

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Centralized Partnership Audit Regime Rules Have Been Implemented; However, Initial No-Change Rates Are High and Measurable Goals Have Not Been Established**

March 17, 2022

Report Number: 2022-30-020

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**HIGHLIGHTS: Centralized Partnership Audit Regime Rules Have Been Implemented;  
However, Initial No-Change Rates Are High and Measurable Goals Have Not Been Established**

Final Audit Report issued on March 17, 2022

Report Number 2022-30-020

**Why TIGTA Did This Audit**

In November 2015, § 1101 of the Bipartisan Budget Act of 2015, repealed the Tax Equity and Fiscal Responsibility Act of 1982 partnership procedures and replaced them with a new centralized partnership audit regime. By the beginning of Fiscal Year 2018, the IRS started to examine partnership returns using the centralized partnership audit regime procedures.

This audit was initiated to determine whether the IRS adequately implemented the changes to the partnership audit rules as specified in § 1101 of the Bipartisan Budget Act of 2015. This report presents the results of our implementation audit.

**Impact on Tax Administration**

The centralized partnership audit regime provides a centralized method of examining items of a partnership that should result in partnership examinations becoming more efficient. Examinations being more efficient should result in more audits being performed, thereby increasing taxpayer compliance.

**What TIGTA Found**

TIGTA's review of the initial examination efforts under the centralized partnership audit regime rules found that as of the end of Fiscal Year 2021, the IRS has completed a total of 480 examinations. These examinations include returns filed for Tax Years 2016 through 2019. The IRS closed 376 (approximately 78 percent) of these partnership returns as a no-change. This rate is high in comparison to the average no-change rate of 50 percent for all partnership returns for the same tax years, closed as of September 30, 2020. IRS management agreed that the no-change rate is high and believes that it is too early in the process to analyze and form conclusions about the no-change rate. However, they also confirmed that they have not determined acceptable rates or ranges they would use to measure closure types for examinations.

The IRS does not establish goals based on audit procedures such as the centralized partnership audit regime. However, the centralized partnership audit regime provides a centralized method of examining items of a partnership that should limit the burden on the IRS in both the examination and judiciary process. Therefore, the IRS should measure whether partnership examinations performed after the centralized partnership audit regime was in place are taking less overall resources to complete and administer in comparison to pre-centralized partnership audit regime results. By not having these targets, the IRS cannot measure the effectiveness of the new audit rules on taxpayer compliance.

The IRS has developed a manual compliance monitoring process to confirm adjustments to partners' returns when a partnership makes a push-out election. However, the process is not fully systemic. Without a proper systemic monitoring process, the underreporting or nonreporting of adjustments may only be detected through a cumbersome time intensive manual process.

**What TIGTA Recommended**

TIGTA recommended that the IRS address the centralized partnership audit regime examination no-change rates, establish goals and measures that address the expected outcomes from the implementation of the centralized partnership audit regime, and implement a fully systemic method to monitor and verify push-outs are properly reported on partners' returns.

The IRS agreed with one recommendation and plans to request the development of a systemic method to verify pushouts. The IRS disagreed with two recommendations. TIGTA believes these recommendations will help the IRS address factors contributing to high no-change rates and establish goals and measurements based on the expected outcomes from the implementation of the centralized partnership audit regime.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

**U.S. DEPARTMENT OF THE TREASURY**  
**WASHINGTON, D.C. 20220**

March 17, 2022

**MEMORANDUM FOR:** COMMISSIONER OF INTERNAL REVENUE

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Centralized Partnership Audit Regime Rules Have Been Implemented; However, Initial No-Change Rates Are High and Measurable Goals Have Not Been Established (Audit # 202030006)

This report presents the results of our review to determine whether the Internal Revenue Service has adequately implemented the changes to the partnership audit rules as specified in § 1101 of the Bipartisan Budget Act of 2015.<sup>1</sup> This review is part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance*.

Management's complete response to the draft report is included as Appendix III.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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<sup>1</sup> Pub. L. No. 114-74, § 1101, 129 Stat. 625 (2015). Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.) (repealed 2015).

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## **Background**

For Federal income tax purposes, a partnership is not a taxable entity. A partnership is a pass-through entity and the items of partnership income, deductions, gains, losses, and credits are reported on the partners' income tax returns. A partnership is required to file Form 1065, *U.S. Return of Partnership Income*, an annual information return that sets forth items of partnership information necessary to carry out the income tax on the partners. Due to partnership and partner returns being so closely related, examinations of partnership returns conducted by the Internal Revenue Service (IRS) have generally involved the partners as well as the partnership.

In November 2015, § 1101 of the Bipartisan Budget Act of 2015 repealed the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) partnership procedures and replaced them with a new centralized partnership audit regime (hereafter referred to as the centralized partnership audit regime).<sup>1</sup> According to the U.S. Department of Treasury and the IRS, applying TEFRA rules to audits of large partnerships was inefficient and the law was overly complex. While TEFRA rules were established to unify audit procedures for covered partnerships, the centralized partnership audit regime was established to help alleviate some of the complexity and inefficiency of auditing partnerships.<sup>2</sup>

TEFRA examination procedures required the tax treatment of all partnership items to be determined at the partnership level, as does the new centralized partnership audit regime. However, under TEFRA, an examination on the partnership's reporting of partnership items also required resolving the issues respectively with all partners, and collection of underpayments established under TEFRA was done at the partner level. In general, the centralized partnership audit regime does not require resolving issues with the partners.

Any adjustment to items of income, gains, losses, deductions, or credits of a partnership for a partnership taxable year are generally determined at the partnership level.<sup>3</sup> The centralized partnership audit regime provides, by default, that the partnership, not the partners, must pay any underpayment of tax (called an imputed underpayment) resulting from adjustments made to the partnership's return. However, one option the partnership has to pay the imputed underpayment is "pushing out" the related examination adjustments to the individual partners for reporting on their tax returns.<sup>4</sup>

Partnerships that file information returns (previously defined as Form 1065) for tax years starting January 1, 2018, must follow rules under the centralized partnership regime unless an eligible partnership elects out of the audit regime under Internal Revenue Code (I.R.C.) § 6221(b). An eligible partnership may make an annual election out of the centralized partnership audit regime

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<sup>1</sup> Pub. L. No. 114-74, § 1101, 129 Stat. 625 (2015). Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.) (repealed 2015).

<sup>2</sup> Under 26 U.S.C. § 6231 (effective September 3, 1982, to December 31, 2017), TEFRA included any partnership required to file a return under Internal Revenue Code § 6031(a) except those having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner.

<sup>3</sup> According to I.R.C. § 6241(2), adjustments to partnership related items may include transactions with, basis in, or liability of, the partnership and any partner's distributive share thereof, such as in imputed underpayment.

<sup>4</sup> The push-out process is further explained on page 14 of this report.

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on a timely filed Form 1065. To be eligible, the partnership must generally have 100 or fewer partners.<sup>5</sup> Furthermore, all partners must be either individuals, C corporations, foreign entities that would be treated as a C corporation if they were domestic, S corporations, or estates of deceased partners.

Under centralized partnership audit regime rules, a partnership must designate a partnership representative (person, entity or even itself) on its tax return for each taxable year unless it makes a valid election out of the centralized partnership audit regime. The partnership representative shall have the *sole authority* to act on behalf of the partnership.

As part of its audit procedures, the IRS will notify the partnership of its selection for examination by sending a Letter 2205-D, *Notice of Selection for Examination*, for each tax year under examination. At that time, the taxpayer is still allowed to file an Administrative Adjustment Request (AAR) for the tax year to be examined.<sup>6</sup> Thirty to 60 days after the Letter 2205-D is sent, the IRS will send the partnership a Letter 5893, *Notice of Administrative Proceeding – Partnership*, and the partnership representative a Letter 5983-A, *Notice of Administrative Proceeding – Partnership Representative*.<sup>7</sup> The Notice of Administrative Proceeding letters inform the partnership and partnership representative that the IRS has started an examination. After this notice is issued, the partnership may not file an AAR.

If the audit issues reviewed during an examination result in no adjustment, it will be disposed of as no-change and closed. If the examination results in adjustments based on identified and developed audit issues, the IRS will send the partnership representative a summary report package. The summary report contains the preliminary audit results and, if applicable, the imputed underpayment computation resulting from the examination adjustments. If certain conditions are met, the partnership has 30 days to decide if it would like to appeal the summary report package. The appeals process is administered by the IRS's Independent Office of Appeals (hereafter referred to as Appeals).

Once the partnership indicates that it agrees with the preliminary audit results or the appeals process of the summary report package is completed, the IRS will issue a Notice of Proposed Partnership Adjustment to both the partnership and partnership representative, which starts the modification period.<sup>8</sup> During this period, the partnership representative has 270 days to submit a request to modify the imputed underpayment. The IRS will consider the submission and calculate a modified imputed underpayment, when applicable. If the partnership disagrees with the modified imputed underpayment, the partnership representative can request a conference with IRS management and an Appeals conference.

After the modification period has ended and any taxpayer requested conferences have been held, the IRS issues the Final Partnership Adjustments package to the partnership and partnership representative. The issue date of this package starts both the 45-day window for

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<sup>5</sup> I.R.C. § 6221(b)(1)(B) defines an eligible partnership as one required to furnish 100 or fewer Schedule K-1s, *Partner's Share of Income, Deductions, Credits, etc.* Therefore, an eligible partnership may meet its maximum Schedule K-1 issuance to 100 or less partners.

<sup>6</sup> Partnerships subject to the centralized partnership audit regime file an AAR instead of an amended return. Generally, a partnership may file an AAR within three years of the date of filing the partnership return or the due date of the return, whichever is later.

<sup>7</sup> Interim Guidance LB&I-04-1019-010, effective date October 31, 2019.

<sup>8</sup> I.R.C. § 6235.

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the partnership to elect a push out of the final partnership audit adjustments to the partners as an alternative to the payment of the imputed underpayment, and the 90-day window to petition the court. The partnership representative may waive the receipt of the package, which nullifies the ability of the partnership to push out the audit adjustments to partners or petition the court.

To push out the underlying audit adjustments to its partners instead of paying the imputed underpayment at the partnership level, the partnership representative must complete and electronically submit Form 8985, *Pass-Through-Statement Transmittal/Partnership Adjustment Tracking Report*, along with Forms 8986, *Partner’s Share of Adjustment(s) to Partnership-Related Item(s)*, which were furnished to its partners.<sup>9</sup>

Examiners in both the Large Business and International (LB&I) and Small Business/Self-Employed (SB/SE) Divisions conduct partnership examinations under the centralized partnership audit regime. The LB&I Division serves corporations, subchapter S corporations, and partnerships with assets of \$10 million or more while the SB/SE Division serves small businesses, approximately 3.8 million partnership filers, and self-employed taxpayers. The Department of the Treasury and the IRS have published Treasury regulations related to the centralized partnership audit regime rules, and the IRS has created interim procedures based on those regulations, which are detailed in Appendix II.<sup>10</sup> Both divisions conduct centralized partnership audit regime examinations in the same manner, relying on the same training materials, job aides, and procedures.

Legislation allowed partnerships to “early elect in” to the application of centralized partnership audit regime procedures for examinations of returns for tax years beginning after November 2, 2015, and before January 1, 2018.<sup>11</sup> By the beginning of Fiscal Year (FY) 2018, the IRS started to examine returns for partnerships that had elected into the centralized partnership audit regime early. Examinations started in FY 2019 for Tax Year 2018 partnership returns that, by default, fell under the centralized partnership audit regime, unless an eligible partnership elected on its return to opt-out. As of September 30, 2021, the year-end for FY 2021, the number of all closed partnership returns examined under the centralized partnership audit regime appears small when compared to the number of total partnership returns annually examined by the IRS.<sup>12</sup> Figure 1 provides closed examined return counts through FY 2021 for all centralized partnership audit regime examinations.

**Figure 1: Centralized Partnership Audit Regime Closed Return Examinations**

	FY 2019	FY 2020	FY 2021	Total
LB&I Division Returns	5	17	62	84
SB/SE Division Returns	20	66	310	396
<b>Total Returns</b>	<b>25</b>	<b>83</b>	<b>372</b>	<b>480</b>

*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of closed examination data provided by the IRS on October 4, 2021.*

<sup>9</sup> I.R.C. §§ 6226 and 6227.

<sup>10</sup> Interim procedures were incorporated into the Internal Revenue Manual (IRM) 4.31.9 as of October 29, 2021.

<sup>11</sup> Pub. L. No. 114-74, § 1101(g)(4).

<sup>12</sup> The last three published IRS Data Books provide the following totals for all partnerships examined by the IRS: 8,945 for FY 2018, 7,478 for FY 2019, and 4,969 for FY 2020.

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The total closed return examinations under centralized partnership audit regime rules as of the end of FY 2021 is 480. Of the 480 returns, 84 (18 percent) were conducted by the LB&I Division and 396 (83 percent) were conducted by the SB/SE Division.<sup>13</sup> The SB/SE Division closed 312 more examinations than the LB&I Division. The difference in the complexity and size of taxpayers audited by each division may explain some of the difference in the number of closed partnership return examinations.

## **Results of Review**

### **The IRS Does Not Have Goals or Processes in Place to Measure Centralized Partnership Audit Regime Examination Results**

We reviewed the FY 2019 through FY 2021 data for partnerships examined under the centralized partnership audit regime. In our review of this initial implementation data, we found that no-change rates for closed examinations are significantly higher when compared to overall partnership examinations closed as of FY 2020, for returns filed during the same tax years. Furthermore, the IRS has not established goals related to the centralized partnership audit regime; therefore, it cannot measure the effectiveness of the new audit rules on taxpayer compliance.

**The no-change rates for the centralized partnership audit regime closed examinations for FY 2019 through FY 2021 are significantly higher than for overall partnership examinations when reviewing the tax years examined.**

### **Initial centralized partnership audit regime examination no-change rates suggest that compliant taxpayers may be burdened and noncompliant taxpayers are not being identified**

We reviewed initial examination efforts under the centralized partnership audit regime rules, using the examination data provided by the IRS, and identified 480 centralized partnership audit regime examinations closed through the end of FY 2021. Figure 2 shows that we evaluated the examination results by the tax year associated with each return and found that on average the IRS closed approximately 78 percent of the returns with a no-change.

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<sup>13</sup> Percentages do not total 100 percent due to rounding.

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**Figure 2: Centralized Partnership Audit Regime Examinations  
Closed No-Change by Tax Year Examined (as of September 30, 2021)**

Tax Year	No-Change Closures	Total Closures	Percentage No-Change
2016	35	48	73%
2017	44	52	85%
2018	259	338	77%
2019	38	42	90%
<b>Totals</b>	<b>376</b>	<b>480</b>	<b>78%</b>

*Source: TIGTA analysis of closed examination data provided by the IRS on October 4, 2021.*

Generally, both the LB&I Division and SB/SE Division closed the majority of their respective centralized partnership audit regime examinations as no-change. Figure 3 shows that when analyzed by division, the LB&I Division had a slightly higher no-change rate at 79 percent than the SB/SE Division at 78 percent.

**Figure 3: Centralized Partnership Audit Regime Examinations  
Closed No-Change by Tax Year Examined and by Division  
(As of September 30, 2021)**

Tax Year	Division	No-Change Closures	Total Closures	Percentage No-Change
2016	LB&I	■	■	69%
	SB/SE	■	■	75%
2017	LB&I	12	16	75%
	SB/SE	32	36	89%
2018	LB&I	42	51	82%
	SB/SE	217	287	76%
2019	LB&I	■	■	100%
	SB/SE	■	■	90%
<b>Totals</b>	<b>LB&amp;I</b>	<b>66</b>	<b>84</b>	<b>79%</b>
	<b>SB/SE</b>	<b>310</b>	<b>396</b>	<b>78%</b>

*Source: TIGTA analysis of closed examination data provided by the IRS on October 4, 2021.*

We compared the centralized partnership audit regime no-change rate presented in Figures 2 and 3 with the overall IRS no-change rate data for all partnership examinations closed for Tax Years 2016 through 2018, as of September 30, 2020. The overall IRS no-change rate for partnership examinations, for the same tax years, was significantly lower than what we found for the centralized partnership audit regime closed examinations. Figure 4 shows that the no-change rate for all IRS partnership examinations for Tax Years 2016 through 2018 was 50 percent, 28 percent lower than the overall centralized partnership audit regime no-change rate of 78 percent, as listed in Figure 2.

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**Figure 4: IRS Partnership Examinations for  
Tax Years 2016 Through 2018 Closed No-Change  
(As of September 30, 2020)<sup>14</sup>**

Tax Year	No-Change Closures	Total Closures	Percentage No-Change
2016	2,654	5,221	51%
2017	762	1,590	48%
2018	37	84	44%
<b>Totals</b>	<b>3,453</b>	<b>6,895</b>	<b>50%</b>

*Source: TIGTA analysis of Table 17, Examination Coverage and Recommended Additional Tax After Examination, 2020 IRS Data Book.*

Having a higher no-change rate for examinations under the centralized partnership audit regime rules, rather than for partnership examinations as a whole, may be an indicator that noncompliant taxpayers are not being identified, thereby negatively impacting taxpayer compliance. Furthermore, taxpayers who are compliant may be burdened by the IRS when they are selected for examinations that overwhelmingly result in no-change.

In July 2021, we held separate meetings with the LB&I and SB/SE Divisions to discuss partnership return selection for each division. Management from both divisions stated that neither selects partnership returns for examination based on whether or not a partnership is under the centralized partnership audit regime. LB&I Division management stated that their division selects partnership returns using partnership models and campaigns, while SB/SE Division management stated that the Discriminant Index Function score is the primary method used by their division to select partnership returns for examination.<sup>15</sup>

Both LB&I and SB/SE Division management confirmed that neither division has determined acceptable rates or ranges of closure types for examinations. In addition, management from both divisions agreed that the no-change rate presented previously is considered high. However, they added that it is too early in the process with too few closed returns to analyze and form conclusions about the no-change rate. While neither division offered a definitive cause for the high no-change rates, both stated that it is likely because examinations resulting in a no-change usually close quicker. SB/SE Division management further stated that no-change examinations close quicker than examinations of returns with an adjustment, due to the administrative procedures. As described previously, the administrative process for these examinations, other than no-change, may take over a year. However, the IRS started examining partnership returns under the centralized partnership audit regime by the start of FY 2018 and began closing examinations in FY 2019.

While the overall administrative process for examinations resulting in other than no-change is designed to take longer, we found that the hours spent on no-change examinations by the examining agents is greater. While analyzing the closed examination data for FYs 2019

<sup>14</sup> At the time of the issuance of this report, FY 2021 data were not available.

<sup>15</sup> The Discriminant Function System score is a computerized scoring method based on the IRS's experience with similar returns.

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through 2021, we further reviewed the hours per case by the disposal code type.<sup>16</sup> The IRS has various disposal codes it assigns to a closed examination, such as no-change or agreed. Our analysis of the examination disposition found that examiners spent more time examining returns closed with the no-change disposal code, which also exceeded the average time spent working agreed examinations. Figure 5 shows that, on average, no-change examinations took 66 hours per return while agreed examinations took 53 hours per return.

**Figure 5: Average Hours for FYs 2019 Through 2021 Closed Centralized Partnership Audit Regime Examinations by Disposal Code**

Disposal Code	Total Hours <sup>17</sup>	Total Returns	Average Hours Per Return
No Change	24,839	376	66
Agreed	4,209	79	53
All Other Disposal Codes <sup>18</sup>	1,251	25	50

Source: TIGTA analysis of closed examination data provided by the IRS on October 4, 2021.

The overall resources spent on no-change examinations exceeded the resources spent on agreed examinations by 20,630 hours. The IRS is expending valuable resources on no-change closures, which may potentially burden taxpayers with examinations closed as no-change and deter compliance for noncompliant taxpayers not identified for examination.

We further reviewed the examination adjustment results for FY 2019 through FY 2021. Figure 6 shows that the cumulative adjustments from all examinations are relatively small, at almost \$1.2 million at the end of FY 2021.

**Figure 6: FY 2019 Through FY 2021 Adjustments From Closed Centralized Partnership Audit Regime Examinations**

Division	FY 2019	FY 2020	FY 2021	Total
LB&I Division	\$0	\$10,423,051	(\$15,904,283) <sup>19</sup>	(\$5,481,232)
SB/SE Division	\$194,969	\$1,805,779	\$4,652,111	\$6,652,859
<b>Total Adjustments</b>	<b>\$194,969</b>	<b>\$12,228,830</b>	<b>(\$11,252,172)</b>	<b>\$1,171,627</b>

Source: TIGTA analysis of closed examination data provided by the IRS on October 4, 2021.

The IRS has incurred considerable costs when implementing procedures and systems to facilitate examinations under the centralized partnership audit regime. Between FYs 2016 and 2021, the IRS spent approximately \$53,942,579 on implementation costs related to the centralized

<sup>16</sup> A disposal code is a two-digit code used to indicate the disposition of an examination. The codes are assigned by the Examination functions.

<sup>17</sup> For presentation purposes, hours were rounded to the nearest whole hour.

<sup>18</sup> "All Other Disposal Codes" includes the following disposal codes that make up 5 percent of the total count of closed examinations: agreed after the opportunity to challenge the adjustments (1 percent), default after the statutory notice of deficiency (less than 1 percent), no change with adjustment (1 percent), and other (3 percent).

<sup>19</sup> Figure 6 presents net adjustments. Under the centralized partnership audit regime, negative and positive adjustments are generally not netted in the calculation of an imputed underpayment. Partnerships that have an imputed underpayment and any other adjustments (e.g., negative adjustments) can elect to push out the net adjustments. If the partnership does not elect to push out or if adjustments do not result in an imputed underpayment, those adjustments are taken into account on the partnership's adjustment year return.

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partnership audit regime. Approximately \$39,670,233 (over 73 percent) of the total costs relate to information technology implementation efforts.

By not specifically monitoring the no-change rate, the IRS is not providing needed attention to an indicator that shows the impact on taxpayer compliance. As stated previously, IRS management believes it is too early to monitor the no-change rates related to these examinations and clarified that they would not focus such a review on returns subject to the centralized partnership audit regime procedures, but rather on the specific methodology that resulted in a high average no-change rate. We believe that the IRS should consider both the methodology that resulted in a high no-change rate as well as any contributing variables specific to partnerships audited under the centralized partnership audit regime. If the no-change rate for the centralized partnership audit regime does not lower to closer resemble the overall IRS closure rates, a study should be conducted to determine what factors (*e.g.*, return selection) are contributing to the high no-change rate, determine a baseline rate that requires corrective actions be implemented, and implement those actions. Examinations becoming more efficient should result in more audits being performed, thereby increasing taxpayer compliance.

**The IRS has not established goals related to the centralized partnership audit regime**

An effective internal control system can help Federal agencies achieve their missions and objectives and improve accountability. The Government Accountability Office's *Standards for Internal Control in the Federal Government*, also known as the Green Book, states that internal controls comprise the plans, methods, and procedures used to meet an entity's mission, goals, and objectives, which support performance-based management.<sup>20</sup> Goals or targets are essential to measuring performance because they:

- Provide direction to program management and employees about where and how the IRS desires to improve in an area.
- Allow meaningful evaluation of progress because it is immediately clear whether the targets have been met or little progress has been made.
- Facilitate accountability for the level of results achieved.

**Examination work plans do not consider audit procedures in establishing targets such as the centralized partnership audit regime**

Both the SB/SE and LB&I Divisions do not establish targets based on administrative procedures, such as those resulting from the enacted Bipartisan Budget Act legislation. IRS management stated that they focus their efforts on identifying high risk regardless of administrative procedures.

We reviewed the LB&I Division's examination plans for FYs 2018 through 2021 and found that they do not include any targets related to the number of partnerships the LB&I Division expects to examine under the centralized partnership audit regime procedures. From FY 2018 to FY 2020, the LB&I Division's Examination Plan continued to classify planned examinations by corporations and partnerships.<sup>21</sup> Partnerships were grouped under one classification with no

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<sup>20</sup> U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO-14-704G, Sept. 2014.

<sup>21</sup> Classifications were mid-corporation, high-corporation, partnerships, and nontaxable Forms 1120.

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further break down. The LB&I Division's projected closures for all partnership examinations from FYs 2018 through 2020 were as follows:

- FY 2018 – 752 partnerships out of 7,877 planned total closures.<sup>22</sup>
- FY 2019 – 708 partnerships out of 7,551 planned total closures.<sup>23</sup>
- FY 2020 – 795 partnerships out of 6,194 planned total closures.

According to LB&I Division management, starting in FY 2019, the LB&I Division moved away from a planned starts or closures plan to a "Resource Allocation Plan." The new resource plan classifies staff time under various compliance program areas such as a combined program area that includes global high-wealth and pass-through entities such as partnerships. In making this change, specific partnership planned metrics were eliminated and incorporated as a component of the mentioned compliance program area. The LB&I Division allocates resources based on direct examination time, which includes only those technical frontline employees who are involved in compliance activities. As shown below, for FYs 2019 through 2021, the overall percentage allocated to the global high-wealth and pass-through entities did not significantly change. However, it is not clear what resources were allocated specifically to partnership examinations.

- FY 2019: 275,771 hours, representing 8 percent of all planned compliance program hours.
- FY 2020: 224,704 hours, representing 7 percent of all planned compliance program hours.
- FY 2021: 252,884 hours, representing 8 percent of all planned compliance program hours.

Similar to the LB&I Division, we reviewed the SB/SE Division's examination plans for FYs 2018 through 2021 and found that it does not include any targets related to the number of partnerships it expects to examine under the centralized partnership audit regime procedures. However, the SB/SE Division does include in its plan an overall expectation for the number of partnership returns to be examined. SB/SE Division management stated that they are in the process of moving from a closures plan to a starts plan. We observed that both starts and closures are presented in their examination plans for FYs 2018 through 2021. Figure 7 reflects the number of overall planned starts for all examinations and partnership examinations versus actual starts (not specific to the centralized partnership audit regime) from FY 2018 through FY 2021.

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<sup>22</sup> The FY 2018 plan also included 589 partnership planned starts out of 8,155. This closure plan was issued on October 2, 2017, after the impact of the hurricanes in the fall of 2017 was determined.

<sup>23</sup> The FY 2019 plan was issued on February 4, 2019, after the impact of the December 2018 Government shutdown was determined.

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**Figure 7: SB/SE Division Planned Versus  
Actual Partnership Starts for FYs 2018 Through 2021**

SB/SE Division	FY 2018	FY 2019	FY 2020	FY 2021
Planned Partnership Starts	4,704	4,144	1,764	3,342
Planned Starts for All	87,244	99,881	80,309	69,334
Percentage of Planned Partnership Starts	5%	4%	2%	5%
Actual Partnership Starts	7,335	4,169	2,427	3,007
Actual Starts for All	175,398	130,315	111,578	95,675
Percentage of Actual Partnership Starts	4%	3%	2%	3%
Difference Between Actual and Planned Partnership Starts	2,631	25	663	(335)
Percentage Over/(Under) Planned Partnership Starts	56%	1%	38%	(10%)

Source: TIGTA analysis of the SB/SE Division's FYs 2018 through 2021 Examination Work Plans.

As Figure 7 illustrates, the SB/SE Division exceeded its total planned starts for all examination types. It exceeded planned starts for partnerships for FYs 2018 through 2020. The only year planned partnership starts were not met was FY 2021. Although we observed a decline from FY 2018 to FY 2020 in the percentage of actual starts attributable to partnerships, in FY 2021, the percentage increased to the FY 2019 rate. Figure 8 further reflects the planned versus actual closures for all examinations and partnerships examinations for FYs 2018 through 2021.

**Figure 8: SB/SE Division Planned Versus  
Actual Partnership Closures for FYs 2018 Through 2021**

SB/SE Division	FY 2018	FY 2019	FY 2020	FY 2021
Planned Partnership Closures	6,551	6,726	4,119	2,567
Planned Closures for All	182,184	162,172	148,562	134,566
Percentage of Planned Partnership Closures	4%	4%	3%	2%
Actual Partnership Closures	6,739	5,760	2,936	2,473 <sup>24</sup>
Actual Closures for All	183,771	147,404	101,371	108,978 <sup>25</sup>
Percentage of Actual Partnership Closures	4%	4%	3%	2%
Difference Between Actual and Planned Partnership Closures	188	(966)	(1,183)	(94)
Percentage Over/(Under) Planned Partnership Closures	3%	(14%)	(29%)	(4%)

Source: TIGTA analysis of the SB/SE Division's FYs 2018 through 2021 Examination Work Plans.

<sup>24</sup> This total may be adjusted when the final counts are available from the computer system used by SB/SE Division Examination to control returns and input assessments and adjustments.

<sup>25</sup> This total may be adjusted when the final counts are available from the computer system used by SB/SE Division Examination to control returns and input assessments and adjustments.

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In contrast to the starts plan, the SB/SE Division did not meet its partnership closure expectations. Actual closures fell from approximately 3 percent over the planned numbers in FY 2018 to almost 29 percent under the plan numbers in FY 2020. In FY 2021, actual closures did have an upswing to 4 percent under the planned closures in FY 2021. This shift upward in percentage is due to the decrease of 1,552 (a 38 percent decrease) in planned partnership closures for FYs 2020 to 2021.

Agencywide, IRS partnership statistics reflect an overall decline in partnership returns examined. Figure 9 illustrates the actual number of partnerships returns filed, examined, and percentage examined for FYs 2018 through 2020.

**Figure 9: IRS Partnership Returns  
Examination Coverage for FYs 2018 Through 2020**

FY	Partnership Returns Filed	Partnership Returns Examined	Actual Percentage Examined	Change in Percentage From Prior Year
2018	4,043,349	8,945	0.22%	(42%) <sup>26</sup>
2019	4,223,801	7,478	0.18%	(18%)
2020	4,470,095	4,969	0.11%	(39%)

*Source: TIGTA analysis of the Number of Returns and Other Forms Filed and Examination Coverage from FYs 2018 to 2020, IRS Data Books.*

The data show that the IRS is reducing the number of all partnership returns examined, in contrast to the increasing number of filed partnership returns.

**Resources assigned to partnership examinations have significantly decreased**

We analyzed resource data for the LB&I and SB/SE Divisions for FYs 2016 through 2020. When comparing FY 2016 to FY 2020, for both divisions, we found a decrease in the number of staff years dedicated to all examinations, indicating an overall decline in resources. We also found, when comparing FY 2016 to FY 2020, that both divisions had a decrease in staff years allocated specifically to partnership examinations. Figure 10 shows the LB&I Division partnership staff years and total staff years for FYs 2016 through 2020.

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<sup>26</sup> The coverage rate for FY 2017 was 0.38 percent.

**Figure 10: LB&I Division Partnership Staff  
Years and Total Staff Years, FYs 2016 Through 2020**

FY	Partnership Staff Years	Total Staff Years	Percentage of Partnership Staff Years
2016	154.73	3,997.6	4%
2017	114.84	3,742.0	3%
2018	103.09	3,481.3	3%
2019	94.25	3,250.3	3%
2020	108.02	3,269.6	3%
<b>Totals</b>	<b>574.93</b>	<b>17,740.8</b>	<b>3%</b>
<b>Percentage Change FY 2016 to FY 2020</b>	<b>(30%)</b>	<b>(18%)</b>	

*Source: TIGTA analysis of staff year data for FYs 2016 through 2020 provided by the IRS on August 31, 2021.*

The LB&I Division staffing data reflect an overall reduction in resources with an 18 percent decrease in total staff years, from approximately 4,000 staff years in FY 2016 to 3,270 staff years in FY 2020. Similarly, the total available resources expended on partnership examinations also decreased. However, the staff years devoted to partnership examinations decreased by a greater rate with a 30 percent decrease in staff years allocated to partnerships, from 155 staff years in FY 2016 to 108 staff years in FY 2020. On average, the LB&I Division devoted 3 percent of its resources to examining partnerships during this five-year period.

We also reviewed the LB&I Division's staff year reports for FY 2021, as of June 30, 2021. As of this date, the LB&I Division reported 2,574 total staff years and of those staff years, 110 staff years (4 percent) were attributed to partnerships, reflecting an increase in comparison to FYs 2016 through 2020. Figure 11 provides the SB/SE Division partnership staff years and total staff years for FYs 2016 through 2020.

**Figure 11: SB/SE Division Partnership Staff  
Years and Total Staff Years, FYs 2016 Through 2020**

FY	Partnership Staff Years	Total Staff Years	Percentage of Partnership Staff Years
2016	211.18	3,371.86	6%
2017	198.49	3,146.47	6%
2018	182.22	2,840.51	6%
2019	141.41	2,345.11	6%
2020	105.69	2,253.30	5%
<b>Totals</b>	<b>838.99</b>	<b>13,957.25</b>	<b>6%</b>
<b>Percentage Change FY 2016 to FY 2020</b>	<b>(50%)</b>	<b>(33%)</b>	

*Source: TIGTA analysis of staff year data for FYs 2016 through 2020 provided by the IRS on November 9, 2021.*

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Like the LB&I Division, the SB/SE Division staffing data reflect an overall reduction in resources with a 33 percent decrease in total staff years, from 3,372 staff years in FY 2016 to 2,253 staff years in FY 2020. Similarly, the total available resources expended on partnership examinations also decreased. The staff years devoted to partnership examinations decreased by a significant rate with a 50 percent decrease in staff years allocated to partnerships, from 211 staff years in FY 2016 to 106 staff years in FY 2020. On average, the SB/SE Division devoted 6 percent of its resources to examining partnerships during this five-year period.

We also reviewed the SB/SE Division's staff year reports for FY 2021, as of June 30, 2021.<sup>27</sup> As of this date, the SB/SE Division reported 1,609 staff years and, of those staff years, 66 staff years (4 percent) were attributed to partnerships, reflecting a continued decrease in comparison to FYs 2016 through 2020. These reports did not reflect the level of new hires in each year that required training before being assigned partnership examinations, which may explain a temporary reduction in certain fiscal years for staff years attributed to partnerships.

Overall, we found that on average, for FYs 2016 through 2020, the SB/SE Division allocated a higher percentage of its resources to examining partnerships, at 6 percent, versus 3 percent by the LB&I Division. While the SB/SE Division allocated more resources during this period to working overall partnership examinations, its total staff years allocated to working partnership examinations is decreasing at a faster rate than the LB&I Division. The SB/SE Division's partnership staff years decreased by 50 percent while the LB&I Division's partnership staff years decreased by 30 percent from FY 2016 to FY 2020. In addition, by the end of FY 2020, the LB&I Division's staffing level allocated to partnership examinations was at 108 staff years and close to SB/SE Division's staffing level of 106 staff years.

When asked about how the IRS will measure the effectiveness of the new centralized partnership audit regime rules for partnership examinations, IRS management commented that there are ad hoc reports that can monitor centralized partnership audit regime examinations at the field level. For example, the IRS provided TIGTA ad hoc reports on the status of open examinations and the disposition of closed examinations. In addition, we were provided with the accompanying data for closed examinations that included but were not limited to time spent examining a return and final adjustment data, allowing us to analyze these metrics as presented previously in Figures 1, 2, 3, 5, and 6.

However, as previously stated, TEFRA was repealed due to the intensive and inefficient use of limited IRS resources required on administrative tasks. The centralized partnership audit regime provides a centralized method of examining items of a partnership that should limit the burden on the IRS in both the examination and judiciary processes. Therefore, the IRS should measure whether partnership examinations performed after the centralized partnership audit regime was in place are taking fewer overall resources to complete and administer. Also, the IRS should measure whether there is an overall increase in the level of partnership examinations completed by a similar resource pool and whether the total adjustments for an equivalent resource pool have increased in comparison to the pre-centralized partnership audit regime metrics.<sup>28</sup>

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<sup>27</sup> According to IRS management, reductions in partnership time may also be impacted by new hire training on partnership returns that may not take place until after the first 12 months of service.

<sup>28</sup> TIGTA is not advocating that employees be measured against any metric; however, the IRS could collect this information as a means to evaluate the effectiveness of the overall program.

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The IRS stated that it views the enacted centralized partnership audit regime legislation as an examination procedure/technique that it must apply and follow during examinations of partnerships under the regime. Management simply stated that the purpose of the centralized partnership audit regime is to provide administrative procedures. As such, it does not establish goals or measures based on an examination process, such as the centralized partnership audit regime, nor does it select returns for examination based on whether or not the taxpayer has elected into or out of the centralized partnership audit regime. The IRS stated that is why there are no clear centralized partnership audit regime goals in the examination plans. However, without goals or processes in place to measure centralized partnership audit regime results, the IRS does not know the effect of centralized partnership audit regime rules on partnership examinations, and whether the centralized partnership audit regime is meeting its intended purpose.

The Commissioners, LB&I Division and SB/SE Division, should:

**Recommendation 1:** Formulate an action plan to reduce the centralized partnership audit regime examination no-change rates, and if the no-change rates do not fall within an acceptable range, a study should be conducted to identify and address the factors contributing to the high rate.

**Management's Response:** The IRS disagreed with this recommendation. IRS management stated that the centralized partnership audit regime cannot be determinative of a partnership examination outcome. An audit regime puts into operation the statutory and regulatory requirements of the administrative steps to examine partnerships. While work is being done to improve the identification of risk to minimize the no-change rate, setting a benchmark for a no-change rate could violate the rules under § 1204 of the IRS Restructuring and Reform Act of 1998. These rules prohibit the IRS, in part, from imposing or suggesting production quotas or goals.

**Office of Audit Comment:** The high no-change rate for examinations conducted under the centralized partnerships audit regime is an indicator that more compliant taxpayers are identified for examinations than noncompliant taxpayers, negatively impacting taxpayer compliance. In addition, on average, no-change examinations took longer to perform than agreed examinations. This could indicate that compliant taxpayers are being burdened by the IRS.

The rules under § 1204 state that the IRS shall not use records of tax enforcement results to evaluate or impose a production quota or goal on employees, which TIGTA is not proposing in this recommendation. However, records of tax enforcement results information may be disclosed for use by those units involved in forecasting, planning, resource management, and the formulation of selection case criteria.<sup>29</sup> TIGTA continues to believe that the IRS should formulate an action plan to monitor no-change dispositions and conduct a study to identify and address high no-change rate contributing factors, as permitted under § 1204 and 26 CFR § 801.6(d)(2).

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<sup>29</sup> IRM 1.5.2.11.1 (Jan. 14, 2015) and related regulation 26 CFR § 801.6(d)(2).

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**Recommendation 2:** Establish overall partnership examination goals and measurements that address the expected outcomes from the implementation of the centralized partnership audit regime.

**Management’s Response:** The IRS disagreed with this recommendation. IRS management referred to the response to Recommendation 1 and stated it would not establish goals related to the outcomes of audits. At the time that it believes it is appropriate, the IRS will establish qualitative goals and measures related to how well examiners follow centralized partnership audit regime procedures. The IRS has begun to determine the quality of examinations based on the statutory and regulatory requirements of administering an examination. These steps include capturing responses to check sheets developed to ensure that procedures under the regime are being followed. When a sufficient volume of responses is available, the IRS plans to use the insight into specific procedures within the regime to identify areas requiring clarification and/or further training.

**Office of Audit Comment:** Without goals and measurements in place, the IRS will not know whether the centralized audit regime is meeting its intended purpose. Our recommended actions are not to establish goals for the purpose of evaluating individual employee performances or for setting production quotas or goals; therefore, they are not a violation of § 1204 of the IRS Restructuring and Reform Act of 1998. While the IRS has started the important task of determining the quality of examinations conducted under the regime, TIGTA continues to believe that the IRS should establish overall partnership examination goals and measurements as permitted under § 1204 and 26 CFR § 801.6(d)(2).

## **The Current Method to Confirm Adjustments to Partners’ Returns When a Partnership Makes a Push-Out Election is Manual and Could Be Improved**

During discussions with the IRS about the push-out process, management confirmed that they did not incorporate a fully systemic process to verify whether partners complied with the requirement to report the pushed-out adjustments on their next filed return.

When a partnership has imputed underpayments due to an examination under the centralized partnership audit regime, the partnership representative may request to modify the amount or push it out to partners. As discussed previously, in order to push out the audit adjustments to its partners, the partnership must provide each partner with a Form 8986. The partnership representative must submit to the IRS through an online portal Form 8985, along with the Forms 8986 that were furnished to its partners.<sup>30</sup> The online submission of these forms allows for the systemic creation of a “Chain of Ownership” report. This report captures the push-out structure, summarizes the push-out results and

**IRS management confirmed that they did not incorporate a fully systemic process to verify whether partners complied with the requirement to report the pushed-out adjustments on their next filed return.**

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<sup>30</sup> After the submission of these forms, the partnership representative will receive Letter 6073, *Push Out Package Acknowledgement*, to acknowledge receipt.

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provides the details of the push-out activity. This systemically generated report aids the IRS when manually monitoring if partners have properly submitted their shares of the imputed underpayment on their next tax return.

The push-out process may continue through multiple tiers if pass-through partners make additional push-out elections. Partnerships may have different types of partners ranging from individuals to corporations to other pass-through partners.<sup>31</sup> Examples of pass-through partners include partnerships and S corporations. A pass-through partner that receives a Form 8986 may elect to pay its portion of the imputed underpayment resulting from its allocated examination adjustments or may elect to further push out the examination adjustments to its partners following the same process as that of the partnership. Pass-through partners that elect to pay their respective tax obligation at the partnership level will electronically submit Form 8985 to report the calculation and amount paid. Pass-through partners that elect to push out the adjustments to its partners will follow the same process to furnish push-out statements to each partner for the reviewed year and electronically submit to the IRS Form 8985 and all Forms 8986 furnished to its partners.

Non-pass-through partners (such as individuals and C corporations) that received Form 8986 are expected to voluntarily comply by reporting any pushed-out adjustments on their next filed tax return. These partners will generally include Form 8978, *Partner's Additional Reporting Year Tax*, with their next filed tax return to report the liability from the adjustments pushed out to them. Manually monitoring whether all non-pass-through partners properly report their shares of the imputed underpayment, on their next filed tax return, would be more cumbersome and open to human error than if conducted systemically.

LB&I Division management confirmed that the manual compliance monitoring process is a time intensive process and continues to advocate and seek the required funding to incorporate an automated process for the future. IRS management further stated that to create a systemic method to monitor the pushed-out adjustments would need a future information technology update as well as additional budgeted resources and funding.

The IRS should implement a systemic method, similar to the matching verification processes that exist in the IRS. For example, the IRS's Information Returns Processing System attempts to match income reported on information returns against income reported by taxpayers on their individual income tax returns. If no match is discovered, the potential nonfiler cases are referred to the Collection function for possible action. If the match discovers sufficient, underreported income, an underreporter case is created and routed to the Examination function for follow-up.

On November 23, 2021, the IRS confirmed that as of October 31, 2021, four partnerships have elected to push out the underlying adjustments related to an imputed underpayment. The IRS expects this number to grow. Therefore, the IRS should prepare for future push-out elections by considering implementation of a systemic matching process to verify accurate reporting of each respective partner's tax liability under I.R.C. § 6226 resulting from a pushed-out adjustment.

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<sup>31</sup> A pass-through partner is a pass-through entity that holds an interest, either directly or indirectly, in a partnership. For purposes of Form 8985, a pass-through entity is not a wholly owned entity disregarded as separate from its owner for Federal tax purposes or a trust that is wholly owned by only one person.

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The Commissioner, LB&I Division, should:

**Recommendation 3:** Implement a fully systemic method of monitoring and verifying pushouts are properly reported on partners' returns.

**Management's Response:** The IRS agreed with this recommendation. IRS management stated that there is a partly systemic method to monitor pushouts. A chain of ownership report can be generated after the submission of pushout statements. This report shows the structure of the pushout including each partner's allocable share of pushed-out adjustments, actions by regulatory deadlines, and if the pushout has been completed. This report will be used to identify areas for further review including verifying if partners reported their allocable share of adjustment on their returns.

The IRS intends to request development of a systemic method for the verification process.

## **Appendix I**

### **Detailed Objective, Scope, and Methodology**

The overall objective of this review was to determine whether the IRS has adequately implemented the changes to the partnership audit rules as specified in § 1101 of the Bipartisan Budget Act of 2015. To accomplish our objective, we:

- Obtained an understanding of the applicable regulatory criteria, procedures, and controls the IRS used to implement the centralized partnership audit regime.
- Obtained an understanding of the push-out process and how the IRS would determine if pushouts are complete.
- Determined the metrics used to monitor the centralized partnership audit regime.
- Determined if the LB&I and SB/SE Divisions include the centralized partnership audit regime examinations in their respective annual plans.
- Obtained the overall implementation costs for the centralized partnership audit regime.
- Analyzed the population of closed centralized partnership audit regime examinations.

#### **Performance of This Review**

This review was performed with information obtained from the Headquarters office of the LB&I and SB/SE Divisions, Office of Chief Counsel, and Office of the Chief Financial Officer in Washington, D.C., during the period August 2020 through December 2021. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Phyllis Heald London, Director; Javier Fernandez, Audit Manager; Eugenia Smoak, Lead Auditor; and Carrie Mares, Senior Auditor.

#### **Validity and Reliability of Data From Computer-Based Systems**

We performed tests to assess the reliability of closed centralized partnership audit regime examinations as of September 30, 2021, provided by the IRS. These tests included evaluating whether all records fell within the expected time frame, record counts were as expected, and there were any duplicates or missing records. We determined that the data were sufficiently reliable for the purposes of this report.

#### **Internal Controls Methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the

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following internal controls were relevant to our audit objective: the procedures implemented by the IRS during the push-out process, the metrics used to measure the impact of the centralized partnership audit regime, and the data collection of closed examinations. We evaluated these controls by interviewing officials in the LB&I and SB/SE Divisions, reviewing annual examination plans and results for the two divisions, and reviewing closed centralized partnership audit regime examination data as of September 30, 2021.

## **Appendix II**

### **Status of Centralized Partnership Audit Regime Regulations and Procedures**

As of October 2021, the Department of the Treasury and the IRS had published Treasury regulations, and the IRS had developed IRM procedures related to the centralized partnership audit regime, but some were still not in finalized status.

#### **Status of centralized partnership audit regime Treasury regulations**

Federal income tax regulations are the official Treasury interpretation of the I.R.C. The IRS publishes proposed Department of the Treasury regulations in the Federal Register to allow the public time to comment on them. Prior to adoption, proposed regulations may be withdrawn or modified at any time.

The following regulations under I.R.C. §§ 6221 through 6241 have been finalized:

- Final Regulation under I.R.C. § 6221(b) (TD 9829 - 83 FR 24) - *Election Out of the Centralized Partnership Audit Regime*, January 2, 2018. Regulations on election out of the centralized partnership audit regime.
- Final Regulation under I.R.C. § 6223 (TD 9839 - 83FR 39331) – *Partnership Representative Under the Centralized Partnership Audit Regime and Election To Apply the Centralized Partnership Audit Regime*, August 9, 2018. Regulations on the designation and authority of the partnership representative and early elect-in procedures for taxable years beginning after November 2, 2015, and before January 1, 2018.
- Regulations finalizing the rules in the August 17, 2018, Notice of Proposed Rule Making except for regulations proposed on February 2, 2018 (TD 9844 - 84 FR 6468) - *Centralized Partnership Audit Regime, Final Regulation*, February 27, 2019. Regulations on the implementation of the centralized partnership audit regime enacted by the centralized partnership audit regime.

The following regulations have been proposed but not finalized:

- *Centralized Partnership Audit Regime: Adjusting Tax Attributes* (REG-118067-17), February 2, 2018. Proposed to supplement prior proposed regulations and amend Income Tax Regulations and Procedural and Administration Regulations to implement the centralized partnership audit regime.
- *Treatment of Special Enforcement Matters* (REG-123652-18), November 24, 2020. I.R.C. § 6241 provides treatment of special enforcement matters such as failure to comply, criminal investigations, and indirect methods of proof of income along with treatment when a partnership ceases to exist.

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The IRS is still developing proposed regulations for publication on I.R.C. § 6232(f), *Failure to Pay Imputed Underpayment*.

- I.R.C. § 6232(f) allows the IRS to assess each partner of the partnership a tax equal to such partner's proportionate share if any amount of imputed underpayment, related to interest or penalties, is not paid within 10 days of the due date.

### **Status of centralized partnership audit regime IRM procedures**

IRM 4.31.9, *Centralized Partnership Audit Regime Field Examination Procedures*, was first published on July 10, 2020. This IRM was limited to background, terminology, and early elect-in procedures for the centralized partnership audit regime, which incorporated Interim Guidance Memo LB&I-04-0719-006 on the *Initial Taxpayer Contact in Partnership Examinations and Elections into the Bipartisan Budget Act of 2015 Centralized Partnership Audit Regime*. The IRM was most recently updated on October 29, 2021. The October 2021 update incorporated Interim Guidance Memos: LB&I-04-0520-0010, *Interim Guidance on Amended Partnership Returns Filed Pursuant to Revenue Procedure 2020-23*; LB&I 04-0320-0005, *Updated Interim Guidance on Administrative Adjustment Requests Under the Bipartisan Budget Act of 2015 Centralized Partnership Audit Regime*; and LB&I-04-1019-0010, *Interim Guidance on the Centralized Partnership Audit Regime Field Exam Procedures*.

The IRS also published on October 19, 2021, IRM 8.19.14, *Bipartisan Budget Act of 2015 Procedures*, which relates to Appeals. This IRM incorporated Interim Guidance Memorandums AP-08-0319-0005, *Bipartisan Budget Act of 2015*; AP-08-1019-0013, *Bipartisan Budget Act of 2015 Procedures*; and AP-08-820-0017, *Bipartisan Budget Act of 2015 – Docketed Cases*.

The IRS has finalized the following IRM sections that also pertain to the centralized partnership audit regime.

- IRM 21.7.4.4.2.9, March 24, 2021. This IRM provides information on Form 1065X, *Amended Return or Administrative Adjustment Request*. This form is used to file an AAR by the partnerships that file hardcopy tax returns.
- IRM 3.17.277.2.4.20, December 13, 2019. This section discusses the payment options, such as payment of the imputed underpayment by the partnership, for the centralized partnership audit regime.

## Appendix III

### Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

February 4, 2022

MEMORANDUM FOR MICHAEL E. McKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Nikole C. Flax *Nikole C. Flax*  
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report # 2020-30-006, "Centralized Partnership Audit Regime Rules Have Been Implemented; However, Initial No Change Rates Are High and Measurable Goals Have Not Been Established"

Thank you for the opportunity to respond to the above referenced report. The implementation of the centralized partnership audit regime (hereinafter referred to as BBA) was a broad and significant undertaking for the IRS. It was a process that was informed by stakeholder input along the way, and entailed developing formal and informal guidance, updating forms, instructions, and educational materials, making changes to our information technology systems and processing, training our employees, and engaging our stakeholders.

While TIGTA's stated objective for the audit was to determine whether the IRS had adequately implemented BBA, the report minimally touches on that topic and instead focuses on the existing coverage and no-change rate for partnership exams. BBA is a series of procedural steps used when examining returns of partnerships subject to the regime. BBA is not the lens for identifying risk nor is it the means for impacting the no-change rate. The report, however, commingles these issues and focuses on closed cases to date (during a period that included a pandemic impacting starts/closures across the IRS) even though it is the case that early closures for a tax year have a higher ratio of no-change (i.e., they close first because IRS determines the risk is not present or is immaterial).

As we previously shared with TIGTA, there are several efforts underway specifically dedicated to increasing and improving partnership coverage. The IRS is aware that there is significant progress to make in this area. Indeed, it is because we are in the early stages of several partnership related efforts that we understood TIGTA agreed to

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postpone a separate audit on efforts to identify and audit high risk partnership issues as it would have been a premature review considering the status of our recently launched Large Partnership Compliance (LPC) program and other initiatives. To support our efforts to increase partnership coverage, we have recently completed a partnership-focused hiring initiative that increased both the number of subject matter experts and field agents who examine these returns (and we will continue to do so as resources allow). We have also undertaken form improvements and are updating our case selection models. Progress from these efforts will take some time to realize. The IRS's increased focus on high income individuals, and the entities they control, is another compliance touch point that will increase enforcement coverage of partnerships.

Additionally, the FY 2022 Treasury budget includes a specific request for resources to increase the IRS partnership coverage rate. In addition to examiners, the budget request includes hiring of the staff needed (Chief Counsel, Campus and Technical Services) to support the increase in partnership examination.

Attached is our response to your recommendations. If you have any questions, please contact me, or members of your staff may contact Clifford Scherwinski, Director, Pass-Through Entities Practice Area.

Attachment

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**Attachment**

**RECOMMENDATION 1:** The Commissioners, LB&I Division and SB/SE Division, should formulate an action plan to reduce the centralized partnership audit regime examination no-change rates, and if the no-change rates do not fall within an acceptable range, a study should be conducted to identify and address the factors contributing to the high rate.

**CORRECTIVE ACTION:** The centralized partnership audit regime is not, and cannot be, determinative of the outcome of a partnership examination. The regime operationalizes the statutory and regulatory requirements of the administrative steps to examine partnerships. Further, while we are working to improve our identification of risk and thereby minimizing the no-change rate, setting a benchmark for a no change rate, whether for examinations under the regime or examinations in general, could violate the rules under Section 1204 of RRA '98 which prohibits the IRS, in part, from imposing or suggesting production quotas or goals.

**RESPONSIBLE OFFICIAL:**

N/A

**IMPLEMENTATION DATE:**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 2:** The Commissioners, LB&I Division and SB/SE Division, should establish overall partnership examination goals and measurements that address the expected outcomes from the implementation of the centralized partnership audit regime.

**CORRECTIVE ACTION:** As noted above, we are working to improve our identification of risk and thereby minimizing the no-change rate. However, the IRS does not and will not establish goals related to the outcomes of audits (i.e., no change rate, tax dollars recommended, etc.). The IRS will, at the appropriate time, establish qualitative goals and measures related to how well examiners are following the centralized partnership audit regime procedures which we have implemented.

The IRS has already taken steps to begin determining the quality of examinations under the regime based on the statutory and regulatory requirements of administering an exam. These steps include capturing responses to check-sheets developed to ensure procedures under the regime are followed. When sufficient volume of responses to the check-sheets are available, the IRS plans to use the insight into specific procedures within the regime to identify and address any areas that require clarification and/or further training.

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Also, as noted in our response, we have started several efforts to increase our coverage and improve the results of our partnership examinations.

**RESPONSIBLE OFFICIAL:**

Director, LB&I Pass-Through Entities Practice Area

**IMPLEMENTATION DATE:**

April 15, 2022

**CORRECTIVE ACTION MONITORING PLAN:**

We will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 3:** The Commissioner, LB&I Division, should implement a fully systemic method of monitoring and verifying pushouts are properly reported on partners' returns.

**CORRECTIVE ACTION:** Currently, there is a method, partly automated, to monitor push outs. A chain of ownership report has been programmed and can be generated after submission of push out statements. This report shows the structure of the push out including, but not limited to, each partner's allocable share of adjustments pushed out, whether a partner is a pass-through entity or not, whether a pass-through partner takes action by regulatory deadlines, and whether a push out is complete. This report will be used to identify areas for further review including verifying if partners reported their allocable share of adjustments on their returns. The IRS intends to input a Unified Work Request (UWR) to IT for development of a method to fully automate the verification process. However, increasing demand for limited IT resources will impact the timeframe for a fully automated system."

**RESPONSIBLE OFFICIAL:**

Director, LB&I Pass-Through Entities Practice Area

**IMPLEMENTATION DATE:**

October 15, 2022

**CORRECTIVE ACTION MONITORING PLAN:**

We will monitor this corrective action as part of our internal management system of controls.

## Appendix IV

### Glossary of Terms

Term	Definition
Administrative Adjustment Request	A request filed by a partnership to amend partnership items reported on a previously filed return with the IRS.
Centralized Partnership Audit Regime	The audit regime created when § 1101 of the Bipartisan Budget Act of 2015 repealed and replaced TEFRA partnership procedures.
Disposal Code	The two-digit code used to indicate the disposition of an examination. The codes are assigned by the Examination function.
Elect In	The election made by a partnership into the centralized partnership audit regime for returns filed after November 2, 2015, and before January 1, 2018.
Election Out Of	The election made by a partnership out of the centralized partnership audit regime for Tax Years 2018 and later. This election is made on a partnership's Form 1065 when filed with the IRS.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Imputed Underpayment	An amount attributable to adjustments of partnership-related items for which a partnership, that does not make a push-out election, is liable.
Internal Revenue Code	The body of law that codifies all Federal tax laws. These laws constitute Title 26 of the United States Code, which is a consolidation and codification by subject matter of the general and permanent laws of the United States.
Internal Revenue Manual	The primary, official source of IRS instructions to staff related to the organization, administration, and operation of the IRS.
Large Business and International Division	Serves corporations, subchapter S corporations, and partnerships with assets greater than \$10 million. These entities typically have large numbers of employees, deal with complicated issues involving tax law and accounting principles, and conduct their operations in an expanding global environment.
Non-Pass-Through Entity	An individual taxpayer or a business that does not pass its tax through to the tax returns of the owners of the business. Non-pass-through business entities include C corporations and Limited Liability Corporations that elect to be taxed as corporations.

**Centralized Partnership Audit Regime Rules Have Been Implemented;  
However, Initial No-Change Rates Are High and Measurable Goals Have Not Been Established**

<b>Term</b>	<b>Definition</b>
Non-Pass-Through Partner	A non-pass-through entity that holds an interest, either directly or indirectly, in a partnership.
Partnership	A contractual relationship between two or more parties to engage in the joint operation of trade or business.
Partnership Representative	A person or entity designated by a partnership each year on its tax return to have the <i>sole authority</i> to act on behalf of the partnership during a centralized partnership audit regime proceeding.
Partnership Tax Year	The tax year of a partnership is generally a tax year that conforms to the majority of its partners. The majority of partnerships file Form 1065 on a calendar year basis.
Pass-Through Entity	A business that literally passes its tax through to the tax returns of the owners of the business. Pass-through entities include partnerships, S corporations, trusts, and decedents' estates.
Pass-Through Partner	A pass-through entity that holds an interest, either directly or indirectly, in a partnership.
Push-Out	An election made by a partnership to have the reviewed-year partners report their share of the adjustment instead of the partnership paying the imputed underpayment. It moves the payment of any amount due from the partnership to the reviewed-year partners.
Small Business/ Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Staff Year	The number of work hours available in any given fiscal year.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

## **Appendix V**

### **Abbreviations**

AAR	Administrative Adjustment Request
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LB&I	Large Business and International
SB/SE	Small Business/Self-Employment
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TIGTA	Treasury Inspector General for Tax Administration



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Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

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