Omnibus Partnership Audit Rule Corrections Strike Familiar Tone

by Andrew Velarde

Partnership practitioners may finally get their long-awaited technical corrections to the partnership audit rules.

The Consolidated Appropriations Act, 2018 (H.R. 1625) includes myriad corrections and clarifying provisions involving the audit rules established under the Bipartisan Budget Act of 2015. Included are rules to address scope, netting, pull-in, push-out, imputed underpayments, and special enforcement matters. The Joint Committee on Taxation released a technical explanation of the new provisions March 22, the same day the House passed the bill. The Senate passed it on March 23.

Most of the provisions may not surprise many practitioners, as they closely follow previous proposals released in the Technical Corrections Act of 2016. Although that bill was never passed, at the time it was thought that its enactment would prompt a thorough revision of proposed regs, which had yet to be drafted.

While Treasury had previously established a goal of releasing final regs on the audit regime as one package this summer, one official admitted March 21 that this prediction may have been too rosy. What the provisions' release will mean for that already deferred timeline remains to be seen. In January the American Institute of CPAs, in asking Congress for a delay to the partnership audit regime, noted that IRS rules would have to be reexamined after technical corrections were enacted.

George Hani of Miller & Chevalier Chtd. predicted that the provisions, if enacted, would cause a delay in the guidance process.

"Treasury and the IRS were certainly aware of these items, but now that they are real, they will need to revisit impacted provisions," Hani said.

'Center of the Fairway'

The corrections would clarify the scope of the rules by eliminating references to adjustments to partnership income, gain, loss, deduction, or credit. References would be made instead to partnership-related items, which are any items or amounts that are relevant in determining the income tax liability, without regard to whether the item or amount appears on the partnership's return. It includes an imputed underpayment and an item or amount relating to any transaction with, basis in, or liability of, the partnership. By defining it as partnership-related items, the scope of the rules will be dramatically expanded and will not be narrower than the rules under the 1982 Tax Equity and Fiscal Responsibility Act.

Glenn Dance of Grant Thornton LLP said that the government sometimes used a previous technical correction proposal as "an expression of legislative intent to guide our drafting efforts" for the audit regs, particularly when there was doubt about the intention of the original statute. Much of the content of the technical corrections is already reflected in the regs that have been issued, said Dance, formerly a special counsel to the IRS associate chief counsel (passthroughs and special industries).

"The scope of the [Bipartisan Budget Act] rules in the regs is broader than what some believed was authorized under the original statute. But I think those regs would be pretty much in the center of the fairway under the technical corrections bill," Dance said.

Dance, however, noted that there are some differences, pointing to the technical corrections bill requirement that an item be relevant to the determination of a partner's tax liability to be in scope, as opposed to providing that anything reflected on a partnership's return is in scope. This difference could affect a partner's share of partnership liabilities, he added.

"If it's wrong on the [Schedule] K-1s, the regs let the government treat that as an adjustment that results in a potential partnership imputed underpayment obligation. Then the partnership has to prove — during the 270-day modification period — that its mistake didn't affect any partner's actual tax liability," Dance said. This is contrasted with the bill's approach, under which the IRS may need to first prove the relevance of the misallocation of partnership liabilities to the determination of a partner's tax obligations before it can make an adjustment. "That would require the exam agent to look at individual partners' tax situations before issuing a notice of proposed partnership adjustment, which clearly would put more of the burden back on the IRS than some of us thought the original statute was trying to do," he said.

Push and Pull

The corrections also clarify that items of different character, either capital or ordinary, may not be netted together for determining an imputed underpayment. The restriction will result in greater imputed underpayments and encourage tiered partnerships to push out adjustments to partners or use the pull-in procedure.

Under the pull-in procedure, reviewed-year partners pay tax that would be due with amended returns, making changes to tax attributes for later years, and provide the IRS with information to check that the tax was correctly computed. Amended returns are not filed by the partners, however. For tiered partnerships, pull-in is available to direct and indirect reviewed-year partners.

The bill also sets forth requirements in tiered structures in which a partnership that is either a direct or indirect partner of a partnership has elected to push out adjustments of partnership-related items to partners. A partnership partner in a push-out must file a partnership adjustment tracking report and it must furnish statements to its partners or compute and pay its imputed underpayment.

Proposed regs released in December permitting partnerships to push out adjustments through tiers were very favorable to taxpayers. While practitioners argued Congress clearly intended push-outs to be permissible, without the technical corrections legislation, there had been some worry that they may not be allowed by the IRS.

Hani argued that the bill, which would fix the "ups and downs" in intervening years when a push-out election is made, would be well received.

"Now taxpayer-favorable correlative adjustments in intervening years can be taken into account," Hani said. He added that the pull-in modification was likewise helpful, as it would get the result of an amended return without incurring the expense or effort required in filing one.

The legislation also clarifies procedures under section 6225(c)(2) involving a partnership seeking modification of an imputed underpayment. Reviewed-year partners may account for adjustments so a partnership's imputed underpayment is determined without regard to that portion of the adjustments. According to the JCT release, the purpose of the provision is to better carry out Congress's intention behind the modification rules "to determine the amount of tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid while at the same time to implement the most efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners."

Like the previous unenacted version of technical corrections, the bill includes provisions granting regulatory authority similar to that under TEFRA for partnership items involving special enforcement matters. The IRS may turn off the partnership audit rules in those circumstances, applying special rules including those related to assessment and collection needed for "effective and efficient enforcement." Special enforcement matters include failure to comply with section 6226(b)(4)(A)(ii), termination and jeopardy assessments, criminal investigations, indirect methods of proof of income, and foreign partners or partnerships.

Although modeled after TEFRA, the IRS never used the provision, which could potentially be a powerful tool for the Service. ■