

NEW PARTNERSHIP AUDIT RULES ARE EFFECTIVE THIS YEAR: DOES YOUR LLC OPERATING AGREEMENT OR PARTNERSHIP AGREEMENT NEED TO BE REVISED?

You have a great relationship with your partners, but would you want to pay for your retiring partners' income taxes? Most partners would not. Without providing clear direction in your LLC operating agreement or partnership agreement, partners could be liable for former partners' taxes under new partnership audit rules. Some explanation follows:

When are these rules applicable?

New partnership audit rules, adopted in 2015, became effective this year. These rules provide a more streamlined approach for the IRS to audit partnerships (including LLCs) beginning with the returns filed for 2018.

Why do these rules matter?

Before the new rules, audit adjustments for partnerships were made at the partner level and most partners were notified directly by the IRS about an audit. Now, adjustment(s) will be made at the partnership level (in the year of the audit, not the year of the return being audited), and the IRS is no longer required to notify partners about an audit. The IRS will deal only with the "partnership representative" who must be designated by the partnership.

Without clear direction in an LLC operating agreement or partnership agreement, partners who benefited from a tax position may not be required to pay the taxes if the IRS audit occurs after they withdraw from the partnership or reduce their interest.

Can partnerships opt out?

Only certain partnerships can opt out of the new rules. They must have less than 100 partners and have no LLCs or other partnerships as owners, among other things. The opt-out election must be made each year on the IRS Form 1065 filed by the partnership. If a partnership opts out of the new rules, audits are conducted at the partner level and the new rules do not apply.

What action should partnerships (including LLCs) take?

LLC operating agreements and partnership agreements should be amended to provide clear direction on how the LLC/partnership should operate under the new rules:

- *Partnership Representative.* Agreements should designate a partnership representative.
- *Direction to Opt Out.* Consider whether to include a requirement for the partnership representative to opt out of the new rules, if applicable, and prohibit transfers of partnership interests to ineligible entities (other LLCs or partnerships).

- *Notice to Partners.* As part of the new streamlined approach under the new rules, the IRS is no longer required to notify partners about an audit. Partners should consider whether the partnership representative should be required to provide notice of an audit to all partners.
- *Push out.* Any audit adjustments to the partnership's income will be charged to and paid by the partnership in the year of audit unless the partnership representative issues adjusted Forms K-1 to those individuals who were partners in the year being audited. A direction to push out all adjustments on amended Forms K-1 can be included in the agreement, if desired.

If you have any questions about this information memo, please contact [Jennifer M. Boll](#), any of the [attorneys](#) in our [Tax Practice Group](#), or the attorney in our firm with whom you are regularly in contact.



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