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To File or Not to File an Amended Partnership Tax Return Subject to TEFRA Rules

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Someone brings to your attention that a previously filed partnership tax return is incorrect. This may require adjustments to the income, deduction, gain, loss or credit, or allocation of such items, on the original return. Perhaps adjustments are needed to correct the identity of partners and report transfers of ownership not known at the time the original return was filed. The list of reasons why an amended partnership tax return may be required could be endless. Given the impact that an amended partnership tax return can have on all of the partners, careful consideration must be given to the procedures required to effect a change to the tax return as the rules have changed with the new Form 1065X.

Background

Generally, an amended partnership tax return is filed on the new Form 1065X. The IRS has also revised and reissued Form 8082, *Notice of Inconsistent Treatment of Administrative Adjustment Request* ("AAR"). Partnerships filing returns are classified as TEFRA or non-TEFRA partnerships. TEFRA partnerships are subject to consolidated partnership procedures which can be quite intricate. A non-TEFRA partnership, or "small partnership," is one with no more than 10 partners at all times during the tax year, each of whom is an individual (or resident alien), a C corporation, or an estate of a deceased partner (and a husband and wife are considered one partner) and are not subject to the consolidated partnership procedures.

Previously, the process for correcting an item on a filed partnership return involved complex rules and forms. TEFRA partnerships made corrections by filing an AAR on a Form 8082. The Tax Matters Partner ("TMP") could elect to have the request treated as a "substituted return" which essentially was an amended partnership return or a claim for credit or refund caused by the correction, on behalf of the partners. Non-TEFRA partnerships made changes to the filed return by filing a revised 1065 and checking the amended return box which was considered an informational return only. The non-TEFRA partners would then file an amended return with the revised Schedule K-1.

The changes made are still complex and require more analysis. Now, TEFRA partnerships that do not file electronically should file Form 1065X instead of Form 8082. The TMP can elect to have Form 1065X treated as a substitute return or request a credit or refund on behalf of the partners (similar to Form 8082). TEFRA partnerships filing electronically should continue to use Form 8082. Non-TEFRA partnerships that do not file electronically should use Form 1065X. Non-TEFRA partnerships that file electronically should file Form 1065 and check the amended return box.



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Issues to Consider

Many issues must be considered before amending a partnership tax return; for example, should Form 1065X be filed? Should it be filed as an AAR by the TMP and if so, should it be treated as a substituted return request? If the amended return reflects a net increase to taxable income, consider a substituted return. This allows the IRS to assess tax to each partner for his/her share of the increased taxable income without an IRS audit. If the amended return reflects a net decrease to taxable income, an AAR may be preferable as the IRS is likely to take no action if a substituted return is filed.

Partners who receive an amended Schedule K-1 from a TEFRA partnership should file Form 8082 as an attachment to their original or amended individual tax return, and file a copy of Form 8082 with the IRS Center where the partnership filed its Form 1065 or Form 1065X. If the partnership filed Form 1065X as an AAR that reflects a net decrease to taxable income, the IRS will do one of the following: start an examination, approve Form 1065X as filed, or take no action. If the IRS takes no action, the TMP can petition the Tax Court.

If the IRS starts an examination, the TMP should timely provide the name, address and tax identification number of every unidentified indirect partner to the IRS office that issued the notice. Otherwise, the assessment of tax to any unidentified indirect partner can be made any time until one year after the indirect partner has been identified.

The TMP must continuously update the partnership's partners of all IRS matters concerning the examination since this could impact the partnership's statute of limitations. For example, one or more partners may choose to "opt out" at any time during the consolidated partnership examination, its settlement, its post examination appeals, or its judicial remedies after a Final Partnership Administrative Adjustment Report is issued. Partners who opt out usually are at a disadvantage in their dealings with the IRS given that they may not have sufficient knowledge of the partnership's affairs.

Clearly, these consolidated audit procedures are complex. An amended partnership tax return should be avoided whenever possible. In some situations, however, there may be no choice but to file.

If you have any questions about your rights and responsibilities when a partnership tax return needs correction, please contact your CBIZ Tofias tax advisor, or you may reach us at TheBottomLine@cbiztofias.com and 617.761.0600.

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