Tax Alert: Operating Agreements Must be Revised to Deal with New IRS Audit Powers

By Gary Bubb on November 26, 2018



The new IRS audit procedures for partnerships (and limited liability companies taxed as partnerships) are now in effect for tax years that begin on or after January 1, 2018. The new procedures are designed strictly to help the IRS when it audits partnerships and LLCs. Legal protections that previously benefited LLC members, such as notice of an audit and the right to appeal IRS assessments, are gone. Protections for LLC members that previously were provided by law must now be spelled out in the LLC's operating agreement.

The key figure in the new regime is the Partnership Representative (the "PR"). The PR is designated each year by the LLC/partnership in its federal tax return. The PR has sweeping powers to deal with the IRS on tax matters, including tax assessments for which LLC members can ultimately be liable. The IRS is not required to deal with anyone other than the PR. Under the new regime it is entirely possible for a PR to conduct an entire audit and settlement with the IRS, and the first time that an LLC member finds out about it maybe when the LLC member receives a tax bill that cannot be appealed.

The IRS does not need to determine whether or not a PR has authority to make decisions for the LLC and its members; the PR has the authority by definition in the new law. The only controls that LLC members have over the PR are the provisions in the LLC operating agreement that require notice to members and prior member authorizations for PR actions.

Many LLCs are simply going to the tax section of their operating agreement and replacing the "tax matters partner" with "Partnership Representative." This is ineffective because the provisions regarding the tax matters partner don't address the sweeping powers of the PR. In a **previous article**, we have detailed some of the questions that LLCs and partnerships should consider when discussing new operating agreement provisions that will give them some control over their PRs.

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