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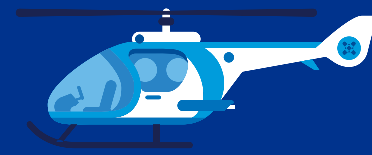


Defining Issues®

Recent IRS audit rules may affect how partnerships account for tax underpayments

November 7, 2017

KPMG reports on what changes partnerships may need to make to their financial reporting beginning in 2018.

Applicability

All US partnerships and their partners.

Key facts and impacts

A recent law[1] includes new rules for audits of partnerships that are intended to ease the administrative burden placed on the IRS when it collects underpayments. The law generally allows the IRS to collect underpayments from the partnership versus the current mechanism of pursuing payment from the partners.

The new rules apply to all partnerships, except for qualifying partnerships that may elect out for a tax year. A partnership that does not (or cannot) elect out for a tax year may file a 'push out election' in which it requires its partners to report the imputed underpayment on their individual tax returns.

Who accounts for potential tax obligations?

Because the law generally requires partnerships to satisfy tax underpayments, stakeholders questioned whether the potential obligations represent income taxes attributable to the partnership or the partners.

We believe that taxes on partnership income should continue to be attributed to the partners. Payments made by a partnership on behalf of its partners are akin to distributions that are recognized with a charge to partners' capital. While a partnership is required to remit an identified underpayment unless it makes the push out election, the partnership remains nontaxable under the tax law and its taxable income and losses continue to flow through to its partners' individual tax returns. We believe a partnership would recognize a liability to remit an underpayment when the obligation exists for accounting purposes – i.e. a distribution is effectively declared. The distribution declaration date differs based on whether the partnership has the right to make the push out election.

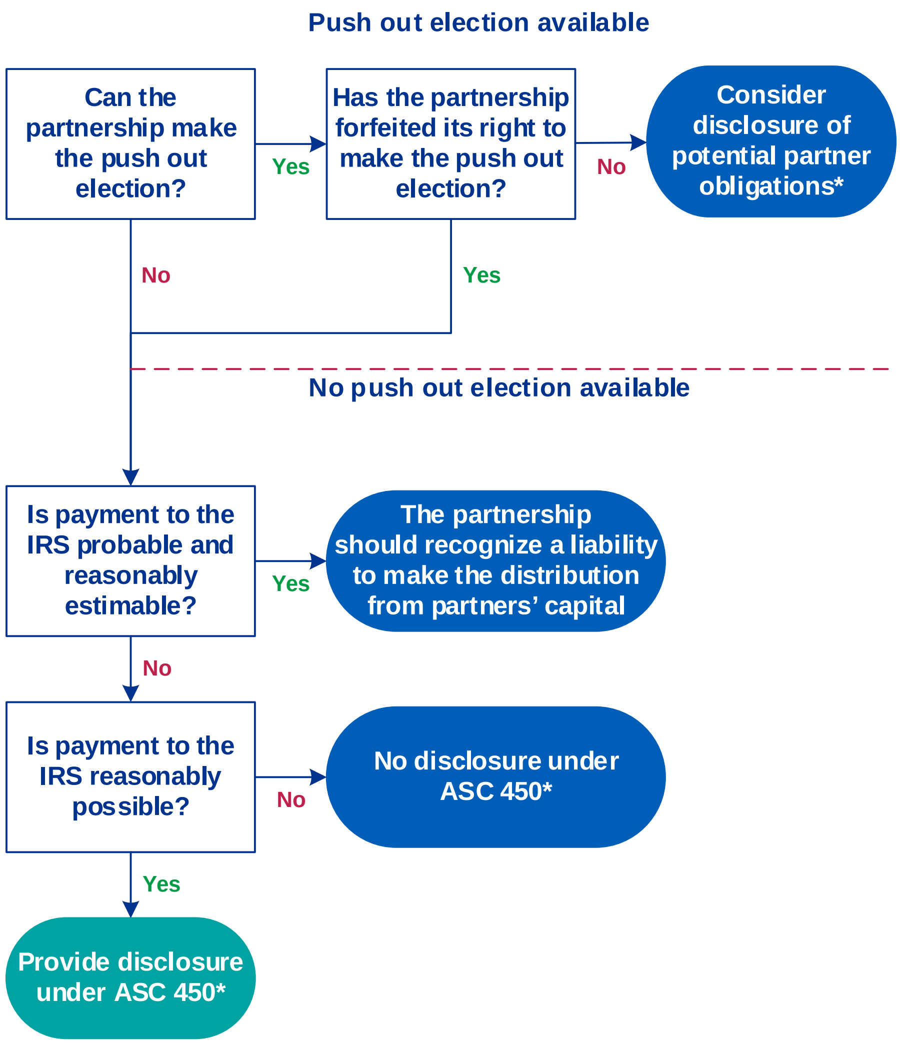
If a partnership has the right to make the push out election at the balance sheet date, we do not believe a distribution has been declared. However, those partnerships should consider disclosing tax audits and providing their assessment about partners' potential obligations.

If a partnership legally cannot make the push out election (e.g. there is uncertainty about the availably of the election when the partners are partnerships) or it has forfeited its right to make the election, we believe the partnership has declared the distribution when a payment is probable and reasonably estimable.

If payment to the IRS is not probable, but is reasonably possible, we believe the partnership should make the disclosure by following the guidance for ASC 450, Contingencies.

We believe all partnerships should disclose their status under the tax law.

[1] Bipartisan Budget Act of 2015 that takes effect for tax years beginning after December 31, 2017



*Disclose partnership status under the tax law – e.g. the existence of the collection mechanism and the partnership's ability to elect out or make the push out election

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KPMG's Financial Reporting View

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