PARTNERSHIP AUDITS & LITIGATION (TEFRA)

Advanced Tax Law Course

October 29, 2015

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TOPICS

- TEFRA Background
- Top 10 traps and tips
- Trends, problems, and the future of TEFRA

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TEFRA BACKGROUND

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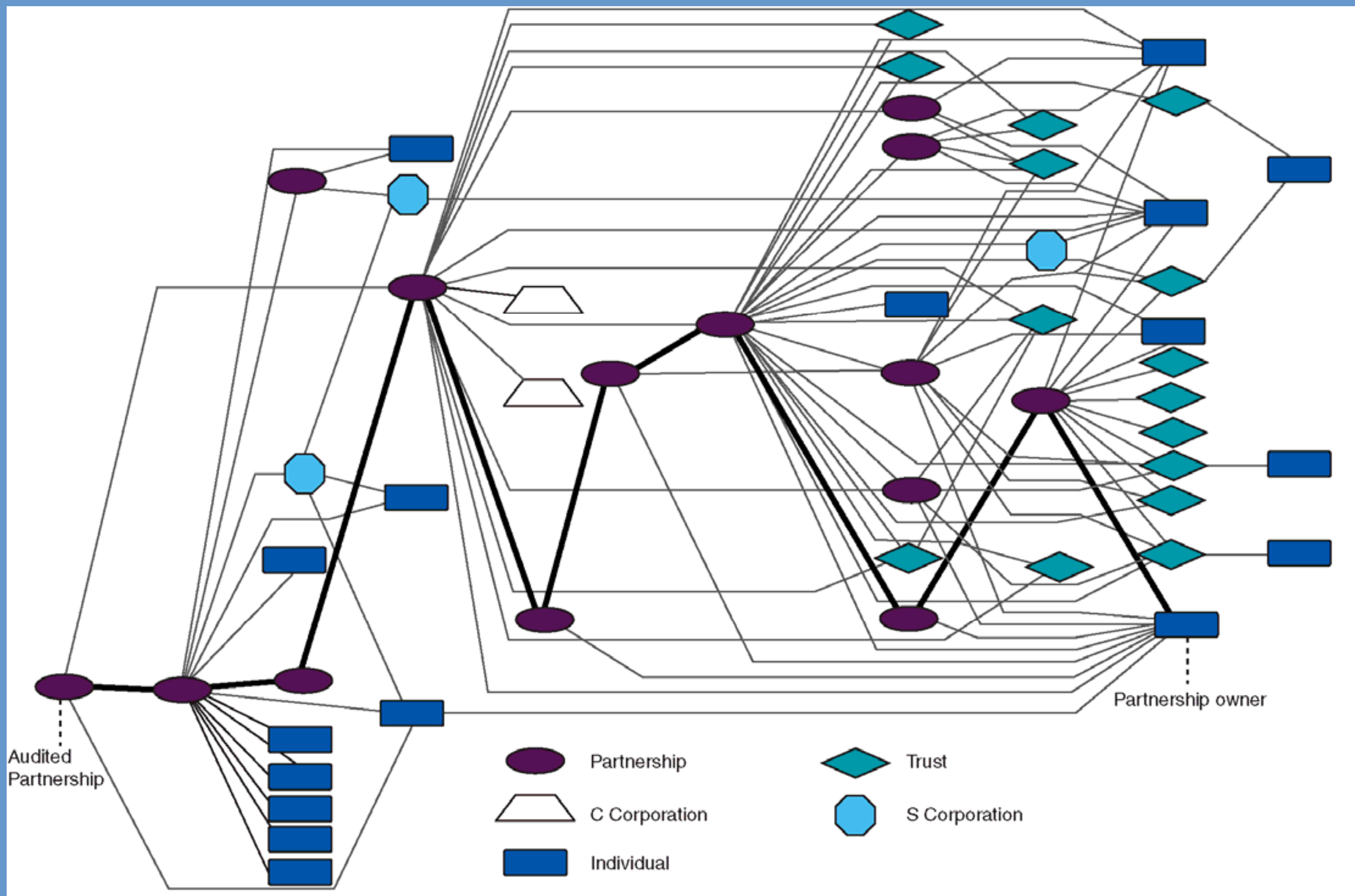
- What is TEFRA?
- What was TEFRA designed to accomplish?
- How does TEFRA work, generally?

Auditing—Different Approaches



Source: GAO analysis of IRS documentation. I GAO-14-732

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The Tax Matters Partner ("TMP")

- Tax Matters Partner (TMP) - The TMP is the primary representative of the partnership in dealing with the IRS during administrative proceedings and litigation. The TMP has specified responsibilities and authority.
- What is the Role of the TMP?
- Who can serve as the TMP?

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The FPAA and AAR

- A Notice of Final Partnership Administrative Adjustment (“FPAA”) is the partnership equivalent of a notice of deficiency.
- An Administrative Adjustment Request (“AAR”) is the partnership equivalent of a refund claim.

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TOP 10 TRAPS AND TIPS

#10 – DEFAULT, PAY, AND FILE A REFUND CLAIM? DOESN'T WORK!

- You can do that in non-TEFRA proceedings, and sometimes it will be the best approach.
- But you can't do it in the TEFRA context. If you don't challenge the FPAA at the first opportunity, there's no second chance.

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CAN’T EVEN FILE A REFUND CLAIM FOR UNRELATED ITEMS

- You can do that in a non-TEFRA proceeding, because no court has ruled on the correct tax liability.
- But TEFRA doesn't allow that. If you don't challenge the FPAA, no partnership items can be challenged later.

#9 – BUT YOU STILL HAVE YOUR CHOICE OF FORUM FOR LITIGATION!

- You can challenge the FPAA in Tax Court, District Court, or Court of Federal Claims.
- But the deadline for District Court or CFC is shorter than for a refund suit in a non-TEFRA proceeding.

AND THE DEPOSIT REQUIREMENT IS LESS ONEROUS THAN *FLORA*

- Non-TEFRA proceeding: pay the full amount assessed before filing for refund (Flora).
- TEFRA proceeding: only one partner has to deposit the additional tax due; the other partners are free-riders.

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#8 – DON'T RELY ON THE TMP TO PROTECT YOUR RIGHTS

- Only the partner filing an AAR can go to court if the IRS denies it.
- If your interests may diverge, consider filing your own AAR.

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#7 – WATCH THAT STATUTE OF LIMITATIONS!

- For FPAA/assessment, it's based on the last return filed—the partner's or partnership's.
- For AAR, it's based only on when the partnership return was filed.

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#6 – WANT TO AVOID TEFRA? DON'T USE A DISREGARDED ENTITY!

- Using a disregarded entity as a direct partner subjects the partnership to TEFRA. The small partnership exception doesn't apply.

#5 – THE CLOCK STARTS RUNNING RIGHT AWAY

- Non-TEFRA: two years after refund claim is disallowed.
- TEFRA: two years after the AAR is filed.

#4 – THE TMP ACTUALLY HAS 150 DAYS, NOT 90, TO CHALLENGE FPAA

- The TMP can challenge the FPAA in its capacity as a notice partner.
- But if another notice partner files first, that partner's suit is the one that goes forward.

#3 – THINK YOU'RE NOT ACTUALLY A PARTNER?

- You have to participate in the TEFRA proceeding to challenge your status as a partner.

#2 – YOU CAN'T ASSERT PARTNER-LEVEL PENALTY DEFENSES

- Court decides whether penalties apply in the TEFRA proceeding, and considers partnership-level defenses.
- The IRS can assess penalties against partners without a notice of deficiency. You'll have to pay and file a refund claim to assert partner-level defenses.

#1 – GET NOTICE!

- All partners: General right to participate in TEFRA proceedings.
- But only "notice partners": filing their own protests or petitions, deciding whether to accept a settlement from Exam or Appeals.

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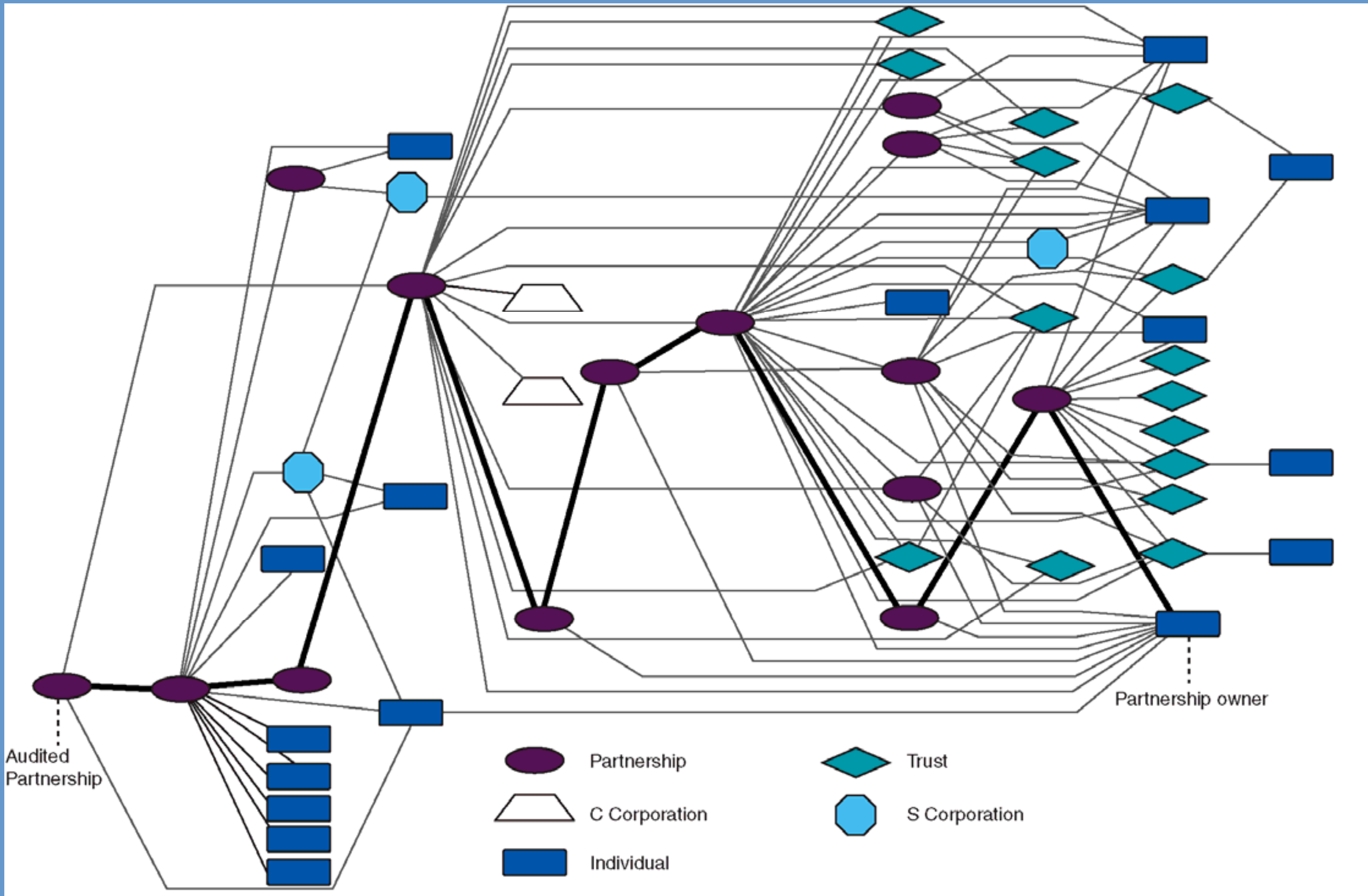
GETTING NOTICE – THE PRACTICAL DIFFICULTIES



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TRENDS, PROBLEMS, AND THE FUTURE

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TRENDS AND THEMES

- Partnership Tax Compliance Remains a Great Unknown.
- Growth in the Number of Partnerships and Large Partnerships.
- Shift From C Corporation Form to Partnerships.
- Huge Audit-Rate and Other Disparities.
- IRS Audit and Practical Problems.

Growth in the Number of Partnerships and Large Partnerships

- Between 2002 and 2011, the number of partnerships increased 47 percent to 3.3 million.
- From 2002 to 2011, the number of large partnerships more than tripled to more than 10,000.

Continued Shift From C Corporations to Partnerships

- While, between 2002 and 2011, the number of partnerships increased 47 percent, during that same period, the number of C corporations decreased by 22 percent to 1.6 million.

AUDIT-RATE AND OTHER DISPARITIES

- Large partnerships enjoy a low audit rate – 0.8% versus 27.1% for large corporations.
- About 64% of large partnership audits resulted in no-change versus 21% for large corporations.

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IRS Audit and Practical Problems

- If the TMP is not designated on the return, it may be difficult to identify a qualified TMP for the partnership. The IRS may need to limit the number of partners to which they pass-through audit adjustments.
- Complicated TEFRA procedures and complex, tiered structures often make it difficult to complete the audit on a timely basis and to link partnership returns to the partners' returns for purposes of flowing through computational adjustments.

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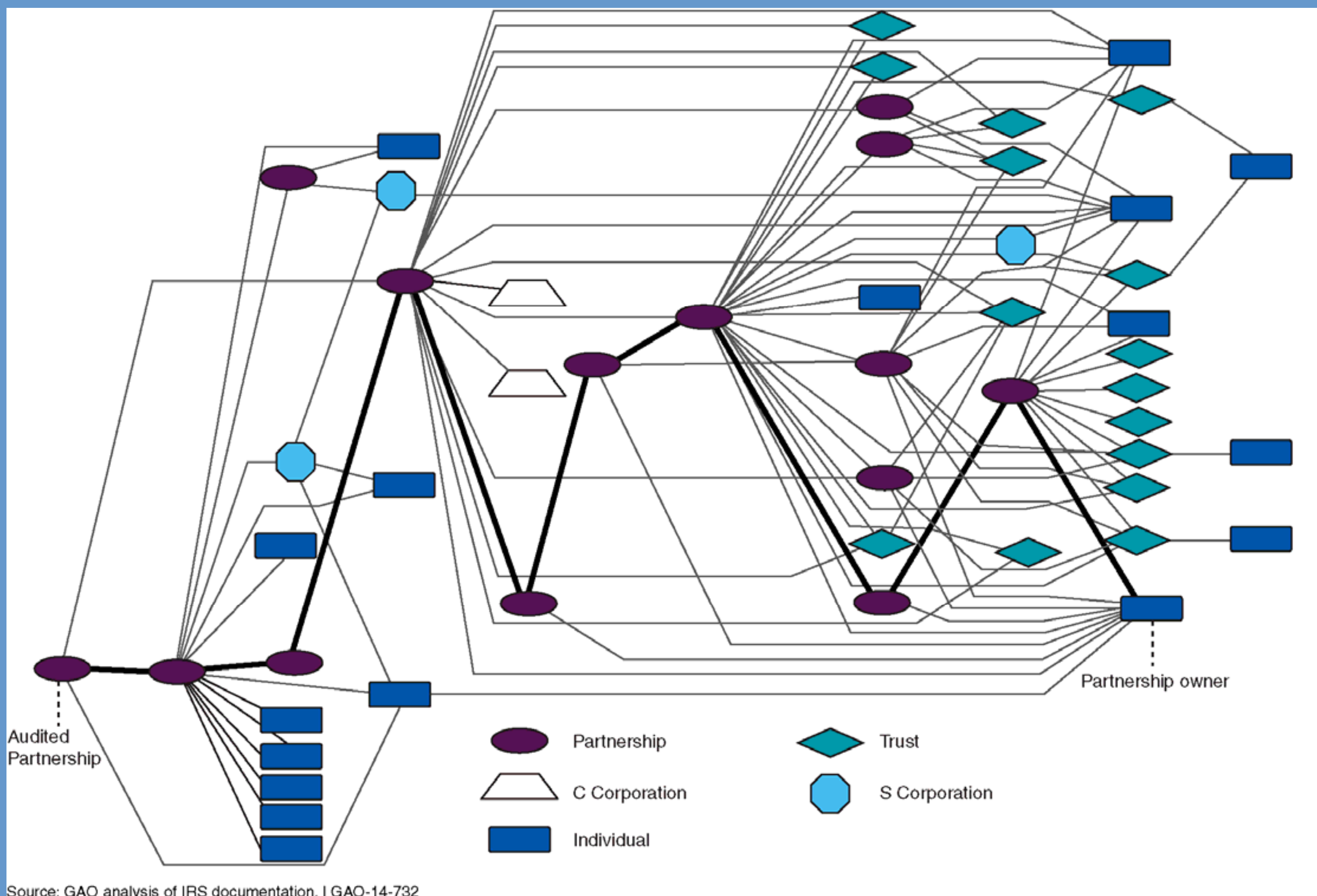
Flow Through Problems



PROBLEMS

- It is difficult to establish adequate IRS performance measures and to track the effect of partnership audits on partners' tax liabilities.

POSSIBLE FUTURE?

- Both the House Ways and Means Committee (in a February 2014 proposal) and the Administration (in the budgets for FY 2013, 2014, 2015, and 2016) have proposed significant changes to the TEFRA process for partnership audits and litigation.
- Although it's unclear whether or when these might become law, the increasing problems with TEFRA make it possible.

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HOUSE WAYS AND MEANS FEBRUARY 2014 PROPOSAL

- IRS adjustments would be assessed to and paid by the partnership itself (affecting current partners), rather than flow through computational adjustments to partners for the audit year.
- Opt out for small partnerships.

ADMINISTRATION'S FY 2016 BUDGET PROPOSAL

- Included a proposal to repeal TEFRA and the electing large partnerships (ELP) procedure.
- Would mandate new simplified partnership procedures (SPP) for partnerships with more than 100 direct partners or with at least one pass-thru partner.
- Under the SPP regime, the IRS would make adjustments at the partnership level that flow through to the partners who held their partnership interest during the year to which the adjustment relates.

QUESTIONS?

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