MEMORANDUM

DATE: February 9, 2021
TO: All
FROM: Wendy J. Manson, CPA and William J. Palazzolo, Esq.
RE: Electing out of CPAR on Form 1065

Electing out of the Centralized Partnership Audit Regime ("CPAR")

The IRS recently instituted CPAR to generate more tax revenue from auditing large partnerships. The IRS estimates the new CPAR rules will generate about $9.3 billion in tax revenue for the US government without changing tax rates.

The basic idea of CPAR is the IRS can audit a big partnership similar to how the IRS would audit a C corporation. There would be fewer forms and fewer administrative proceedings and an unfavorable audit finding would lead to an imputed underpayment, which is a payment at the top tax rate for an individual, currently 37%, plus interest and penalties.

Congress wanted CPAR to offer safeguards, so partnerships are allowed to elect out of CPAR each year. A partnership can elect out if the partnership has:

1) 100 or fewer K-1's; and
2) Only the following as partners:
    a. Individuals
    b. Deceased partner's estates
    c. C corporations
    d. S corporations
    e. Foreign entities that would be treated as a C corporation if it were domestic

Thus, partner types that prevent election out are:

1) Trusts (including grantor trusts)
2) Partnerships
3) Disregarded entities
4) Nominees and others who hold for another
5) Estates other than those of deceased individuals

We recommend every partnership that can elect out of CPAR should elect out each year.