

# Audit Regime's Modification Options Also Have Consequences

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By Eric Yauch

Recent guidance on the partnership audit regime highlights the importance of understanding the procedural drawbacks of each option available for taxpayers challenging adjustments.

Depending on what taxpayers choose to do under the audit regime's modification process, they may have to pay taxes, penalties, and interest upfront before seeking judicial review, Kate Kraus of Allen Matkins Leck Gamble Mallory & Natsis LLP told *Tax Notes*.

But if it's later determined that those amounts shouldn't have been paid, getting that money back could be problematic, Kraus said.

The centralized partnership audit regime allows the IRS to audit partnerships at the entity level and provides taxpayers with options for challenging imputed underpayments. The partnership can seek a modification at the entity level, but whether it will be accepted is at the discretion of the government.

The partners can also file amended returns or use what's referred to as the pull-in procedure, which allows partners to pay their share of tax and adjust tax attributes without having to file an amended return. To use these types of modifications, taxpayers must pay any additional amounts due when requesting the modification.

Procedural questions have been raised since the IRS initially released proposed regulations in 2017, and with the release of the latest batch of final regs ([T.D. 9844](#)) in December 2018 and [new forms](#) in February, it's becoming clear that taxpayers need to carefully consider the consequences of every option.

## Being Proactive

For example, if the partnership — whose partners use the amended return or pull-in procedures and make full payment of taxes, penalties, and interest — then seeks judicial review and prevails, that means the partners would have paid tax under the modification procedure that they shouldn't have had to pay.

Under the final regulations from December and according to the modification forms, the partners would have to file another amended return to reflect the court's judgment and request a refund, Kraus noted.

"The problem is that the statute of limitations for the refund claim is not coordinated with the

audit regime proceeding in court,” Kraus said. “The statute of limitations is determined under [section 6511](#), and it might expire before the court has issued its judgment.”

The partners would therefore have to file a protective refund claim before the statute of limitations expires, Kraus said.

Kraus said it’s good that this issue is addressed in the instructions for Form 8982, “Affidavit for Partner Modification Amended Return Under IRC [Section 6225\(c\)\(2\)\(A\)](#) or Partner Alternative Procedure Under IRC [Section 6225\(c\)\(2\)\(B\)](#).” She added, however, that “I expect that many partners will not realize that they may have to file a protective claim in order to be entitled to a refund in the event that they prevail in court.”

The regs from December provide that no refunds are available under the pull-in modification procedure, Kraus said. If a partner used the pull-in procedure and paid too much tax, the partner will need to file an amended return to get a refund.

The instructions for Form 8980, “Partnership Request for Modification of Imputed Underpayments Under IRC [Section 6225\(c\)](#),” and the Form 8982 certification “by the applicable partner who is requesting the alternative procedure approach also state that no refunds are available under the ‘alternative procedure,’” Kraus added. “It’s good that the instructions and certification emphasize this point; many people might not expect that result.”

Jonathan Stein of Goulston & Storrs PC agreed that this is a salient point and taxpayers should be aware of it.

What it means is that if an audit results in a reallocation of income or expense from one partner to another, the partner who owes money can use the alternative procedure, but the partner who could be entitled to a refund must file an amended return to get the modification and the refund.

## Penalty Issues

Kraus also cautioned that if the partnership doesn’t request modification or make a push-out election, penalties are determined solely based on the partnership’s facts — it doesn’t matter whether a partner had reasonable cause or good faith.

One might think that with the amended return modification a partner could take into account her reasonable cause and good faith when calculating the amount of penalties she must pay in conjunction with the modification process, Kraus said.

But she would be wrong, Kraus said, adding, “Instead, she has to pay the full amount of penalties and then request a refund for the IRS based on her reasonable cause and good faith.”

Stein said some in the tax community hoped that Treasury and the IRS would use the amended return modification procedure and the pull-in procedure to provide a relatively frictionless way of having the right partners pay the right amount of tax.

“Instead, what they’ve done is provided for procedures that either provide limited relief in the

case of penalties or lack flexibility in terms of requiring amended returns to address all partnership items,” Stein said. “As a result, most partnerships without tax-exempt partners are still expecting to use the push-out election.”