The rapid growth of the use of partnerships, as well as the increase of large partnerships with complex structures, puts more pressure on the IRS to properly and efficiently execute the procedures for auditing partnership returns under TEFRA.¹ This column discusses the difficulty that the IRS has with the first step of any TEFRA audit, identifying the tax matters partner (the “TMP”). After a brief discussion of the qualifications for TMPs and the methods for identifying the TMP, this column discusses how the common-law doctrine of equitable estoppel, as well as tax practitioners’ duties under Circular 230, relate to this issue.

Recent GAO and TIGTA Reports on Partnerships

From 2002–2011, the number of partnerships has increased by 47 percent while the number of C corps has gone down by 22 percent.² The U.S. General Accountability Office (“GAO”) recently issued a report regarding large partnerships, those that GAO defined as having $100 million or more in assets and 100 or more direct and indirect partners.³ GAO reported that during 2002–2011, the number of large partnerships has almost tripled.⁴

A recent report issued by the Treasury Inspector General for Tax Administration (“TIGTA”)⁵ described the results of a review of partnership audits under TEFRA and identified several problem areas in compliance with the procedures created to ensure that TEFRA audits are conducted properly. The TIGTA report found that necessary checks to ensure that the TMP was qualified were not being conducted in many audits. For audits closed in 2004 and 2005, the rate of error was 38 percent, and in audits closed in 2012, the error rate had substantially decreased, but was still at 17 percent.⁶ Specifically, TIGTA found that in one out of every five audits, there was no documentation of the TMP’s qualifications.⁷ As noted by TIGTA, this is concerning because an unqualified TMP could result in a barred assessment.⁸

Identifying the Tax Matters Partner or Authorized Person

The TMP acts as a liaison between the IRS and the partnership and is a fiduciary to the partnership and the individual partners.⁹ One of the first steps in a TEFRA
audit is for the revenue agent to determine if a TMP has been designated, and, if so, whether the designated TMP is qualified. The qualifications for acting as a TMP are that the person (i) was the general partner in the partnership at some time during the tax year for which the TMP designation is made, or (ii) is a general partner in the partnership as of the time the designation is made. For LLCs, the member-manager is treated as a general partner, and thus only a member-manager is qualified to serve as the TMP. The TMP can be an entity rather than a natural person. A non-U.S. person can be the TMP only with the consent of the Commissioner.

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The partnership does not have to designate a TMP. The regulations state that the partnership “may” identify the TMP for a particular tax year on the Form 1065 for that year. In addition, the partnership “may” later designate the TMP or change the TMP by filing a certification with the IRS Service Center where the partnership return is filed. If the TMP designated by the partnership is not qualified, i.e., is not or was not a general partner, an individual TMP has died, an entity TMP has been dissolved or if the partnership never designated a TMP in the first place, the revenue agent conducting the TEFRA audit is responsible for taking appropriate steps to designate a TMP on his or her own. If the partnership fails to designate a TMP, “the general partner having the largest profits interest in the partnership at the close of the tax year involved” becomes the TMP. The IRS also may designate another partner as TMP, if the partnership has not made a designation and it would be “impracticable” to identify the general partner with the largest profits interest.

Identifying a qualified TMP can be challenging for the IRS, especially for large partnerships. The GAO report contains examples that illustrate the complexity of this issue, such as a large partnership with over 50 different tiers of entities and individuals and another large partnership with over one million partners. As noted above, because TEFRA does not require a partnership to designate a TMP on its return and a TMP can be an entity, it may be difficult to figure out who is or who should be the TMP. As explained by the GAO, revenue agents are forced to spend valuable audit time requesting that the partnership designate a TMP or tracking down an actual person to act as a representative for the TMP. The GAO reported that some of the participants in their focus group stated that “large partnerships are purposely unclear about the TMP as an audit-delay strategy,” and that “[e]ntities will often be elusive about designating the [TMP]” as a first line of defense against an audit.

If the IRS cannot identify or designate a TMP or an authorized person in a timely fashion, it not only wastes time and resources, but risks having the clock run out on the audit itself, and if the person acting as the TMP is not actually qualified, the consent to extend the statute of limitations may not be valid. Generally, there is a three-year statute of limitations for the IRS to complete the partnership audit. The three-year period begins on the due date of the return or the date that the return is filed, whichever is later. The adjustment to partnership items are made through the Notice of Final Partnership Adjustment (“FPAA”). After the issuance of the FPAA, or if there is a subsequent Tax Court case, the audit adjustments must be passed through to the partners within one year. Code Sec. 6229(b)(1)(B) provides that the period of limitations for assessment may be extended “with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner (or any other person authorized by the partnership in writing to enter into such an agreement).” IRS Form 872-P, Consent to Extend the Time to Assess Tax Attributable to Partnership Items, is used to obtain consent to extend the statute of limitations for assessment in TEFRA audits. Internally, revenue agents are supposed to utilize Form 13828, TMP Qualification Check Sheet, to evaluate the TMP designation for each tax year under audit.

The inability to promptly and accurately identify the TMP raises at least two significant issues. First, should a partnership, whose ostensible TMP signed a Form 872-P, be estopped from later claiming that a statute extension was not valid? And, are practitioners who attempt to delay an audit by not promptly identifying a TMP in violation of Circular 230?

Equitable Estoppel

Where the IRS’s time to assess is extended by the agreement of someone purporting to be the TMP or an authorized agent of the partnership, but with no actual authority, equitable estoppel may apply to extend the statute of limitations, even though the signed consent is technically invalid. Equitable estoppel “is a judicial doctrine that precludes a party from denying that party’s
The elements of equitable estoppel are: (i) a false representation or “wrongful misleading silence”; (ii) the misrepresentation was of fact rather than an opinion or a statement of law; (iii) the party claiming estoppel must be ignorant of the true facts; and (iv) the party claiming estoppel must have been adversely affected by the acts or statements of the party against whom estoppel is claimed.

Cascade Partnership is a classic example of the application of equitable estoppel in this context. One of the general partners of the partnership signed the statute extensions, and later filed the Tax Court petition challenging the FPAA, as the TMP. This purported TMP later argued that he was never actually authorized to act as the TMP and the partnership could not be bound by his consent to extend the statute of limitations. The Tax Court found that the partnership was equitably estopped from denying the ostensible TMP’s authority because the partnership was aware that the TMP was signing on its behalf, and the IRS relied to its substantial detriment on the purported TMP’s representation by not issuing the FPAA within the statutory time period.

In the more recent decision of Peking Fund, the Tax Court again applied equitable estoppel in favor of the IRS where a party who later participated in the Tax Court case had held himself out as the TMP and signed the Form 872-P on behalf of the partnership. The participant had argued that because he was a nonmanaging member of the LLC, he was not actually qualified to act as the TMP. The Tax Court found that the IRS had relied on the participant’s actions to its substantial detriment and that the reliance was reasonable under the circumstances because the participant had sent the revenue agent a letter that formally designated him as the TMP, and it was “clear that respondent did not know” that participant was not a qualified to be the TMP.

The IRS will not succeed on a claim of equitable estoppel, however, unless it can show that its reliance was reasonable. For example, in Medical & Business Facilities, Ltd., the court of appeals for Fifth Circuit rejected the IRS’s claim of equitable estoppel. In that case, the revenue agent advised one of the partners and the partnership’s counsel that if they did not formally designate a TMP, the IRS would do so. The partnership still did not designate a TMP, but instead submitted statute consents signed by a person whom one of the partners had authorized to deal with the IRS, but not to extend the statute of limitations for assessment. The revenue agent never received any document, such as a partnership agreement or other formal authorization, showing that the TMP was authorized to sign the consents. Instead, the partnership agreement, which the revenue agent had access to, indicated that the partners could only act collectively. The court found that under these circumstances, the IRS had not reasonably relied on any representation that the person signing the statute extension was authorized to do so.

These cases indicate that where a party holds himself or herself out as the TMP or is otherwise authorized to consent to the extend the statute of limitations, a partnership will be estopped from later claiming that the extension was not valid because the person was not actually authorized to sign the statute extension, but only if the IRS was reasonable in relying on the party’s representation. It appears that the IRS’s reliance will not be reasonable if the revenue agent could have discovered the true facts, such as by checking the IRS’s own records. As stated by the Fifth Circuit in Medical & Business Facilities, Ltd., “[b]ecause any designation of a TMP would be filed with the IRS itself, the IRS cannot reasonably rely on the representations of a third party as to the identity of the TMP.” And, as noted above, according to the TIGTA report, in one out of five audits, there was no documentation showing that the revenue agent had confirmed that the designated TMP was actually qualified. Although the doctrine of equitable estoppel provides some protection to the IRS against an unscrupulous (or perhaps merely disorganized) party who signs the Form 872-P without actually being authorized to do so, the burden still falls on the IRS to make sure that it is dealing with an authorized party.

Circular 230

As noted above, the GAO found that the IRS has experienced large partnerships as being intentionally unclear and elusive regarding the TMP as a delay tactic. Because the burden largely falls on the IRS to ensure that Forms 872-P are being signed by a qualified TMP or other person with proper authorization, it is vital to tax administration that representatives who practice before the IRS do not attempt to thwart revenue agents by engaging in gamesmanship or delay tactics. Indeed, it may be unethical for a practitioner to intentionally “hide the ball” from the revenue agent conducting the audit.

There are at least three provisions of Circular 230 that may require a practitioner, if requested, to assist the IRS in good faith in identifying a qualified TMP. First, Section 10.23 provides that “a practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.” The tactic of purposefully avoiding designating a qualified TMP with the goal of running out the clock on the audit may
be inconsistent with this provision. Second, if a revenue agent directly requests information from a practitioner to aid the IRS in identifying the TMP, Circular 230 requires the practitioner to respond. Section 10.20(a) states that a practitioner must, “on a proper and lawful request” by the IRS, “promptly submit records or information in any matter before the [IRS] unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.” A request for information regarding the TMP is a proper and lawful request, and it is difficult to imagine a scenario in which the identity or qualifications of a TMP would be privileged information.

Finally, before a practitioner submits a statute extension signed by a partner or third party, he or she should take steps to independently ascertain whether the signor is qualified to act as the TMP or otherwise authorized to consent to the extension. Under Section 10.22(a), a practitioner must exercise due diligence in documents submitted to the IRS as well as in determining the correctness of oral or written representations. As stated in Section 10.34(d), the practitioner can rely on information provided by the client partnership, but he or she may not, however, “ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.” Accordingly, it would be a violation of Circular 230 for a practitioner to submit a statute extension either knowing, or having reason to suspect, that the party signing the Form 872-P lacks authority to do so.

Some practitioners reading this column may object and argue that not assisting the IRS in conducting an audit of their clients is not unethical, but merely zealous advocacy and required by their duty of loyalty to their client. There may be circumstances where this will be the case and that the practitioner is not required to assist the IRS in identifying a qualified TMP. Practitioners should consider the Circular 230 provisions governing conduct before engaging in any tactics to delay or thwart the audit, and certainly before providing any information or documents related to the identity or qualifications of the IRS that may not be accurate.

ENDNOTES

1 Act Sec. 4.02 of The Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) [P.L. 97-248] enacted procedures for consistent treatment of all partners in a partnership and to reduce the IRS’s administrative burden of determining partnership-level tax issues at the individual partner level.


3 Id. at 5.

4 Id. at 15.


6 Id. at 10.

7 Code Sec. 6231(a)(7); Transpac Drilling Venture 1982-12, CA-2, 147 F2d 221, 225 (1998).

8 Reg. §301.6231(a)(7)-1(b)(1). The partner must have an actual economic interest in the partnership. See Montana Sapphire Assoc. Ltd., 95 TC 477, Dec. 46,958 (1990) (partnership’s accountant, who had been elected as the “managing general partner,” could not qualify as the TMP because he had no interest in the profits or capital of the partnership).

9 Reg. §301.6231(a)(7)-2(a).

10 Reg. §301.6231(a)(7)-1(b)(2). The regulation cross-references the definition of “United States Person” found in Code Sec. 7701(a)(30).

11 Reg. §301.6231(c).

12 Reg. §301.6231(a)(7)-1(d).


14 Code Sec. 6231(a)(7).

15 Id.


17 Id. at 17.

18 Id. at 27.

19 Code Sec. 6229(a).

20 Code Sec. 6229(f).

21 I.R.M. 4.31.2.2.3 (June 20, 2013).


24 Cascade Partnership, 71 TCM 3226, Dec. 51,426(M), TC Memo 1996-299.


26 Medical & Business Facilities Ltd, CA-5, 95-2 ustc 150,394, 60 F3d 207, 212.

27 Id.

28 Practice before the IRS is governed by Treasury Department Circular No. 230, 31 USC §10.0 et seq., authorized by 31 USC §330.