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Partnership Representatives: Eligibility, Designating, IRS Designation, Authority and POA

Treasury has published final regulations regarding the designation and authority of the partnership representative under the centralized partnership audit regime.

BACKGROUND

On August 6, Treasury and the IRS published final regulations regarding the designation and authority of the partnership representative under the centralized partnership audit regime (CPAR). Starting with tax years that begin after December 31, 2017 (i.e. 2018 tax years), partnership tax filings will now be subject to the new centralized partnership audit regime that was enacted within the 2015 Bipartisan Budget and Reconciliation Act. This new audit regime replaces in its entirety the former unified audit procedures, more commonly known as the TEFRA (Tax Equity and Fiscal Responsibility Act) rules. Included within the new regime is the position of Partnership Representative (PR), replacing the position of Tax Matters Partner that existed under TEFRA. As enacted in IRC Section 6223, the designation and eligibility of the PR was vague, and the powers provided to the PR were extremely broad and absolute. As a consequence, there is a clear and definite need for substantive regulatory guidance.

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The final regulations do an admirable job of balancing several specific interests:

- Certainty – specifically, making clear that state law is subordinate to the federal law in these administrative matters.
- Administrative efficiency – in particular, the drafting of the regulations focused on avoiding rules or procedures that allow for unnecessary delays in the administration of a proceeding.
- Flexibility – the rules are designed to allow the partnership and interested parties maximum flexibility to appoint the person that is in the best position to manage a proceeding.

MAIN PROVISIONS

THE FINAL REGULATIONS IN DETAIL

Proposed regulations regarding the PR were first published on June 4, 2017, followed by a public comment period and a public hearing on September 18, 2017. The preamble to the final regulations contains an extensive discussion of the public comments, outlined in the five broad categories of guidance that is contained in the regulations:

1. Eligibility to serve as PR
2. Designating or changing a PR
3. IRS designation of a PR
4. Authority of the PR
5. Other matters

The final regulations are best viewed within these five primary categories of guidance.

1. ELIGIBILITY TO SERVE

The only requirement to serve as PR under IRC Section 6223(a) is that the PR be a "partner (or other person) with a substantial presence in the United States." The 2017 proposed regulations further clarified by including "capacity to act" language. The capacity to act language has been removed in the final regulation, leaving only the substantial presence in the U.S. requirement. The substantial presence test requires that the person make themselves available to meet in person with the IRS in the United States at a reasonable time and place, have a U.S. taxpayer ID, and must also have a United States street address and telephone with a United States area code.[1]

The proposed regulations allowed for the designation of an entity as PR. This is retained and is further clarified by specifically noting that a disregarded entity can serve as PR. If an entity is designated as PR, the partnership must also then appoint a "Designated Individual" (DI) to act on behalf of the PR. Just like the PR, the DI must also satisfy the requirement of having a substantial presence in the United States. The purpose of the substantial presence requirement is to ensure the ability for the PR to be available to the IRS in reasonable manner.

One of the most significant clarifications contained in the final regulations is that the partnership may actually designate itself as the PR.[2] As an entity serving as PR, the partnership would then need to appoint a DI to act on its behalf. Ultimately, by designating itself as the PR, this allows the partnership to appoint an appropriate partner or employee, such as the CEO or CFO, to serve in this role. It is worth noting that the DI does not have to be an employee of the partnership or an employee of the designated PR, but the rules do allow that flexibility.

2. DESIGNATING OR CHANGING A PR

The rules make it clear that each partnership must have a PR.[3] The preamble confirms that designation of a PR cannot be delayed until there is a notice of a proceeding. A key theme that is seen consistently within the preamble is that the rules are clearly intended to prevent the sort of administrative delays that occurred under TEFRA. As such, holding out the designation of a PR will not be allowed. Designation of the PR, and if necessary the DI, shall be made on the Form 1065 for each taxable year, although if a partnership has chosen to elect out of the CPAR no PR designation is required to be made.

Taxpayers will have limited opportunity for a partnership to change its PR and/or DI designations for a particular taxable year. However, such changes can only be made by the partnership with the filing of a valid Administrative Adjustment Request (AAR) (that is being filed for reasons other than making the change) or upon receipt of a notice of administrative proceeding from the IRS, i.e., in the context of an administrative proceeding. It is important to note that because the selection for examination is issued to the partnership, not the PR, there should be adequate opportunity at that time for the partnership to change the PR designation if necessary.

The preamble discusses whether there might be a separate form or system provided for making ongoing changes and/or designations. It was noted that the IRS does not currently have a system to process such changes outside of the administrative proceeding process or when an AAR is filed, hence the limitations on the timing of such changes. It is also noted that as experience is gained in the system these rules may be revisited in the future with additional forms, instructions or guidance.

In addition to the partnership having the authority to unilaterally change the PR and/or DI designation, the PR/DI may also resign from the role. However, the resignation of a PR may only occur after receipt of a notice of administrative proceeding (NAP), and may not be done with the filing of an AAR.

1 Reg. Sec. 301.6223-1(b)(2).

2 Reg. Sec. 301.6223-1(b)(1).

3 Reg. Sec. 301.6223-1(a).

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3. IRS DESIGNATION OF PR

The basic rules provide that a PR designation is in effect unless and until there is a valid resignation, revocation, or the IRS determines that the designation is not in effect.[4] A determination that the designation is not in effect would occur if, as an example, the PR no longer has a substantial presence in the United States as required by the Code and a revocation or resignation has not occurred. Allowing the designation to remain in place would run counter to the objective of avoiding unnecessary administrative delays.

The regulations clarify that the IRS may not designate an IRS employee, agent, or contractor as the PR, unless the individual is actually a partner in the partnership.

4. AUTHORITY OF THE PR

An important aspect of the new consolidated audit regime is that the authority of the PR to act on behalf of the partnership in administrative proceedings emanates from the federal law that grants such authority. As such, state laws, rules or requirements regarding who may or may not have authority to act on behalf of the partnership and its partners are considered by the Treasury and IRS to be superseded by the rules outlined in Section 6223 and the regulations. A key administrative burden under the TEFRA rules was in the deference that was provided to state law on such matters. Therefore, as it relates to these administrative proceedings, the PR has been provided with absolute authority to act on behalf of the partnership.

It is noted in the preamble that this absolute authority does not preclude the partnership and/or its PR from entering into an agreement that makes the PR accountable for any actions taken, but any such agreement does not directly impact the administration of the consolidated audit rules.

5. OTHER MATTERS

The final regulations clarify that a Power of Attorney can be utilized by the PR/DI to appoint a representative to act on its behalf. It further clarifies that designation of a POA does not designate the POA as the PR/DI. The POA is merely authorized to act on behalf of the PR/DI.

BDO INSIGHTS

The final regulations provide much needed guidance and address the many open points and questions that existed regarding the PR under the new partnership consolidated audit rules. While much uncertainty continues to exist with respect to implementation of the centralized partnership audit rules, we are now more prepared to face these challenges. As such, there are a number of very important steps and considerations that should evaluated by partnerships and their advisors, including:

- Determine whether the partnership is eligible to elect out of the CPAR. Given the continuing uncertainty around implementation of these rules, electing out when possible may be advisable.
- To the extent subject to the CPAR, it is necessary to ensure that the 2018 tax filings include the designation of a proper PR and, if applicable, a DI to act on behalf of the PR.
- It is very important to recognize the extent of the authority to bind the partnership and its partners that is provided to the PR. The authority of the PR to bind the partnership and its partners in IRS administrative proceedings is significantly greater than any authority provided to the Tax Matters Partner under the TEFRA rules. As such, making the selection of a PR and DI should not be taken lightly and care is warranted in selecting the individual and/or entity to fill these roles.
- In order to ensure that a clear and agreed upon set of processes and procedures exist to identify, designate, and potentially replace the PR and DI, consideration should be given to formally amend the Operating or Partnership Agreement. In addition to incorporating the PR “options” into the operating agreement, consideration should be given to incorporating the many other possible implications resulting from application of the CPAR.
- An additional matter to consider is inclusion of any sort of indemnification or similar clauses within the agreements or requirements related to the obligations of the PR. Given the extensive authority granted to the PR, reasonable control ought to exist to ensure protection of past, present, and future partners.

4 Reg. Sec. 301.6223-1.

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