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Prepare for 2019: Issues in Designating a Partnership Representative under the BBA

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Learning objectives

1

Recognize the scope of the BBA and whether the new rules apply to your partnership

2

Evaluate the limits of authority, if any, a PR should have over your partnership and its partners

3

Identify the needs of each of the partners in coming to a decision on who to designate as the PR

4

Define the BBA rules and the potential controversy that could arise in the scope of an IRS examination

Agenda

- 1 What is the BBA?
- 2 Near-term action items
- 3 Considerations in designating a PR

What is the BBA?

What is the BBA?

Background

- New centralized partnership audit regime was enacted as part of the Bipartisan Budget Act of 2015 ("BBA").
 - Effective for taxable years beginning after December 31, 2017 (§§ 6221 – 6241).
- Provides an easier way for the Internal Revenue Service ("IRS") to collect underpayments of tax from partnerships and partners by generally requiring payment at the partnership level.
 - Replaces TEFRA (§§ 6221 – 6234), which required IRS to pursue individual partners following a partnership-level proceeding.

What is the BBA?

Background

- IRS will conduct examination at the partnership level, similar to TEFRA.
- Collection of any underpayment of tax has historically been difficult, with IRS chasing down partners that may be far removed from the entity under examination.
- Result has been that large partnerships have been under-examined compared to similarly-sized corporations.

What is the BBA?

Which Partnerships are Subject to the BBA?

- Under BBA, all partnerships are subject to the new audit/collection rules unless:
 - Partnership issues 100 or fewer Schedules K-1
 - The number of Schedules K-1 the S corporation partner issues counts toward the 100 partner limitation.
 - Each partner is an individual, C or S corporation, or estate of a deceased partner
 - Partners that are disregarded for Federal tax purposes, such as single member LLCs and grantor trusts, are ineligible partners.
- These so-called "small partnerships" can elect out of the BBA, but must affirmatively do so on each year's Form 1065.

What is the BBA?

Terminology

Imputed Underpayment: The amount of tax owed by the partnership and its partners after adjustment by the IRS

Adjustment year: The year in which the adjustment becomes final

Adjustment year partner: Any person who held an interest in the partnership during the adjustment year (i.e., "current" partners)

Reviewed year: The year under examination by the IRS

Reviewed year partner: Any person who held an interest in the partnership during the reviewed year (could be current partners, but may also include former partners)

Partnership Representative (PR): The person with sole authority to represent and act on behalf of the partnership and its partners

Designated Individual (DI): If PR is an entity, partnership must appoint a designated individual to represent partnership

What is the BBA?

Why is this important now?

- Partnerships must designate a partnership representative (PR) on their 2018 Forms 1065.
 - Determining whom to designate is important, given vast authority of the PR to act on behalf of the partnership and all of its partners.
 - Partners may have competing interests and not all partners may agree with the decisions made by the partnership representative.
 - This may require modifications to the partnership agreement.
- Eligible partnerships wishing to opt out of BBA for 2018 must also do so on 2018 Form 1065.
- Partnerships contacted for an audit of an earlier year may also consider electing into the BBA early, if possible.

Status of BBA guidance and examinations

- Final regulations issued on electing out of BBA (T.D. 9829) and designating a partnership representative (T.D. 9839).
- Re-proposed regulations (REG-136118-15) on most other aspects issued August 2018 after passage of tax technical corrections legislation as part of Consolidated Appropriations Act of 2018. Final regulations expected in Q1 2019.
- States are only beginning to consider the impact of BBA. Expect non-conformity in the beginning.
- Some partnerships with pre-2018 tax years that have come under examination have elected into the BBA early.
- IRS Large Business & International (LB&I) division conducting extensive training and preparation for an increase in centralized partnership examinations in 2019 and beyond.

Near-term action items

Near-term action items

Early election into the BBA

- Partnerships with a taxable year beginning after November 2, 2015 and before January 1, 2018 are permitted to elect into the BBA early, under Treas. Reg. § 301.9100-22.
- Partnership, through the tax matters partner ("TMP") or an individual authorized to sign the Form 1065 for the year under examination, may make the election for the partnership.
- Election must be made within 30 days of notification that the return has been selected for examination.

Near-term action items

Early election into the BBA

- IRS will issue an initial contact letter (Letter 2205-D), which contains instructions on how to make the early election.
- Partnership can file Form 7036, or prepare its own statement making the election that includes all of the information required under the final regulations (Treas. Reg. § 301.9100-22(b)(2)).
- At the same time, partnership must designate its PR.
- Once the election is made, it may only be revoked with the consent of the IRS.
- IRS instructed to issue notice of administrative proceeding ("NAP") at least 30 days after valid election is received, and is also supposed to check Form 7036 or the election statement to make sure all the information is correct, and the election is valid.

Near-term action items

Opting out of the BBA

- Final regulations (T.D. 9829) issued in January 2018 provide guidance on how eligible partnerships may affirmatively opt out of the BBA audit regime.
- Election to opt out made on a timely-filed Form 1065, and partnership must disclose all of its partners' information, as well as the information of any and all owners of S corporation partners.
- Partnership must also notify its partners within 30 days of making the election out.
- IRS may determine that the election is not valid.

Near-term action items

Opting out of the BBA – Special Considerations

- Eligible partners do not include partnerships, trusts, certain foreign entities, disregarded entities, estates of individuals other than deceased partners, nominees that hold interests on behalf of another person.
 - But: Shareholders of partner-S corporations may be one of these "ineligible" entities. See Treas. Reg. § 301.6221(b)-1(b)(3)(iv), Ex. 2.
- Reviewing the K-1s alone may not be enough to determine whether the partnership has ineligible partners.
 - Ex.: Partner may be disregarded entity (e.g., single member LLC or grantor trust) and K-1 issued in name of ultimate owner, who may be eligible. Regulations do not allow for look-through.
- Determining the number of partners is based on actual partners and also the number of Schedules K-1 issued by the partnership. Sale, exchange or other disposition of a partnership interest mid-year may increase the number of Schedules K-1 issued. For example:
 - In the 2020 taxable year, Partnership has three individual partners (A, B, and C) as it begins the year in January. In June, Partner A dies, and his interest becomes an asset of his estate (D). In September, B sells her interest to individual E. Partnership is required to file five Schedules K-1, and so for purposes of the BBA, Partnership has five partners in 2020.

Near-term action items

Other issues

- Partnership agreement review
 - Likely does not account for the BBA, and partnerships / partners should review these agreements for conflicts with the BBA.
 - Changes may be necessary to delineate responsibilities of partners under various imputed underpayment payment options.
- Life cycle review / mock audit for potential red flags
- Partnership capital account maintenance in advance of a potential examination

Considerations in designating a PR

Partnership Representative Background

- Whom may the partnership designate as the PR?
 - Partnership may designate "any person" as the PR so long as they have a "substantial presence" in the U.S.
 - Substantial presence means the person (1) makes themselves available to meet in person with the IRS and (2) has a TIN and U.S. street address and phone number.
- If the PR is an entity:
 - Partnership must appoint a designated individual (DI), who must meet the same substantial presence requirements of the PR.
- The IRS wants to talk to a person. It does not care who that person is, so long as they meet the substantial presence rules of the BBA.
 - Unlike under TEFRA, PR can be literally anyone who meets the requirements of substantial presence. Does not have to be a partner.

Partnership Representative Background

- PR has the sole and exclusive authority to act on behalf of the partnership and the partners under the BBA.
- Broad authority of the PR includes ability to, among other things:
 - Respond to requests for information by the IRS
 - Extend the statute of limitations
 - Determine the method by which an imputed underpayment is paid
 - Appeal or decide to litigate an adjustment by the IRS
 - Settle a matter with the IRS
- Actions of the PR are binding on the partnership and its partners.
- Contractual or state law limitations on agency placed on the PR are not respected by the IRS.

Partnership Representative Designation

- Final regulations (T.D. 9839) issued in August 2018 govern rules regarding the designation of a PR.
- Each partnership subject to the BBA must designate a PR for the 2018 tax year. If partnership does not, or PR designation is determined to not be in effect, IRS may designate a PR.
- Designation made on Form 1065 for the taxable year for which the designation relates.
 - Form 1065 for tax year ended December 31, 2018 is due March 15, 2019 (without extensions) or September 16, 2019 (with extensions)
- Designation, once made, remains in effect unless and until PR resigns, PR designation is revoked by partnership, or PR designation is made by IRS.
- Form 2848, "Power of Attorney and Declaration of Representative," may not be used to designate a PR or appoint a DI.

Partnership Representative

Resignation of PR or DI

- PR or DI may resign for any reason by notifying IRS, but may not choose their successor. Partnership must designate a new PR or DI.
- Resignation may only occur after IRS has issued a NAP to the partnership.
- Resignation is in effect immediately upon IRS's receipt of the written notification, at which point PR or DI may not take any action on behalf of partnership; designation is no longer in effect for the year affected by the resignation.

Partnership Representative

Revocation of PR or DI by the partnership

- Partnership may revoke PR or DI for any reason by notifying IRS, and must designate a successor PR or appoint a successor DI.
- Revocation may only occur after IRS has issued a NAP to the partnership, or through the filing of an administrative adjustment request ("AAR") by the partnership.
 - However, AAR cannot be filed for the sole purpose of revoking a PR designation or DI appointment.
- Revocation is generally in effect immediately upon IRS's receipt of the written notification, which must be signed by any person who was a partner at any time during the partnership tax year to which the revocation relates.

Partnership Representative Designation of PR by the IRS

- If PR designation or DI appointment is "not in effect," the IRS will notify the partnership and the PR/DI. Partnership has opportunity for new designation within 30 days.
- IRS may determine that a PR designation is not in effect if:
 - PR or DI do not have substantial presence
 - Partnership failed to appoint a DI
 - Designation was not valid
 - PR or DI resign and new PR or DI are not designated by partnership timely
 - Partnership makes multiple revocations
 - PR designation no longer in effect, based on other guidance.
- IRS will consider a number of factors in designating a PR (e.g., views of the majority partners, knowledge of person in tax matters and administrative organization of partnership, access to books and records, etc.)

Partnership Representative

The powers of the PR

- "The failure of the partnership representative to follow any state law, partnership agreement, or other document or agreement **has no effect on the authority** of the partnership representative or the designated individual..." – Treas. Reg. § 301.6223-2(d)(1).
- However, nothing in the regulations restricts a PR from authorizing a person to represent the PR, in the PR's capacity as the PR, before the IRS under a valid power of attorney.

Partnership Representative Permission structure?

- PR has significant authority under the BBA and can bind the partnership. Should the partnership place restrictions on the PR?
 - Restricting the PR would allow partnership to control the examination and the actions of the PR.
 - Restricting the PR could also potentially slow the examination down.
- Consider the extent to which PR will be involved in day-to-day examination with IRS. Prudent for PR to engage competent tax controversy advisors.
- Should PR be required to obtain permission from partnership prior to a certain event occurring? Same considerations of balancing control versus unnecessarily restricting the PR.
 - Election under §6226 for alternative payment of imputed underpayment
 - Filing AAR
 - Filing suit
 - Extending the period of limitations

Partnership Representative

Other considerations

- Provisions to indemnify or hold harmless the PR based on PR's actions in that capacity
- Compensation of the PR
- If PR is partner, should allocative share, or status (e.g., foreign partner, tax-exempt, individual, C corporation) matter?
 - What potential conflicts of interest may arise if partner is a PR or DI?
- Should ultimate settlement authority or "big" decisions (filing suit) be relegated to PR, despite PR's apparent authority?
- What notice should be given to partners of the partnership?

Next Steps

Next Steps

What to accomplish in 2019

- On 2018 Form 1065
 - Designate PR
 - Determine whether to opt out of BBA, if possible
 - Identify owners and attributes (e.g., DREs, S corp shareholders, etc.)
- Review and update partnership agreement to account for BBA
- Ensure capital accounts are maintained properly
- Consider mock audit of partnership in preparation for potential examinations by IRS

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