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The New IRS Partnership Audit Rules

Legal Update
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The IRS audit rules for all partnerships (including LLCs that are taxed for income tax purposes as partnerships) have changed dramatically. Effective for tax years beginning on or after January 1, 2018, unless a partnership can "elect-out" of the new audit rules altogether, the partnership will be liable for tax underpayments arising from an audit. This shift basically causes a partnership's current year (the year when the audit is conducted) partners to be responsible for reviewed year (the audited year) tax liabilities. Under the old audit rules, taxes were assessed against those who were partners during the reviewed year. Therefore, unless certain steps are taken to "push out" tax liabilities to reviewed year partners, there is a significant risk that a partnership's current year partners will be liable for taxes attributable to reviewed year partners. This result could be particularly problematic if current year partners are different than reviewed year partners.

The new audit rules also require partnerships to have a partnership representative (PR). Unlike tax matters partners under the old audit rules, the PR has greatly expanded powers to make decisions and elections in an audit on behalf of the partnership and bind the partnership, all without being required to obtain partner consent or give notice to partners. The PR does not have to be a partner, may be an individual or an entity, and may designate its own successor.

Consider reviewing and possibly amending your partnership and LLC agreements to provide the following:

1. Designate how the PR will be appointed, removed, and replaced;
2. Require that during an audit, the PR update the partners at various stages and obtain consent for its decisions;
3. Require the PR to make annual elect-out and push-out elections where available; and
4. Require the PR keep all information necessary to make these elections (including names and addresses of all partners).

A partnership or LLC agreement amendment could also add provisions clearly requiring reviewed year partners to be responsible for reviewed tax year liabilities and that they indemnify the partnership, the current year partners, and/or the PR for amounts not pushed out for any reason. These provisions can be structured to survive termination of a partner's interest or the partnership itself. Provisions shifting

responsibility and indemnification rights should also be considered in partnership interest purchase and sale agreements.

Contact your Fredrikson attorney to discuss the appropriate steps you need to take to address these rules.