

New Partnership IRS Audit Procedures

For tax years beginning after 2017, new federal procedures are in effect for auditing partnerships (and limited liability companies treated for tax purposes as partnerships). Under these new audit rules, the partnership is audited at the partnership level. Any additional tax related to audit adjustments of partnership income, gain, loss, deduction, etc. (imputed underpayment) must be paid by the partnership. The imputed underpayment is assessed at the highest individual or corporate tax rate effective for the year of audit.

Partnerships are required to designate a "partnership representative," who must have a substantial presence in the United States. The partnership representative will have sole authority to act on behalf of the partnership for purposes of the new audit rules and elections. The IRS will appoint a partnership representative if one is not designated.

Alternatives to the New IRS Audit Procedures

Election-Out for Small Partnerships

Electing out of the new audit rules removes the tax liability associated with adjustments to taxable income from the partnership and places them on the individual partners as was generally the case in earlier tax years.

To Be Eligible to Elect-Out

- The partnership must make an election to opt-out of the new provisions
- The partnerships must have 100 or fewer partners (issue 100 or fewer K-1s per year). Each K-1 issued by an S corporation is counted as if it were the electing partnership's own K-1 for purposes of calculating the 100 or fewer partners.
- Each partner must be an eligible partner:
 - Individual
 - C Corporation
 - Foreign entity that would be treated as a C corporation if it were domestic
 - S Corporation, or
 - Estate of a deceased partner
- The election must be made with a timely filed partnership return, and include the name and identification number of each partner. The partnership must notify each partner that the election was made.
- The election must be made annually.
- When a partnership includes an S corporation partner, the electing-out partnership must attach a disclosure to the return that includes the name and taxpayer identification number of each shareholder of the S corporation.
- Ineligible partners:
 - Partnership
 - LLC treated as a partnership

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Alternative Election for Large Partnerships

For large partnerships and those with a disqualified partner, an election may be made to have all partners from the audited year pay the imputed underpayment.

- The election must be made within 45 days of receipt of the final partnership adjustments (FPA).
- The partnership is required to issue a statement of each partner's share of adjustment to the IRS and to each partner.
- Each partner must pay their share of the partnership adjustment with their current return.

Modification – Lower the Imputed Tax

This option allows for all partnerships who may be ineligible, or failed to make an election, to seek a reduction in the imputed underpayment. The imputed underpayment is assessed at the highest individual tax rate. This option is not a removal from the new audit rules.

To be Eligible for Modification:

- At least one partner from the audited year files an amended return consistent with the final partnership adjustment (reflecting its share of the partnership level adjustment) within 270 days of receipt of a notice of proposed partnership adjustment (NOPPA), and pays the tax in full; or
- At least one partner from the audited year is tax exempt; or
- A lower rate applies because a partner from the audited year is a C corporation or because the adjustment is made to a qualified dividend or capital gain.
- **No partnership amended returns after 2017.**
The Form 1065X amendment will not be available for filing beginning January 1, 2018.

The change in federal procedures does not necessarily alter how individual states will address partnership audit adjustments.

We believe that most partnerships which qualify to elect-out should consider making the election to do so.



For more information please contact your ACT representative or one of the following consultants:

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