns 2021 and 2022 and paid additional tax (and interest) for these years because the reduction in capital loss for 2020 affected the tax due from F for 2021 and 2022. The reduction of the capital loss in 2020 did not affect any other taxable year of F.

(c) The IRS approves the modification with respect to F and on June 1, 2023, mails an FPA to partnership for partnership's 2020 year reflecting the partnership adjustment reducing the capital loss in the amount of $2 million.

(d) The FPA also reflects the modification to the imputed underpayment based on the amended returns filed by F taking into account F's share of the reduction in the capital loss.

(e) Partnership makes a timely election under section 6226 with respect to the imputed underpayment in the FPA for partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments. The Tax Court upholds the determinations in the FPA and the decision regarding partnership's 2020 tax year becomes final on December 15, 2025. The partnership adjustments are finally determined on December 15, 2025.

(f) On February 1, 2026, partnership files the statements described in §301.6226-2 with the IRS and furnishes to its partners statements reflecting their shares of the partnership adjustment. The statement issued to F reflects F's share of the partnership adjustment for partnership's 2020 taxable year as finally determined by the Tax Court. The statement shows F's share of the capital loss reported on partnership's return for the reviewed year of $1 million and the $1 million reduction in capital losses taken into account by F as part of the amended return modification. The statement shows that F's safe harbor amount is $0 ([$1 million adjustment less the $1 million taken into account in the amended return] multiplied by 40 percent). F elects to pay the safe harbor amount, which is zero.

## IX. ADMINSTRATIVE ADJUSTMENTS REQUESTS ("AARs")

### A. Procedures for Amending Partnership Tax Returns.

1. All corrections or adjustment to a partnership tax return for tax years beginning after December 31, 2017 must be accomplished by filing an administrative adjustment request ("AARs") with the IRS. Amended partnership tax returns will no longer be permitted. [56]

2. AARs may be filed with respect to one or more items of income, gain, loss, deduction or credit and any partner's distributive share thereof.[57]

3. AARs cannot be filed more than 3 years after the later of the date the return was filed or the due date of the return including extensions.[58] AARs cannot be filed for any partnership tax year after a notice of administrative proceeding with respect to such year has been mailed by the IRS under Code § 6231. AARs must be filed by the partnership representative on behalf of the partnership.[59]

4. The corrections or adjustments set forth in the AAR are binding all of the partners and subject to the consistency rules.[60]

### B. Consequences of AARs.

1. If the AAR results in an imputed underpayment, the partnership must either (a) pay any resulting imputed underpayment for the tax year in which the AAR is filed, taking into account modifications (other than the amended return modification); or (b) make an election to cause the reviewed year partners to filed amended returns reporting such adjustments in accordance with rules similar to, but not identical to, those applying to push-out elections. [61]

2. If the AAR does not result in an imputed underpayment, each reviewed year partner must report its share of the adjustments in the AAR on an amended return and claim a refund.

### C. Partnership Ceases to Exist.

1. If a partnership is not in existence in the adjustment year, the partnership adjustments are taken into account by the former partners for what would be the adjustment year and the partnership ceases to be liable for any imputed underpayment that would have resulted from such adjustments.[62]

2. The IRS may in its discretion make a determination that a partnership ceases to exist. The IRS may determine that a partnership ceases to exist if the partnership terminates under 708(b)(1)(A)(ceases to carry on a business) or does not have the ability to pay the tax. A partnership does not cease to exist solely because of a 708(b)(1)(B) technical termination, has made a push-out election or has not paid the tax due from an imputed underpayment.[63]

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[56] IRC § 6227(a); Prop. Reg. § 301.6227-1(a).

[57] Prop. Reg. § 301.6227-1(a).

[58] IRC § 622(c); Reg. § 301.6227-1(b).

[59] Prop. Reg. § 301.6227-1(a).

[60] Prop. Reg. 301.6226-1(f).

[61] Prop. Reg. § § 301-6226-2 and -3.

[62] Prop. Reg. 301.6241-3.

[63] Prop. Reg. 301.6241-3.

## X. DRAFTING CONSIDERATIONS: DESIGNATION, REVOCATION AND RESIGNATION OF PARTNERSHIP REPRESENTATIVE.

### A. Method of Designation, Qualifications and Acceptance of Designation

1. The method and criteria for annually selecting the partnership representative should be set forth in the partnership/operating agreement. The designation is made annually on the partnership's income tax return. These rules do not change who has authority to file the partnership income tax return. See Chief Counsel Memorandum 201425001 (June 20, 2014) stating that a Form 1065 that is not signed by a general partner or a limited liability company member manager is not a valid partnership return.

2. Should the partnership representative be identified in the partnership/operating agreement; in a separate service agreement and/or by a vote of the general partner(s), the manager(s), the partners and/or the members?

3. What criteria or qualifications should be used for selecting a partnership representative? The agreement should consider obtaining a certificate from the partnership representative to that effect he/she/it meets the requirements of a US presence.

4. The position should be accepted in writing. The partnership representative should agree to be bound by the terms of the partnership/operating agreement and/or the service agreement.

5. The agreement should address identifying, waiving and/or resolving potential conflicts of interest between the partnership representative and the partners. For example, suppose Ann, the partnership representative, is a partner and the adjustment result from the reallocating income from another partner to Ann. If Ann and the other partner both file amended returns reporting the adjustment, Ann will pay additional tax and the other partner will receive a refund. If Ann doesn't file an amended return, the partnership will pay the imputed underpayment and the other partner will not receive any refund for the excess tax paid.

6. The partnership representative should want to negotiate indemnification, exculpation, and waiver of claims provisions prior to accepting the position.

### B. Term of Appointment; Resignation and Revocation.

1. The agreement should address how long a designation will continue. Should it continue until death, incapacity, resignation or revocation or should a new designation be made annually.

2. Once a designation has been made for a tax year, a revocation or resignation for that year cannot be made prior to the commencement of the audit or the filing of an AAR (AAR cannot be filed solely to effect a resignation or revocation).

a. The agreement should address the anomaly of a resignation or revocation that is not effective for the partnership audit rules, but is effective under the terms of the partnership agreement or state law.

b. The agreement should contain provisions requiring a resigning or revoked partnership representative to designate the successor chosen by the partnership.

c. The agreement should require the resigning or revoked partnership representative to file all necessary forms, agreements and take all actions as directed by the partnership prior to the date the resignation or evocation is effective for purposes of the new audit rules.

## XI. DRAFTING CONSIDERATIONS: AUTHORITY, RESTRICTIONS AND DUTIES OWED BY THE PARTNERSHIP REPRESENTATIVE TO THE PARTNERSHIP AND PARTNERS

### A. Explicit or Implicit Authority; Mandatory or Discretionary Authority.

1. The new audit rules give the partnership representative the sole and exclusive authority vis a vis the IRS (including Chief Counsel and Justice Department) to represent and to bind the partnership and the partners with respect to all matters, decisions and elections related to a federal income tax audit of the partnership.

2. The agreement can provide the partnership representative with a general statement of authority that might reference the new audit rules or the agreement could provide a specific authority reserving to the partnership any authority not granted to the partnership representative. Note: The proposed regulations state that the partnership representative's authority is absolute notwithstanding any provision of the agreement or state law to the contrary. As a matter of contract between the partnership representative and the partnership, the partnership agreement can contain restrictions on the partnership representative that could give rise to a cause of action against the partnership representative.

3. The agreement should specify whether the partnership representative's exercise of authority is mandatory, discretionary and/or conditioned of someone else (such as the general partner, manager, partners or members is required).

4. The agreement should acknowledge and affirm the partnership representative's authority to bind the partnership and the partners in connection with the audit.

### B. Partnership Elections.

1. Should all elections authorized by the new audit rules be mandatory or discretionary? These elections include the election out of the new audit rules and the push out election.

2. Should the partnership representative be required to obtain the consent of the partnership before making these elections?

3. The agreement should specify what information and notices about the audit are required to be provided to the partners.

4. Should the partnership representative have the authority to require partners to provide all necessary information in connection with the audit and to impose penalties or specific performance to obtain the information?

5. Should the partnership representative have the authority to require the partners to file amend returns without filing a push-out election in order to qualify for amended return modifications?

### C. Duties Regarding Information to the Partners.

1. What should be the content and the frequency of the audit information provided by the partnership representative to the partnership and to the partners? Who should receive the information, the general partner/manager and/or the partners/members?

2. Should the partnership representative be required to provide copies of all notices and information received regarding the audit and resulting litigation or should periodic summaries be sufficient?

3. The partnership representative should provide copies of all elections and statements required by new audit rules to the partnership and the partners, including election out and push out elections.

4. The partnership representative should provide timely information regarding AARs to the partners/members.

**D. Economic Distortions.**

1. Should the partnership representative have the authority to correct economic distortions by making corrective allocations and distributions and/or requiring capital calls? Should this authority be mandatory or discretionary?

2. Should the partnership representative have the authority to issue capital calls to pay the imputed underpayments, as well as costs, expenses and fees related to the audit? Should this authority be mandatory or discretionary?

**E. Modifications.**

1. Should the partnership representative have the authority to require reviewed year partners to amend returns to reduce the imputed underpayment? Should the partnership representative have authority to imposed penalties on partners who fail to comply?

2. Should the partnership representative have the authority to require a tax exempt partner to provide information and a certification of tax exempt status in order to establish a tax exempt partner modification? Should the partnership representative have authority to imposed penalties on partners who fail to comply?

3. Should the partnership representative have authority to require corporate and individual partners to provide information and certifications to establish a tax rate modification?

**F. Standard of Care.**

1. Should the partnership representative be bound by fiduciary duties to the partnership and the partners; subject to a business judgement standard; or be required to act in the best interests of the partnership/partners?

2. Should the partnership representative be liable for any adverse result from an audit, negligence, gross negligence, bad faith or willful neglect?

3. Will the partnership provide indemnification and costs of defense for claims made against the partnership representative by the partners, by the IRS or by third parties in connection with the performance of the required duties?

4. Can partnership representative engage and pay experts and professionals to assist with the audit; cause the partnership to pay those costs and fees; and rely on advice of professionals without liability for any resulting damages, costs or losses?

5. Should partnership representative's duties be limited to the express duties identified in the agreement or should it be any duty or authority permitted by new audit rules?

6. Should the agreement require the partnership to purchase "D&O" insurance to protect the partnership representative.

**G. Duty of Confidentiality.**

1. What duties of confidentiality should be imposed on the partnership representative?

2. What exceptions should be set forth in the agreement?

## XII. DRAFTING CONSIDERATIONS: DUTIES OWED TO THE PARTNERSHIP REPRESENTATIVE

**A. Indemnification, Expenses, Costs, Fees, and Compensation.**

1. The partnership should be obligated to indemnify the partnership representative, except for certain specified actions, such as breach of fiduciary duty, negligence, gross negligence, bad faith or willful neglect.

2. The partnership should be obligated to pay for all costs, expenses and fees related to the audit and advance defense fees, costs and expenses in the event the partnership representative is sued.

3. The agreement should provide for compensation to the partnership representative.

**B. Duties to Provide Information and Take Specified Actions.**

1. The partnership and the partners could release and agree not to sue the partnership representative, its officers, directors or affiliates except for specified actions such as breach of fiduciary duty, negligence, gross negligence, bad faith or willful neglect.

2. The partners could be obligated to provide information requested by the partnership representative including individual tax returns and liabilities relevant to its duties.

3. The partners could be required to timely file amended tax returns and to timely pay any tax due.

4. The agreement could specify that the partners will not be released from any from obligations except by the partnership representative in writing and that these obligations will continue after withdrawal or the disposition of their interests.

5. The partners could be required to notify the partnership representative of any inconsistent reporting with the partnership return and of any individual settlement of any partnership item.

6. The agreement could require the partners to commit to satisfy their obligations under a push-out election including timely filing amended returns and paying any taxes due.

**C. Capital Calls and Reserves.**

1. Should the partners be subject to capital calls by the partnership representative to pay the imputed underpayment, correct economic distortions and pay costs, expenses and fees associated with the audit and what penalties should apply for failure to contribute?

2. Should the partnership representative be permitted hold back to pay the imputed underpayment, correct economic distortions and pay costs, expenses and fees associated with the audit?

## XIII. DRAFTING CONSIDERATIONS: MISCELLANEOUS MATTERS

### A. Survival of Partner Duties.

1. Should partner duties continue upon termination of the partnership?

2. Should partner duties continue upon withdrawal of partner or transfer of partnership interest?

### B. Election Out of New Audit Rules.

1. Whether the election out should be filed yearly on Federal partnership tax return (Form 1065).

2. Whether election out is default rule unless a majority or supermajority vote not to make such election on that year's returns.

3. Who has the responsibility to determine if partnership is eligible for the election out.

4. Should the partnership agreement contain restrictions on transfers to ineligible partners?

5. Should ineligible partners be required to transfer the partnership interest to an eligible partner to permit the partnership to make an election out?

### C. Transfers or Sales of Partnership Interests.

1. Should transfer agreements contain warranties and representations about prior tax years?

2. Should the transferor be obligated to indemnify and hold transferee liable for imputed underpayments?

## XIV. DRAFTING CONSIDERATIONS: SAMPLE PROVISIONS

The provisions set forth below are the author's first attempt to address the potential issues existing under the new audit rules. These provisions should be considered as merely a starting point for your drafting. Every situation and every drafter's style will be different. Some partnership will want mandatory provisions requiring the partnership representative to make the election out, the push-out election and to obtain input from the partners in the audit process. Other partnerships will give the partnership representative absolute discretion to make these elections and to guide the audit process. Some partnership agreement will reflect a minimalist approach, while others will contain extensively negotiated partnership audit provisions.

### A. Partnership Representative [Generic Duties and Authority].

For tax years beginning after December 31, 2017, [TBD] is hereby designated as the partnership representative for purposes of federal and state income tax matters.

1. The partnership representative shall have all of the authority, duties and responsibilities as set forth in Code §§ 6221 – 6241 and the regulations thereunder (the "Partnership Audit Rules").

2. The partnership representative must accept such appointment in writing and provide a written confirmation to the partnership that it satisfies the substantial presence requirement of Code § 6223(a) and the regulations thereunder. A tax matters partner/partnership representative shall serve until his, her, or its death, resignation, incapacity, bankruptcy, revocation/removal or a determination by the Internal Revenue Service that the designation is not effective.

3. The partnership representative shall [or may with the consent of [TBD] or may in her sole and absolute discretion] timely file such election forms, statements and other information required by the Partnership Audit Rule (a) to make the election out of the Partnership Audit Rules if the partnership is eligible for such election; and (b) to make the push-out election, for each [any] tax year of the partnership

**B. Partnership Representative [Specific Duties and Authority].**

For tax years beginning after December 31, 2017, [TBD] is the partnership representative for purposes of federal and state income tax matters.

1. The partnership representative shall have all of the authority, duties and responsibilities as set forth in Code §§ 6221 – 6241 and the regulations thereunder (the "Partnership Audit Rules") including but not limited to elections related to an audit; matters arising from the audit; the audit proceedings, including receiving notices of the commencement of an audit and requests for information; providing information to the IRS with regards to the audit; meeting with IRS personnel to discuss and settle the audit; extending the statute of limitations for the partners and the partnership; binding the partnership and the partners to a settlement with respect to the audit matters; electing not to contest the notice of final partnership adjustments in court or to contest all or any portion of the matter in court and to choose the court forum; filing an election out; making decisions regarding the payment of the imputed underpayment; making a push-out election; entering into a closing agreement with the IRS; requesting multiple imputed underpayments; filing an ARR; and deciding whether to settle with IRS appeals or to settle litigation and whether to appeal an adverse court decision.

2. The partnership representative must accept such appointment in writing and provide a written confirmation to the partnership that it satisfies the substantial presence requirement of Code § 6223(a) and the regulations thereunder. A tax matters partner/partnership representative shall serve until his, her, or its death, resignation, incapacity, bankruptcy, revocation/removal or a determination by the Internal Revenue Service that the designation is not effective.

3. The partnership representative shall [or may with the consent of [TBD: general partner, manager, management committee, partners or members, whichever is applicable] or may in her sole and absolute discretion] timely file such election forms, statements and other information required by the Partnership Audit Rule (a) to make the election out of the Partnership Audit Rules if the partnership is eligible for such election; and (b) to make the push-out election, for each [any] tax year of the partnership

**C. Resignation**. A partnership representative may resign at any time by giving written notice to [TBD: manager, general partner, management committee, partners, or members]. The resignation of the partnership representative shall take effect upon the appointment of a successor partnership representative or at such other time agreed upon by [TBD: manager, general partner, management committee, partners, or members, whichever is applicable]. The resigning partnership representative shall follow the directions of [TBD: manager, general partner, management committee, partners, or members, whichever is applicable] in connection with the appointment of a successor partnership representative and the filing of such statements, forms and other document with the IRS as required by the Partnership Audit Rules.. Notwithstanding the foregoing, in the event such resignation is not effective for purposes of the Partnership Audit Rules, the resigning partnership representative shall take any and all actions and sign and deliver any and all documents, instruments,

elections and agreement as directed by the [TBD: manager, general partner, management committee, partners, or members, whichever is applicable] until such resignation is effective for purposes of the Partnership Audit Rules.

**D. Revocation of Designation.** The designation of partnership representative may be revoked with or without cause by a written notice from the [TBD: manager, general partner, management committee, partners, or members, whichever is applicable]. The partnership representative whose designation has been revoked shall follow the directions of [TBD: manager, general partner, management committee, partners, or members, whichever is applicable] in connection with the appointment of a successor partnership representative and the filing of such statements, forms and other document with the IRS as required by the Partnership Audit Rules.. Notwithstanding the foregoing, in the event such revocation is not effective for purposes of the Partnership Audit Rules and in any event prior to the effective appointment of a successor, the partnership representative whose designation has been revoked shall take any and all actions and sign and deliver any and all documents, instruments, elections and agreement as directed by the [TBD: manager, general partner, management committee, partners or members, whichever is applicable] until such revocation is effective for purposes of the Partnership Audit Rules.

**E. Vacancies**. If there is a vacancy in the position of partnership representative, a successor partnership representative shall be designated by [TBD: manager, general partner, management committee, partners, or members, whichever is applicable].

**F. Compensation**. The partnership representative may receive reasonable compensation for the services rendered [TBD].

**G. Costs, Expenses and Professional Fees**. The partnership shall reimburse the partnership representative for all costs and expenses reasonably incurred in connection with her actions under the Partnership Audit Rules. The partnership representative is hereby authorized to engage professionals, experts and advisors in connection with its performance of its duties under the Partnership Audit Rules and incur costs, expenses, professional and other fee on behalf of the partnership.

**H. Standard of Care; Liability for Certain Acts**. The partnership representative shall act in good faith and shall use commercially reasonable best efforts to carry out the duties, authority and responsibilities set forth in this Agreement and the Partnership Audit Rules. Unless fraud, deceit, gross negligence, willful misconduct or a wrongful taking shall be proved by a non-appealable court order, judgment, decree or decision, the partnership representative shall not be liable or obligated to the partnership or to any of the partners for any breach of fiduciary duty, for any mistake of fact or judgment, or for the doing of any act, or the failure to do any act, which may cause or result in any loss or damage to the partnership or to its members. The partnership representative does not, in any way, guarantee the results of any partnership audit.

**I. Partnership Representative Has No Exclusive Duty to Company**. The partnership representative shall not be required to act in such capacity as her sole and exclusive function. The partnership representative shall devote such time to this position as is commercially reasonably to fulfill her obligations, responsibilities and duties.

**J. Indemnification of the Partnership Representative.** The partnership representative shall be indemnified and held harmless by the partnership under the following circumstances and in the manner and to the extent indicated: In any threatened, pending or completed action, suit or proceeding to which the partnership representative is or was a party or is threatened to be made a party by reason of the fact that she is a partnership representative involving an alleged cause of action for damages arising from the performance of her activities in such capacity, the partnership shall indemnify and hold the partnership representative harmless against costs, liabilities, damages and expenses, including attorney's fees, judgments and amounts paid in settlement, actually and reasonably incurred by her in connection with such action, suit, or proceeding if the partnership representative acted in good faith and in a manner she reasonably believed to be in, or not opposed to, the best interests of the partnership and the partners, and provided that her conduct has not been found by a non-appealable court judgment, order, decree, or decision to constitute gross negligence, fraud, willful or wanton misconduct. The termination of

any action, suit, or proceeding by judgment, order, or settlement shall not, of itself, create a presumption that the partnership representative did not act in good faith and in a manner which she reasonably believed to be in and not opposed to the best interests of the company. To the extent the partnership representative has been successful on the merits or otherwise in defense of any action, suit, or proceeding, or in defense of any claim, issue, or matter therein, the company shall indemnify the partnership representative against the expenses, including attorney's fees, actually and reasonably incurred by her in connection therewith. The company shall advance such expenses to the partnership representative in advance of the conclusion of such action, suit or proceeding. The indemnification set forth in this paragraph shall in no event cause the members to incur any liability beyond their capital contributions, plus their share of any undistributed profits of the company, nor shall it result in any liability of the members to any third party.

**K. Correction of Economic Distortions.** The partners intend that the economic consequences of an imputed underpayment for any reviewed year shall be borne by the reviewed year partners in the same manner as if the adjustments had been correctly reported on the reviewed year partnership return. Therefore, notwithstanding anything to the contrary herein, [TBD: general partner, manager or management committee whichever is applicable] shall make such offsetting special allocations of partnership income, gain, loss or deduction in whatever manner it determine appropriate so that, after such offsetting allocations are made, each partner's capital account balance at the end of the adjustment year is to the extent possible, equal to the capital balance such partners would have had if all partnership items in the reviewed year had been allocated to the partners in accordance with the adjustments as determined by the notice of final partnership adjustments, any settlement with the IRS, the Justice Department or the final court decision, whichever is applicable. In addition, the [TBD: general partner, manager or management committee whichever is applicable] shall have the authority to require reviewed year partners who have transferred their partnership interests to reimburse the partnership for the imputed underpayment.

**L. Limitation on Authority of Partnership Representative.** Notwithstanding anything to the contrary herein, the partnership representative shall not make any election, settlement or take any actions to settle or to litigate any adjustments set forth in the notice of final partnership adjustment under the Partnership Audit Rules without the consent of [TBD: the general partner, the manager, a vote of the majority of the partners/members or the management committee, whichever is applicable].

**M. Duties Owed by the Partners to the Partnership Representative.** Each partner hereby covenants and agrees to promptly provide the partnership representative with all information regarding the partner's tax returns and tax liabilities as requested from time to time, including but not limited to proof that the partner has filed an amended return and paid any resulting tax, the partner's address, taxpayer identification number and current contact information, the partner's status as a tax-exempt partner, the tax rate applicable to the partner and the partner's status as an eligible partner. The partner's obligations hereunder shall continue notwithstanding the partner ceasing to be a partner whether resulting from a transfer, sale, withdrawal or other disposition of her partnership interest. Each partner shall notify the partnership representative of any inconsistent treatment of any partnership item on the partner's return and of any settlement with the IRS regarding any partnership items.

**N. Reliance on Advice.** The partnership representative may rely on the services and advice of attorneys, accountants and other professional advisors or experts. The partnership representative shall not be liable to the partnership or to any partner for damages, losses, or costs, any loss of value or any liability arising from such reliance.

**O. Binding Effect of Actions by Partnership Representative.** The partnership and the partners hereby agree and acknowledge that (a) the actions of the partnership representative in connection with the Partnership Audit Rules shall be binding on the partnership and the partners; and (b) neither the partnership nor the partners have any right to contact the IRS or participate in an audit or proceedings under the Partnership Audit Rules.

**P. Communications to Partners.** The partnership representative shall provide reports to the partners on a reasonable basis to keep them reasonably informed of the status, issues and resolution of any partnership income tax audit.

**Q. Ineligible Partners**. The transfer of a partnership interest to an ineligible partner shall not be permitted except upon the written consent of [TBD: general partner, manager, management committee, partners or members whichever is applicable]. Any purported transfer shall be null and void [or trigger the buy-sell provisions in the partnership agreement]. If any partner is an ineligible partner on the date that is 90 days prior to the due date for filing the election out for any tax year, such partnership interest shall be transferred to an eligible partner prior to the due date for filing such election.