

GAO Highlights

Highlights of [GAO-14-732](#), a report to congressional requesters

Why GAO Did This Study

More businesses are organizing as partnerships while fewer are C corporations. Unlike C corporations, partnerships do not pay income taxes but pass on income and losses to their partners. Large partnerships (those GAO defined as having \$100 million or more in assets and 100 or more direct and indirect partners) are growing in number and have complex structures. Some partnerships create tiers of partnerships with hundreds of thousands of partners. Tiered large partnerships are challenging for IRS to audit because tracing income through the tiers to the ultimate partners is complex.

GAO was asked to assess IRS's ability to audit large partnerships. GAO's objectives include: 1) determine what IRS knows about the number and characteristics of large partnerships, 2) assess IRS's ability to audit them, and 3) assess IRS's efforts to address the audit challenges. GAO analyzed IRS data from 2002 to 2011 and IRS audit documentation, interviewed IRS officials, met with IRS auditors in six focus groups, and interviewed private sector tax lawyers knowledgeable about partnerships.

What GAO Recommends

Congress should consider requiring large partnerships to identify a partner to represent them during audits and to pay taxes on audit adjustments at the partnership level. IRS should take multiple actions, including: define large partnerships, track audit results using revised audit codes, and implement project planning principles for the audit procedure projects. IRS agreed with all the recommendations, but noted that revision of the audit codes is dependent upon future funding.

View [GAO-14-732](#). For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

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LARGE PARTNERSHIPS

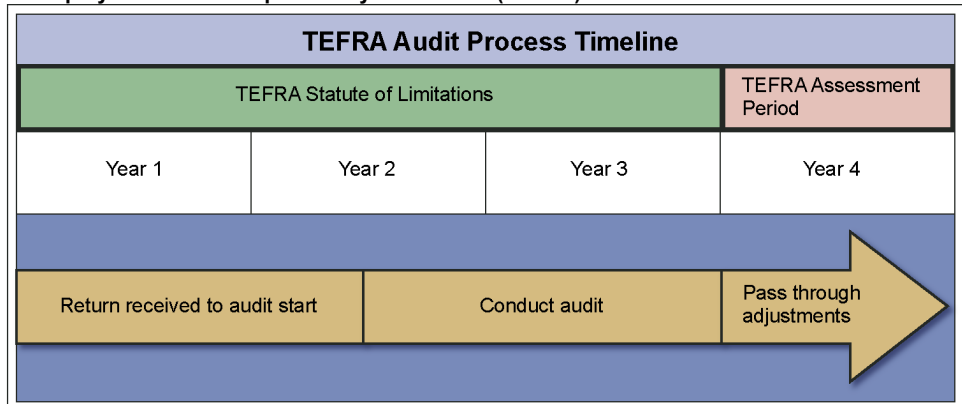
With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency

What GAO Found

The number of large partnerships has more than tripled to 10,099 from tax year 2002 to 2011. Almost two-thirds of large partnerships had more than 1,000 direct and indirect partners, had six or more tiers and/or self reported being in the finance and insurance sector, with many being investment funds.

The Internal Revenue Service (IRS) audits few large partnerships. Most audits resulted in no change to the partnership's return and the aggregate change was small. Although internal control standards call for information about effective resource use, IRS has not defined what constitutes a large partnership and does not have codes to track these audits. According to IRS auditors, the audit results may be due to challenges such as finding the sources of income within multiple tiers while meeting the administrative tasks required by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) within specified time frames. For example, IRS auditors said that it can sometimes take months to identify the partner that represents the partnership in the audit, reducing time available to conduct the audit. TEFRA does not require large partnerships to identify this partner on tax returns. Also under TEFRA, unless the partnership elects to be taxed at the entity level (which few do), IRS must pass audit adjustments through to the ultimate partners. IRS officials stated that the process of determining each partner's share of the adjustment is paper and labor intensive. When hundreds of partners' returns have to be adjusted, the costs involved limit the number of audits IRS can conduct. Adjusting the partnership return instead of the partners' returns would reduce these costs but, without legislative action, IRS's ability to do so is limited.

Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) Audit Timeline



Source: GAO analysis of IRS data and documentation. | [GAO-14-732](#)

Note: A 3-year statute of limitations governs the time IRS has to conduct partnership audits, which is about equally split between the time from when a return is received until the audit begins and the time to do the audit. IRS then has a year to assess the partners their portion of the audit adjustment.

IRS has initiated three projects—one of which is under development—to make large partnership audit procedures more efficient, such as identifying higher risk returns to audit. However, the two projects implemented were not developed in line with project planning principles. For example, they do not have clear and measurable goals or a method for determining results. As a consequence, IRS may not be able to tell whether the projects succeed in increasing audit efficiency.