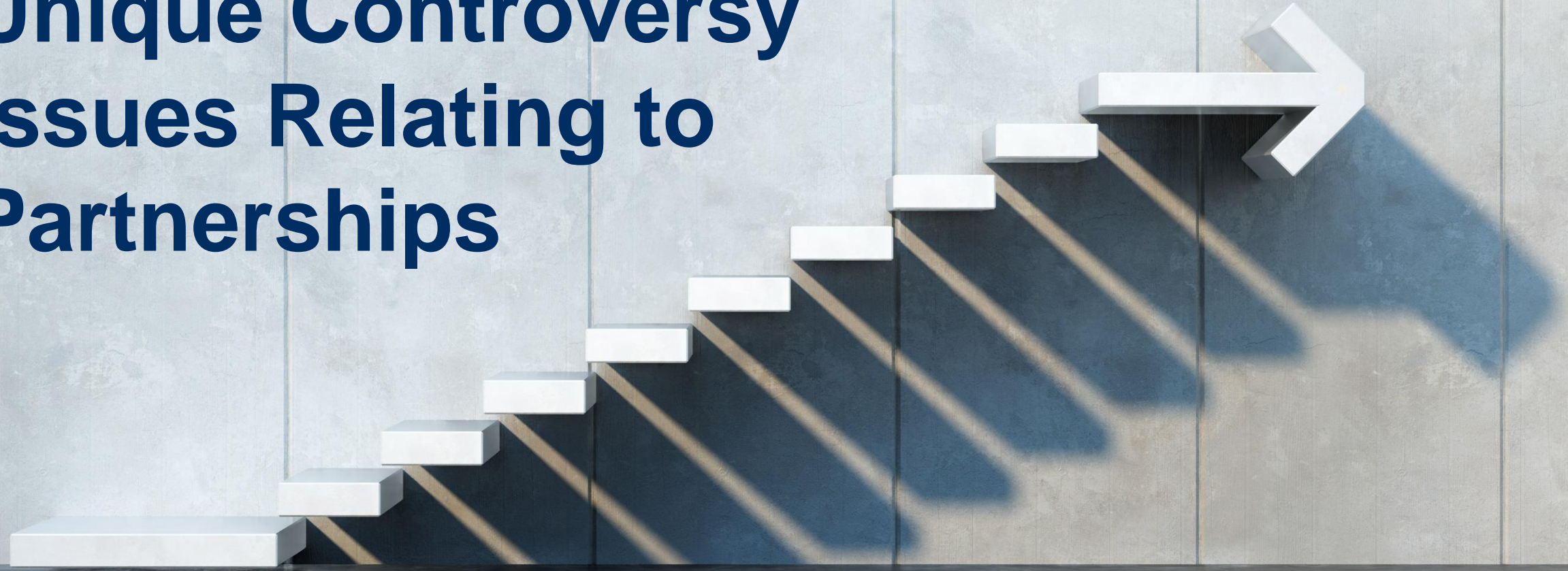




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Unique Controversy Issues Relating to Partnerships



PLI's Nuts and Bolts of Tax Controversy

March 27, 2023



Live Content Slide

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Poll: 1. Have you been involved in an IRS BBA audit?



Presenters

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Agenda

- BBA Overview
- What to Expect at the Start of the Audit
- Modification
- Push Out
- Computing the Imputed Underpayment
- Special BBA Collection Tools

Overview



Increase in Partnership Audits

- Large Partnership Compliance (LPC) Program
- LB&I campaigns specific to partnerships
 - Distribution in excess of partner's basis
 - Sale of partnership interest
 - SECA tax
- IRA increased funding for enforcement
 - Hiring
 - Technology

BBA - Overview

- The Bipartisan Budget Act of 2015 (BBA) replaced the partnership audit procedures under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the electing large partnership rules. It is generally effective for partnership taxable years beginning on or after January 2018.
- Adjustments are done at the partnership level and the partnership is liable for a tax computed on those adjustments. A partnership may elect to have the partners take into account the adjustments and pay their applicable tax.
- A partnership representative (PR) (and a designated individual (DI) if the PR is an entity) with a substantial presence in the U.S. must be designated for each partnership tax year. The PR has the sole authority to act on behalf of the partnership for purposes of BBA. Actions of the PR bind the partnership and the partners.



BBA - Overview

- Partners must report items consistent with the partnership return unless they attach notification of the inconsistency to their return.
- Partnerships with 100 or fewer eligible partners can elect out of the BBA regime for a taxable year. Eligible partners are individuals, C corporations, a foreign corporation that would be treated as a C corporation if domestic, estate of a decedent. Special rules apply for S corporations.



Understanding the Jargon

- **Imputed Underpayment (IU):** Partnership-level tax calculated on adjustments to partnership-related items.
 - Generally, adjustments are appropriately netting, multiplied by the highest tax rate, and the product is increased (or reduced) by changes in credits
- **Reviewed year:** Partnership tax year being adjusted
- **Adjustment year:** Year adjustments are finally determined or, in the case of an AAR, the year the AAR is filed
- **Pass-through partner:** Generally, any direct or indirect partner that is a partnership, S corporation, non-grantor trust, or estate of a decedent



Understanding the Jargon

- **Partnership-related item (PRI):**
 1. Any item or amount (a) with respect to the partnership (b) which is relevant in determining the income tax liability of any person

AND

 2. Any partner's distributive share of any partnership-related item
- A PRI is not required to be on the partnership's return and includes the imputed underpayment and any item or amount relating to any transaction with, basis in, or liability of, the partnership

Bipartisan Budget Act (BBA) Roadmap for Taxpayers



CENTRALIZED PARTNERSHIP PROCESS

FILING/AUDIT SELECTION

Taxpayer Files Original Return

- For all tax years beginning 01/01/2018 and forward, partnerships are automatically BBA unless taxpayer meets the criteria and "Elects Out of BBA" on a timely filed return
- Partnership Representative (PR) is designated on the filed return and will have sole authority to act on behalf of the partnership

Return Selected For Examination

- Verification of PR by exam team

AAR

- If filed, must be filed prior to issuance of NAP

30 DAYS

Issuance of NAP must be at least 30 days after date of L2205D

Notice of selection for examination
Letter 2205D

Notice of administrative proceeding (NAP)
Letter 5893/5893A

AUDIT PROCESS

Examination

- Examination steps to complete the audit issues generally remain unchanged under BBA procedures

Notice of Preliminary Partnership Examination Changes

Notice of Proposed Partnership Adjustment (NOPPA)

- Final imputed underpayment (IU) is determined

Taxpayer Can File an Appeal

- Partnership can not appeal an issue/matter more than once

270 DAYS

Issuance of the NOPPA starts the 270 day modification request period

Notice of preliminary partnership exam changes and IU (summary report package)
Letter 5895 Form 14791/886A

BBA 30-day letter
Letter 5891 Form 14791/886A

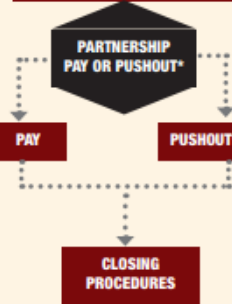
Notice of proposed partnership adjustment (NOPPA)
Letter 5892/5892A Form 14792/886A

POST AUDIT**

Modification

- Modification requests may be submitted to reduce the IU amount shown on the NOPPA
- The partnership is responsible for providing all required information to the IRS for review and approval of the request

Final Partnership Adjustment (FPA)



*Pushout Responsibilities

- Partnership is no longer liable for the IU
- Partnership will provide statements to its partners, and the IRS, on what adjustments and amounts, are being pushed out

45/90 DAYS

Issuance of FPA starts:
• 45 days to elect pushout
• 90 days to petition court

Modification determination package
Letter 5975 Form 15027

Notice of final partnership adjustment (FPA)
Letter 5933/5933A Form 15027/886A

TIMEFRAMES

TAXPAYER NOTIFICATIONS

** For information about mandatory registration and electronic filing of Post Audit forms, see <https://www.irs.gov/BBaSubmit>



Critical Deadlines

- **Critical deadlines to be aware of**
 - Modification can only be requested within 270 days of when the NOPPA is mailed
 - Time can be extended
 - An election to push out the adjustments can only be made within 45 days of when the FPA is mailed
 - Cannot be extended
 - 90 days to petition the FPA
 - Cannot be extended
 - Push out statements must be issued by the audited partnership within 60 days of when the adjustments become finally determined
 - Cannot be extended
 - Pass-through partners who receive a push out statement must furnish their own statements by the extended due date of the audited partnership's adjustment year return
 - If do not timely issue statements, must pay an imputed underpayment
 - Cannot be extended

What to Expect At the Start of An Audit

Confirm/Change Partnership Representative

- Change PR/DI using Form 8979
 - Two forms if PR/DI resigns: one signed by the resigning PR/DI, one signed by a partner for the reviewed year appointing a new PR (and DI if necessary)
 - Partnership can revoke and designate a new PR/DI on the same form
- IRM 4.31.9.7.10 requires a new POA required if PR/DI that signed the form is revoked or resigns
 - But see Treas. Reg. § 301.6223-2(b) (stating that actions prior to termination remain in effect, including example of statute extension)

Validate the POA – IRM 4.31.9.7.10

For Individual Partnership Representative:

John Tiger as partnership representative for
ABC Partnership
1111 Maple Street
Anywhere, USA 00000-0000

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.		
Taxpayer name and address	Taxpayer identification number(s)	
	TIN of BBA Partnership	
John Tiger as Partnership Representative for ABC Partnership 1111 Maple St, Anywhere, USA 00000-0000	Daytime telephone number	Plan number (if applicable)

For Entity Partnership Representative and Designated Individual:

DEF, LLC as partnership representative for
ABC Partnership
1111 Maple Street
Anywhere, USA 00000-0000

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.		
Taxpayer name and address	Taxpayer identification number(s)	
	TIN of BBA Partnership	
DEF, LLC as Partnership Representative for ABC Partnership 1111 Maple St, Anywhere, USA 00000-0000	Daytime telephone number	Plan number (if applicable)

Period of Limitation to Make Partnership Adjustment

- Section 6235 is an independent period of limitations
 - For adjustments, not assessments
- IRS may make adjustments within the later of:
 - (1) – Three years after later of date return is due or filed, or AAR is filed
 - (2) – 270 days (plus the number of days of any extension of the time to request modification of the imputed underpayment) after the date everything is required to be submitted in modification
 - (3) – 330 days (plus the number of days of any extension of the time to request modification) after the NOPPA is issued – when no modification documentation submitted

For (2) and (3), NOPPA will be issued within three years of the later of the date the tax return is due or filed (including extensions) or AAR is filed

- Partnership can agree to extend the period of limitations



Extension of Period to Make an Adjustment

- BBA exam can take longer because:
 - 270 days to request modification/assessment can't happen during this period unless waived by the taxpayer
 - Two options to go to Appeals
 - New process, significant coordination
- Long statute extensions requested (see IRM 4.31.9)

Modification



Modification Requests

- PR has 270 days from the date the NOPPA is mailed to submit modification request
 - Can request an extension
 - IRS cannot issue an FPA during this 270-day period unless the taxpayer consents
- Modification request (Form 8980, *Partnership Request for Modification of Imputed Underpayment Under IRC Section 6225(c)*) must be submitted electronically with required documentation for the modifications requested
- IRS has complete discretion to approve or deny modification request
 - Taxpayer can go to the Independent Office of Appeals if modification request denied



Modification Requests

Types of Modifications

- Partner Amended Returns or Partner Alternative Procedure
- Rate Modifications (corporate or individual partners)
- Tax-exempt partners
- Number and composition of imputed underpayments
- Passive losses of publicly traded partnerships
- Partnerships with qualified investment entity partners
- Closing agreements
- Tax treaty modifications
- Other

Amended Return Modification

- Reviewed year partner (direct and indirect) files an amended return taking into account allocable share of adjustments, penalty, and interest and pays tax due
 - All affected years must be amended
 - 6511 doesn't preclude a refund
 - Protective refund claim might be necessary if the partnership goes to Tax Court
 - After filing amended return, partner cannot file additional amended returns with respect to partnership adjustments unless partner receives IRS permission
 - PR/DI must submit an affidavit from the partner that amended return is filed and tax, penalties and interest are paid
- In a reallocation adjustment, all affected partners must file amended returns
- Imputed underpayment does not include adjustments taken into account on the amended return



Alternative to Amended Return Modification: Pull-In

- Partner determines the change in tax if they took their allocable share of adjustments into account for the reviewed year and intervening years and pays the total tax, interest, and penalties due
- No amended return filed
- PR/DI must submit an affidavit from the partner that amended return is filed and tax, penalties and interest are paid
- No refunds available under pull-in
- Adjustments to tax attributes are binding for future years and failures subject to math error assessment

Push Out

Push Out Election

- Effect of a push out election
 - Partnership is no longer liable for the imputed underpayment resulting from the adjustments pushed out
 - The correct tax is paid by the correct partners
 - Underpayment interest is 2% higher for audit push out (currently 9%)
- A valid push out election has two parts: Election + Statements
 - Election statement must be filed within 45 days of the date the FPA is mailed
 - Push out statements must be filed/furnished within 60 days of a final determination of the adjustments
- A push out election is valid until the IRS says it isn't
- Partnership can go to Tax Court even if they make the push out election



Audit Push Out Procedures

- Audited partnership and passthrough partners
 - Electronically submit Form 8985, *Pass-Through Statement – Transmittal/Partnership Adjustment Tracking Report*, and Forms 8986, *Partner’s Share of Adjustments(s) to Partnership-Related Items*
- Non-passthrough partner recipients of Forms 8986
 - Attach Form 8978, *Partner’s Additional Reporting Year Tax*, (and Schedule A (Form 8978), *Partner’s Additional Reporting Year Tax (Schedule of Adjustments)*) with their reporting year tax return

Audit Push Out Procedures

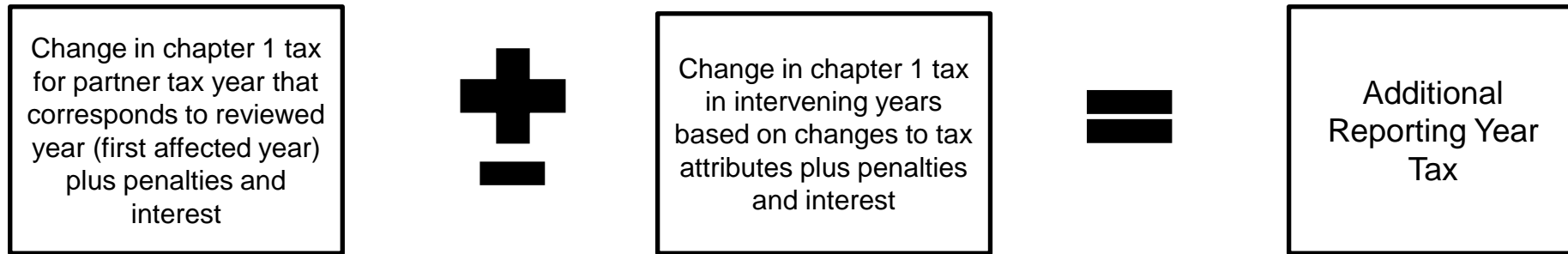
- **Reporting year:** Partner's tax year that includes the date the audited partnership mails the Forms 8986
- **Intervening year:** Year(s) between the reviewed year and the reporting year
- **Correction amount:**
 - Change in chapter 1 tax for partner tax year that corresponds to reviewed year (first affected year) plus penalties and interest
 - Change in chapter 1 tax in an intervening year based on changes to tax attributes from the reviewed year or preceding intervening year plus penalties and interest
- **Additional reporting year tax:** aggregate of the correction amounts; increases or decreases the partner's chapter 1 tax in the reporting year



Form 8986 Recipient Procedures – Non-pass-through partner

- A non-pass-through partner computes what their change in chapter 1 tax would have been if the partner correctly reported the adjustments to begin with
 - Prepare a pro forma amended return for the reviewed year and intervening years
- Add all correction amounts for each year together to get the additional reporting year tax
 - This can either be a negative or positive amount
 - A positive amount increases chapter 1 tax in the reporting year
 - A negative amount reduces chapter 1 tax in the reporting year
- Computes any applicable penalties and interest (+2% for audit) for each of those tax years

Additional Reporting Year Tax



Stranded Overpayment or Disappearing Refund

- Any reduction in chapter 1 tax reported by the partner on its reporting year return could exceed the other tax liabilities on the partner's reporting year return
- A negative additional reporting year tax will not create an overpayment where one does not exist
 - The application of the negative additional reporting year tax amount is like the application of a non-refundable credit
 - A negative additional reporting year tax can reduce other chapter 1 taxes to zero, but not below zero
- If you can't use the entire amount of the negative additional reporting year tax in the reporting year, it goes unused forever

Examples

- Example 1. Partner A determines that his additional reporting year tax is negative \$100. A's other chapter 1 tax for the reporting year is \$150. Applying the rules in Treas. Reg. § 301.6227-3(b)(1), A reduces A's chapter 1 tax of \$150 by the negative \$100 additional reporting year tax to arrive at a total tax liability of \$50 for the reporting year.
- Example 2. Same facts as Example 1, except that partner A's other chapter 1 tax (prior to application of the additional reporting year tax) is only \$75. Therefore, there is only \$75 of chapter 1 tax against which A can apply A's negative \$100 additional reporting year tax.



Green Book Proposal

“Amend IRC § 6226 and § 6401 to provide that the amount of the net negative change in tax that exceeds the income tax liability of a partner in the reporting year is considered an overpayment under § 6401 and be refunded.”

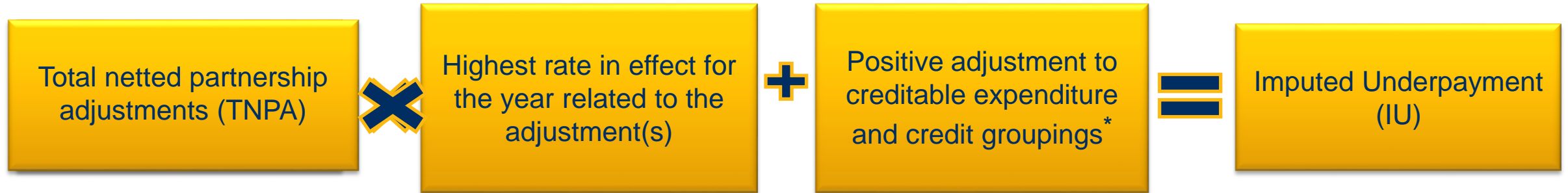
General Explanation of the Administration's Fiscal Year 2023 Revenue Proposals, at p. 75 (March 2022)

Form 8986 Recipient Procedures – Pass-Through Partners

- Pass-through partners must file the partnership adjustment tracking report (Form 8985) and furnish statements (Form 8986) to flow through the adjustments to their owners from the reviewed year
 - Section 6698 penalty for failing to timely file the partnership adjustment tracking report
 - Section 6721 and Section 6722 apply to failure to file correct Forms 8986 if required
- If the pass-through partner fails to furnish statements by the due date, the pass-through partner must pay an imputed underpayment calculated on the adjustments allocable to the pass-through partner on the Form 8986 it received
 - If any modifications were approved with respect to the pass-through partner or its owners, those modifications may be taken into account in computing any imputed underpayment
- All statements (Form 8986) and the adjustment tracking report (Form 8985) must be filed, and any imputed underpayments paid, by the extended due date of the audited partnership's adjustment year return (without regard to whether the audited partnership actually requested an extension)
 - If the adjustment year is 2023 and the audited partnership is a calendar year taxpayer, the due date will be September 15, 2024

Computing the Imputed Underpayment

Imputed Underpayment



**IRS may determine that negative adjustments reduce the IU*

Imputed Underpayment

- There are six steps to determine an imputed underpayment
 1. Categorizing partnership adjustments into one of four groupings.
 2. Identifying items within the four groupings which cannot be netted (subgroups).
 3. Net all adjustments together within each grouping or subgrouping, as appropriate.
 4. Add all net positive (sub)groupings together (TNPA)
 5. Calculate the IU multiply step 4 by the highest rate.
 6. Adjust for any adjustments to credits and creditable expenditures.
- If there are no negative adjustments, the calculation is simple – add all the adjustments together and multiple by the highest rate, then add/subtract (if allowable) any adjustments to credits

Adjustments and Groupings

- Negative adjustment: Decrease in an item of gain or income; increase in an item of deduction, loss or credit, a decrease in tax, penalty addition to tax or additional amount for which the partnership is liable under chapter 1, or a decrease in the imputed underpayment calculated by the partnership
- Positive adjustment: An adjustment that is not a negative adjustment
 - Unexpected adjustments: Non-income items
- Groupings
 - Reallocation grouping
 - Credit grouping
 - Creditable expenditure grouping
 - Residual grouping
- Subgrouping: Negative adjustments are put in their own subgroup in each grouping

Adjustments That Do Not Result In an Imputed Underpayment

- Except as described below, adjustments that make up the net negative adjustment are “adjustments that do not result in an imputed underpayment”
 - Allocated to adjustment year partners unless pushed out to reviewed year partners
 - For an AAR, must be pushed out
- A net negative adjustment to tax, penalty, an addition to tax, or an additional amount for which the partnership is liable under chapter 1, or a decrease in the imputed underpayment calculated by the partnership, are not treated as an adjustment that does not result in an IU

Grouping, Subgrouping, TNPA, Net Negative Adjustments

		Residual Grouping				Reallocation Grouping		
Adj #	Adj Description	Subgroup 1	Subgroup 2	Subgroup 3	Total	Subgroup 1 (Partner A)	Subgroup 2 (Partner B)	Total
1	Interest Income, Sch K, line 5	2,000						
2	Other Income (Loss), Sch K, line 11		(500)					
3	Gross Receipts, Form 1065, line 1 & Sch K, line 1			2,500				
4	Interest Expense, Form 1065, line 15 & Sch K, line 1			(1,500)				
5	Reallocation of Other Income from Partner A to Partner B					(700)	700	
Subgrouping	<i>Net Positive</i>	2,000		1,000			700	
	<i>Net Negative</i>		(500)			(700)		
Total Netted Partnership Adjustments		2,000		1,000	3,000		700	700
Net Negative Adjustments			(500)			(700)		

IU Computation

	Net Positive Adjustments
Reallocation Grouping	700
Residual Grouping	<u>3,000</u>
Total Netted Partnership Adjustment (TNPA)	3,700
<i>Highest Tax Rate (Section 1 or Section 11)</i>	<u>37%</u>
<i>TNPA x Highest Rate</i>	1,369
Creditable Expenditure Grouping	0
Credit Grouping	<u>0</u>
IU	<u>1,369</u>

Special BBA Collection Tools

Section 6232(f)

- Allows collection of the unpaid imputed underpayment (and any unpaid interest or penalties on the imputed underpayment) from the partners at the end of the adjustment year of the audited partnership and certain pass-through partners (partnerships and S corporations)
 - If partnership has ceased to exist, collect from former partners
- Collection of proportional share of the remaining amounts due from partners not to exceed 100% of the unpaid amounts
- Additional 2% underpayment interest charge
- Awaiting regulations

Cease to Exist

- If the IRS determines that a partnership has ceased to exist prior to the adjustments becoming finally determined, the former partners must take the adjustments into account and pay the tax
- Cease to exist
 - No part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership under section 708; or
 - The partnership does not have the ability to pay, in full, any amount that may be due under the BBA for which the partnership is or may become liable. A partnership does not have the ability to pay if it is currently not collectible based on the information the IRS has at the time.
- Former partners: Generally, adjustment year partners and if no adjustment year partners, the partners for the tax year of the last return filed by the partnership



Special Enforcement

- Allows the IRS to adjust PRIs determined to involve special enforcement matters outside of the BBA rules
 - PRIs involving special enforcement matters can be adjusted at the partner-level rather than the partnership-level
 - IRS required to notify in writing the taxpayer to whom the adjustments are made
- IRS had similar authority under TEFRA

Special Enforcement Matters

- Similar to TEFRA and listed in statute
 - Termination and jeopardy assessments
 - Criminal investigations
 - Indirect methods of proof of income
- Special relationships and extensions of the partner's period of limitations
 - Statute of related partner under 267(b) or 707(b) is open, but partnership period closed
- PRI underlying items that are not PRIs
 - Exam conducted of the partner and a PRI is part of or underlies a non-PRI item
- Penalties and taxes imposed on the partnership under chapter 1
 - This is still adjusted at the partnership-level, just not under the BBA procedures



Thank You

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