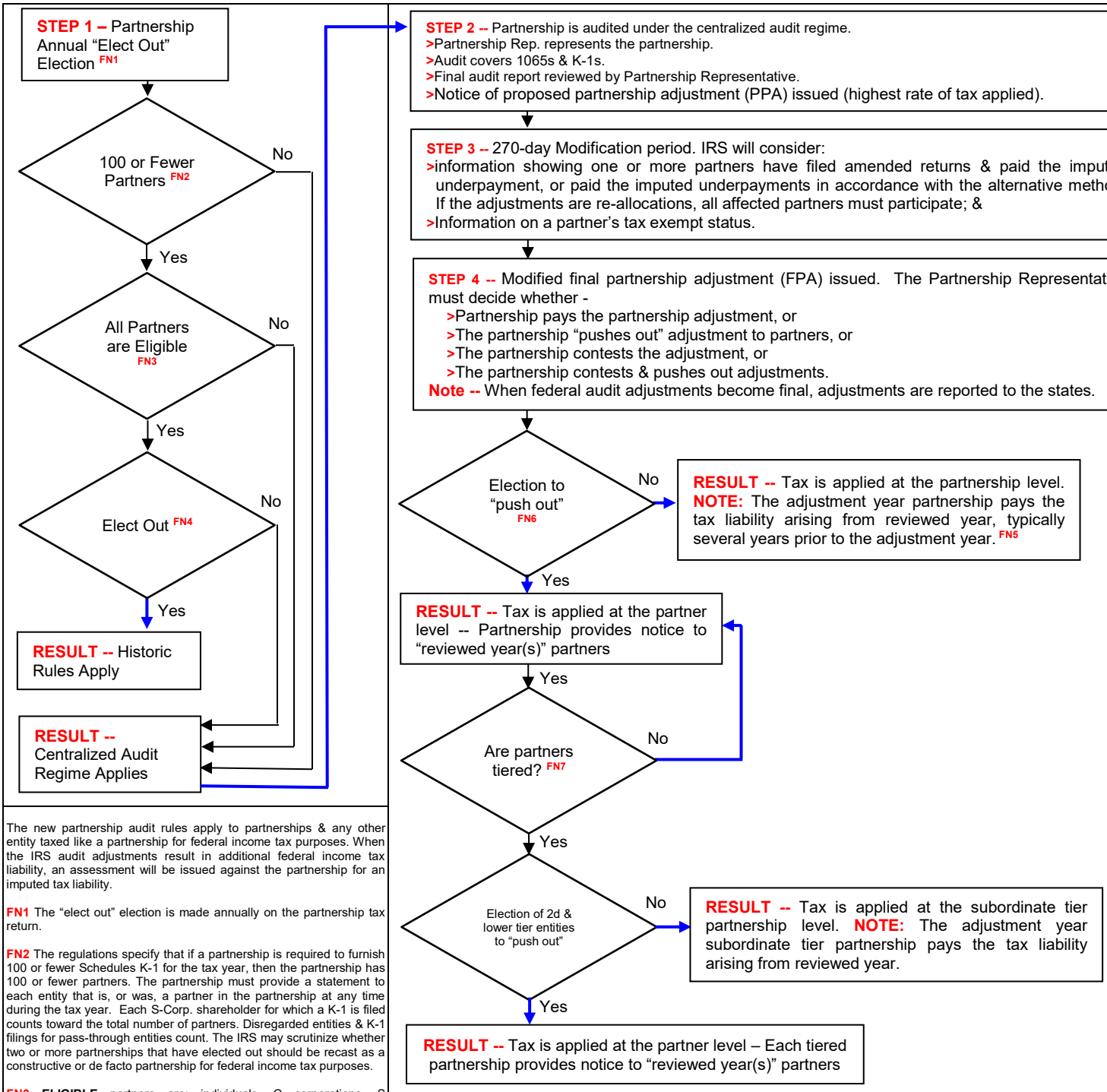
FEDERAL PARTNERSHIP AUDIT REGIME



The new partnership audit rules apply to partnerships & any other entity taxed like a partnership for federal income tax purposes. When the IRS audit adjustments result in additional federal income tax liability, an assessment will be issued against the partnership for an imputed tax liability.

FN1 The "elect out" election is made annually on the partnership tax return.

FN2 The regulations specify that if a partnership is required to furnish 100 or fewer Schedules K-1 for the tax year, then the partnership has 100 or fewer partners. The partnership must provide a statement to each entity that is, or was, a partner in the partnership at any time during the tax year. Each S-Corp. shareholder for which a K-1 is filed counts toward the total number of partners. Disregarded entities & K-1 filings for pass-through entities count. The IRS may scrutinize whether two or more partnerships that have elected out should be recast as a constructive or de facto partnership for federal income tax purposes.

FN3 **ELIGIBLE** partners are: individuals, C corporations, S corporations, certain eligible foreign entities, & estates of deceased partners. **INELIGIBLE** partners are: partnerships, trusts, foreign entities not qualified under Treas. Reg. § 301.6221(b)-1 (b)(3)(iii), disregarded entities described in § 301.7701-2(c)(2)(i), an estate of an individual other than a deceased partner, & persons that hold an interest in the partnership on behalf of another person.

FN4 An eligible partnership must elect out of the centralized partnership audit regime on the partnership's timely filed tax return, including extensions. For entities that were partners at any time during the tax year, an "electing out" partnership must disclose to the IRS each partner's name & TIN, or alternative form of identification as required by the IRS Federal tax classification, an affirmative statement that the partner is an eligible partner, & any other information required by the IRS. If a partner is an S corporation, the partnership must also disclose to the IRS the same information about each shareholder of the S corporation that was a shareholder at any time during the tax year of the S corporation, ending with or within the partnership's tax year.

An "electing out" partnership must notify each of its partners of the election within 30 days of making the election. The partnership is not required to provide notice to S-Corp. shareholders because such shareholders are not partners in the partnership. The "election out" cannot be revoked without IRS consent. For identification purposes, foreign partners that are subject to the centralized audit regime must have a U.S. TIN. **Note** -- It has been suggested that an "electing out" partnership should nevertheless appoint a partnership representative, to act in the event that the IRS disallows the "election out."

FN5 Imputed tax liability is paid by the partnership, at the partnership level, in the tax year in which the federal audit adjustments become final, & embedded economic cost of the liability affects ultimate profit of the partnership, & so in turn, affects distributive shares of partners in the tax year in which the federal audit adjustments become final, without regard to whether they were partners during the "reviewed year."

Former practice recognized a "tax matters partner," who acted as a representative of the partnership. Partners formerly had the right to "notice" of an audit & the right to participate in the audit. Under the new regime, a "partnership representative" is recognized to act on behalf of the partnership. The "partnership representative" has exclusive authority to act on behalf of the partnership & bind the partnership & its partners during an IRS audit or other tax proceedings involving the partnership. The IRS is authorized to appoint a "partnership representative" for the partnership if partnership fails to appoint a "partnership representative."

FN6 The partnership is treated essentially "as an entity," & is required to pay the imputed tax, interest & penalties assessed, unless the partnership elects to "push-out" the assessed liability to the partners. The partnership is not treated as a taxpaying entity under the "push out" alternative.

Under a "push-out" election, imputed tax liability is paid by the partners or equity owners who were partners in the partnership IN THE REVIEWED YEAR, & not by the partners or equity owners who are current partners/owners in the tax year in which the federal audit adjustments become final, unless they were also partners/owners in the partnership in the reviewed year. If the election is made to push out the additional imputed tax to the equity owners of the partnership, or other passthrough entity, the additional imputed tax is paid by the equity owners when they file their federal income tax return for the tax year in which the federal audit adjustments become final & are pushed out to the equity owners.

FN7 Second tier & subordinate tier partners are treated as partnerships with the same capacity to adopt, or abstain from, the "push out" election.

Note that the **"elect out"** election (distinguished from the **"push out"** election) is **NOT** available to partnerships that are subordinate to a superior tier partner that is under the centralized audit regime.