

TEFRA and the Tax Matters Partner (TMP) Too Much Power?

Partnership Committee

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Panelists

Steven Schneider, Goulston & Storrs

Steven Dixon, Miller & Chevalier

Ronald Buch, Bingham McCutcheon

Thomas Greenaway, KPMG

Scope/Role of TMP

Scope:

- The term “tax matters partner” carries meaning only within TEFRA unified partnership audit and redetermination proceedings. *See* IRC § §6221-6234.

Role:

- TMP generally represents the partnership before the IRS and in federal civil tax litigation (including choice of litigation forum).
- The TMP is required to keep the partners informed of partnership proceedings.

Going Beyond TMP Scope

Section 8.04 Tax Matters Member.

- X-COMPANY shall be the tax matters partner (“Tax Matters Member”) of the Company for purposes of all applicable tax laws. The Tax Matters Member shall perform the following:
- Prepare and file or supervise the preparation and filing of the Company’s foreign, federal, state and local partnership income tax returns.
- Furnish or cause to be furnished to the Members, within sixty (60) days after the close of the taxable year of the Company, all tax information with respect to the Company as may be required by the other Members for the preparation of any separate tax return which they may be required to file.
- Prepare or cause to be prepared, within fifteen (15) days after the close of each month, a financial report for such month, and shall cause a copy of the report to be furnished to the other Members.

Who may be a TMP?

- A general partner of a partnership or a member-manager of a limited liability company.
- General partner may be a TMP only if that person was a general partner at some time during the tax year at issue, or is a general partner at the time of the designation.
- Query: Can a partner with no economic stake in the tax year at issue (e.g., 0% general partner) be a TMP?

What happens if there is no TMP?

The regulations provide ordering rules for the IRS to select a TMP if there is otherwise no TMP:

- (i) General partner with the largest profits interest for the year at issue.

- (ii) IRS may select another TMP if the general partner with the largest profits interest cannot be determined or is disqualified.

- (iii) IRS may select a limited partner if no general partner is available.

TMP Responsibilities/Notice

- Notice: the TMP must give partners notice of all significant events in a TEFRA partnership proceeding, including notice of the beginning of partnership proceedings and the notice of final partnership administrative adjustments.
- TMP must furnish information to all “notice partners” and all representatives of “five-percent notice groups” of all significant audit and litigation events, including, but not limited to, closing conference with the examining agent, proposed adjustments, rights of appeal and requirements for filing a protest, and consent of the period of limitations with respect to all partners.

TMP Responsibilities/Notice

Sample notice language:

“Notwithstanding anything herein to the contrary, the Tax Matters Partner shall, upon receipt of notice from the IRS, give notice of an administrative proceeding with respect to the Company to all Members in accordance with, and as if such Members were each a “notice partner” pursuant to, Section 6231(a)(8) of the Code.”

TMP Powers

- **Settlement:** TMP can enter into a binding settlement agreement at the administrative stage of TEFRA proceedings, but the settlement only binds non-notice partners.
 - **Statute of Limitations:** TMP has the power to execute an extension of the statute of limitations for the partnership items and affected items of all partners in the partnership.
 - Revised Form 872 (Oct. 2009): “... this agreement also extends the period of limitations for assessing any tax ... attributable to partnership items, affected items, computational adjustments, and partnership items converted to nonpartnership items.”
 - **Substituted Returns:** In some cases, the TMP may file a request for an administrative adjustment.
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Reigning in your TMP

- **SAMPLE 1.** In the event of an income tax audit of any Return, to the extent the LLC is treated as an Entity for purposes of the audit, including administrative settlement and judicial review, the tax matters partner shall be authorized to act for the LLC, **subject, however, to the Consent of the Members as to any extensions, filings, agreements, settlements** or any other material action as to any such matter.
 - **SAMPLE 2:** . . . [X] shall be the tax matters partner . . . shall exercise all rights, obligations and duties of a tax matters partner under the Code; *provided, however,* that . . . [X] **shall not have any right to settle** or compromise any matter raised by the Internal Revenue Service **without the approval of the Executive Committee**, and the **other Partners** shall be kept informed of, and **given an opportunity to participate in a non-binding manner** in, all such matters which the tax matters partner deems to be material; *provided, however,* that **if a tax settlement involves any items or would have a disproportionate material adverse impact on any Partner**, or any of its respective interest holders, such Partner shall be given a reasonable period of time to approve or disapprove the proposed settlement, which approval shall not be unreasonably withheld, conditioned or delayed.
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Things to think about when Drafting TEFRA/TMP provisions

- TMP with no stake in the fight
- TMP with power to make all tax elections
- Appointing and ineligible TMP, including limited partners, non-managing members and non-partners
- Imposing no restriction on TMP's ability to extend the statute of limitations or choose litigation forums

Moving Power Away From TMP – Sample language

Tax Matters Handled By the Company: The Board of Managers, on behalf of the Company, shall have full authority to negotiate with, to conclude agreements with or to refuse to agree with Federal, state, local and foreign taxing authorities as to the taxable income of the Company for any taxable period and any determination of such taxable income shall be binding upon the Members, each of whom individually shall be liable to pay any additional tax and interest and shall be entitled to receive any refund and interest resulting from such determination, provided, that the Company shall not bind any Member to any extension of the applicable statute of limitations or to a settlement agreement without such Member's prior written consent which consent shall not be unreasonably withheld. The Company may also make such elections, including, without limitation, an election under Section 754 of the Code, as the Board of Managers may determine.

Appointing an Alternative TMP – Sample language

[General Partner] delegates to [Ineligible TMP] in its capacity as Tax Agent, to the extent permitted under the Code, its authority as Tax Matters Partner of [Entity], and [Ineligible TMP] accepts this delegation. For the avoidance of doubt, [Ineligible TMP]'s authority under this Agreement includes the authority to extend the period of limitations for the assessment of any taxes imposed by the Code with respect to any person which is attributable to any item of income, gain, loss, deduction, or credit of [Entity].

To the extent that the Internal Revenue Service does not recognize [General Partner]'s delegation of its authority as tax matters partner to the Tax Agent pursuant to this Agreement or otherwise refuses to treat the Tax Agent as the Tax Matters Partner, [General Partner] will execute and discharge its duties and obligations as Tax Matters Partner in accordance with the advice, and at the direction, of the Tax Agent.

Things to think about when Drafting TEFRA/TMP provisions

- TMP behaves badly
- Tax shelters where promoter is TMP
- Failing to provide deadlines for partners and the partnership to provide information to each other
- Failing to provide for minimum tax distributions if necessary (e.g., when TMP chooses district court litigation)

K-1 Deadlines – Liberal vs. Restrictive

Complete discretion. Managing Member shall use all reasonable efforts to cause the preparation and timely filing of all tax returns required to be filed by the Company pursuant to the Code and all other tax returns deemed necessary and required in each jurisdiction in which the Company does business.

Restrictive... The Administrative Manager shall cause to be prepared and timely filed (not including any extensions of their due date, unless the Consent of the Managers shall have been obtained) all federal, state and local tax returns of the LLC (the “Returns”) for each taxable year for which such Returns are required to be filed, and **shall use all reasonable efforts to provide the Members by March 1st of each year with draft tax information** required to be furnished to the Members for federal, state and local income tax reporting purposes, and the final such information in all events no later than March 15th of each year.

Other TMP Administrative matters

- **Costs:** “The Tax Matters Member will be entitled to reimbursement from the Company for all reasonable costs and expenses incurred by it in complying with and carrying out its responsibilities as Tax Matters Member. The Tax Matters Partner shall receive no compensation for its services.”
- **Changing TMPs:** “The Tax Matters Member may be changed by a vote of the Board.”

Circular 230

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