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How Auto Dealers May Use Insurance to Cover Losses Incurred in Connection with Hurricanes Florence and Michael

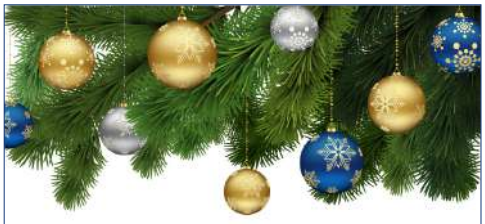
By Barry Buchman and Michael Scanlon, *Haynes and Boone, LLP*


Buchman


Scanlon

Two major storms hit the Southeast within a single four-week period. Hurricane Florence struck the Carolinas in mid-September, while Hurricane Michael crashed into the Florida Panhandle on October 10. The two storms were quite different. A Category 1 hurricane by the time it made landfall, Florence stalled over the Carolinas and was basically a rain event, dropping almost three feet of rain in some areas on its way to becoming the eighth-wettest storm in the contiguous United States. Michael, on the other hand, crashed ashore as a Category 4 hurricane with winds of over 150 miles per hour, a storm surge of about nine feet, and torrential rains, leaving a trail of destruction as it quickly moved through Georgia, the Carolinas, and Virginia.

Media attention has rightly focused on the human cost. Both storms killed people, cut off power to millions, and damaged or destroyed may people's homes. But, the media also has addressed the economic impact of the storms, including within the auto industry.[1] Large-scale flooding in the wake of Florence devasted North Carolina's agricultural and livestock industries, and Michael may have caused $1 billion in crop damage in Georgia alone.[2] Many other businesses, including auto dealers, were also impacted by the stormsand may be faced with financial ruin if forced to bear the full cost of cleanup.



NADC would like to wish you and your family a healthy and happy holiday season!

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Luckily, many dealerships likely have first-party property damage policies that will cover at least some of their losses. Such policies often provide coverage for lost profits in addition to physical property damage. And, depending on the precise policy language used, some businesses may be able to obtain coverage even if they did not sustain any physical damage to their own facilities.

This article focuses on the main categories of losses that might be covered under these policies and summarizes some of the coverage disputes that may arise. It also identifies the steps that businesses may take now to preserve their right to pursue a claim later.[3]

Coverage for Physical Damage and Related Losses

Dealerships that sustained physical property damage likely have coverage for the cost of repairing or rebuilding their facilities and replacing their inventory.

First, unlike most homeowner insurance policies, many commercial property policies cover flood damage. Flood coverage may be subject to higher deductibles and/or lower policy limits; however, businesses with such coverage in place likely will be able to avoid the "flood v. wind" dispute that typically arises in homeowner insurance claims after hurricanes.

Second, even a business with a policy excluding flood damage may still be entitled to coverage, if the damage resulted from both flooding and a covered cause of loss, such as wind or fire. Some insurers attempt to cut off such coverage through "anti-concurrent causation" clauses, but jurisdictions differ in the enforcement and treatment of such provisions. Therefore, a dealership affected by Florence or Michael should pay attention to the issue of which jurisdiction's law applies to its insurance claim, including any choice-of-law provision in its policies.

Third, property policies typically cover so-called "extra expenses" that businesses incur mitigating storm-related losses. For example, auto dealers may have coverage for the cost of overtime pay that they incur to reopen operations, and potentially even for incentives offered to win customers back.

Potential Coverage for Losses Even Without Physical Damage to the Insured's Own Property

Civil Authority Provisions

Commercial property insurance policies typically have "civil authority" coverage for business interruptions caused by the order of a civil authority that prevents access to an insured's property. Civil authority coverage can be triggered by evacuations, airport or mass transit closures, curfews, or other orders that prevent or restrict access to the insured's facilities.

Civil authority provisions can vary. Some require actual physical

damage to the insured's property or an adjacent property, while others provide coverage if the order is based on the threat of physical damage (*e.g.*, an incoming missile). These variations often are subtle but can have a big impact on coverage. For example, U.S. Airways and United Airlines each brought a lawsuit seeking coverage under the civil authority provisions of its respective property insurance policy for losses stemming from the closure of Reagan National Airport after the September 11 terrorist attacks; U.S. Airways won, while United lost, based on subtle differences in policy language.[4] Therefore, businesses should examine the exact language of their civil authority provisions carefully to determine whether a loss is covered. Moreover, many policies contain waiting periods—typically of twenty-four to seventy-two hours—before coverage begins. For example, if the civil authority provision contained a twenty-four-hour waiting period, a dealership would have a claim only for losses occurring more than a day after a road closure. Thus, a business should review its policy language carefully when evaluating coverage.

Ingress/Egress Provisions

Commercial property insurance policies also often contain "ingress/egress" provisions that cover interruption of an insured's business when the policyholder's facilities are inaccessible for reasons other than a civil authority order. Many policies require that the inaccessibility results from covered damage to some property, which usually must be within a certain distance of the insured location.

Business Interruption and Contingent Business Interruption Coverage

Commercial property insurance policies typically provide protection for lost profits under "business interruption" provisions (covering losses stemming from damage to the insured's property) and "contingent business interruption" provisions (covering losses stemming from damage at a supplier's or customer's property that inhibits the insured from obtaining material from the supplier or selling its goods or services to a customer). This coverage could be of great importance to dealers affected by Florence or Michael, because the storm likely caused damage to inventories on a dealer's properties, may have prevented it from receiving scheduled deliveries, and may also interfere with its ability to obtain replacement vehicles quickly.

As with civil authority provisions, disputes may arise regarding whether actual physical damage is required to trigger these two types of coverage. Although business interruption and contingent business interruption coverage generally require some type of property damage to trigger coverage, something short of actual physical damage may suffice. For example, in the context of a flu outbreak, some courts have ruled that a policyholder may be covered if a potential contamination of its building renders that property unusable.[5] Moreover, some courts interpret the term "supplier" to include more than just direct suppliers; thus, property damage sustained by entities further down the supply chain could trigger contingent business interruption coverage.

Practical Pointers for Preserving Insurance Rights

Even before an auto dealer determines whether it has or should pursue an insurance claim, there are steps to take now to put it in the best possible position to secure coverage if the need arises:

- **Gather and Review Insurance Policies**. Businesses should collect the insurance policies they have purchased and identify policies issued to other entities, such as affiliates and vendors or other business partners, that may provide coverage. Those policies should be organized and reviewed to determine which policies and provisions are most likely to provide coverage.

- **Submit Notice of Claims and Proof of Loss Quickly.** Most policies require the insured to provide notice of potential claims, and to submit proofs of loss, quickly after the damage is incurred, sometimes as quickly as sixty or even thirty days afterward. Some policies also include private "statutes" of limitations clauses, requiring insureds to bring coverage lawsuits within a year or two. (Some policies may even require a business to bring suit within *six months* of a loss.) It is therefore critical for policyholders to act quickly to protect their rights by providing a precautionary notice of their loss, absent business reasons to refrain from doing so. Dealers also should consider talking to their insurers about postponing or "tolling" these deadlines.

- **Document Damages and Set Up Communications Protocols.** Businesses should immediately begin documenting their losses, including lost revenues and additional expenses. Further, to preserve the attorney-client privilege and to avoid inadvertent characterizations of the nature or cause of the losses that could be used by the insurance company later, businesses should set up internal and external communications protocols, including the involvement of legal counsel, and make sure that those protocols are followed.

The insurance policies of any business, including auto dealers, are critical assets. Dealers can maximize the value of those assets by acting proactively now to analyze them and to comply with their procedural requirements. ■

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2. Joshua Sharpe, *Georgia fears $1 billion in crop damage as farmers report devastation*, The Atlanta Journal-Constitution, Oct. 11, 2018, https://www.ajc.com/news/georgia-fears-billion-crop-

damage-farmers-report-devastation/IThe Atlanta Journal-ConstitutionfQZJm2unNiEitzAMUuiuI/.

3. A full treatment of these issues is beyond the scope of this article, and the views expressed in the article are solely those of the writers, not Haynes and Boone, LLP or any of its clients. Moreover, the views of the writers are not legal advice.
4. *Compare U.S. Airways, Inc. v. Commonwealth Ins. Co.*, No. 03-587, 2004 WL1094684, at *5 (Va. Cir. Ct. May 14, 2004) (finding coverage despite a lack of physical damage to the insured's property), *with United Airlines, Inc. v. Insurance Co. of State of Pa.*, 385 F. Supp. 2d 343, 348-50 (S.D.N.Y. 2005) (finding no coverage in the absence of physical damage at an insured location).
5. *See Port Auth. of New York & New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3d Cir. 2002) (agreeing with district court's finding that "physical loss or damage" may occur "if there exists an imminent threat of the release of a quantity of asbestos fibers that would" render a structure useless or uninhabitable).

Barry Buchman is a partner in the Insurance Recovery practice group at Haynes and Boone, LLP and has been recognized as a leading policyholder insurance lawyer by The Best Lawyers in America, Woodward/White, Inc. (2016-2019), Chambers USA, Chambers & Partners (2012-2018), and Washington, D.C. Super Lawyers, Thomson Reuters (2013-2018). Barry represents policyholders in a wide variety of complex insurance coverage matters, including representing one of the nation's largest automotive companies in a residual value insurance case, which involved pursuing coverage for nine-figure losses on a portfolio of several hundred thousand leased vehicles. He has also handled disputes over general liability coverage for various toxic tort and environmental claims, including "medical monitoring" claims and claims by governmental entities related to public health; disputes over directors and officers (D&O) coverage for shareholder class actions and government investigations; disputes over errors and omissions (E&O) coverage for consumer class actions; disputes over coverage for sexual misconduct claims; and disputes over coverage for "first-party" losses such as property damage and business interruptions after natural disasters. Barry regularly publishes and speaks on insurance issues, and he has been quoted in leading publications such as the Wall Street Journal, Reuters, the National Law Journal, and Business Insurance.

Michael Scanlon is a litigation associate at Haynes and Boone, LLP. He has represented policyholders and brokers in insurance coverage cases involving general liability coverage for construction defects, directors and officers coverage for merger objection lawsuits, and bad faith claims in the context of burning-limits policies. He is a frequent author on legal matters, including insurance law topics.

President's Message

Andy Weill
Weill & Mazer
NADC President

Some of you may know that my younger son is now in his first year at UCLA Law School. Among the many pleasures this has brought have been numerous deep discussions with my son about the details of the law and the nature of the practice of law.

One of the topics we repeatedly discuss is the importance of collegiality as an attorney. I noted that all of his classmates are likely to be his future co-counsel, adversaries, referral sources, judges, public officials, and otherwise be involved in his career. I have tried to instill, and hopefully model, the importance of listening to differing points of view and always maintaining respect and integrity in the event of disputes.

My son appears to have kept this in mind. He noted that he has gone out of his way to study often with a classmate who holds very different political views from his. He said to me, "I know he'll see issues from a different point of view and challenge my perspective, rather than just reinforce my beliefs." I think his observation goes to the heart of one of the aspects of NADC that I find particularly valuable. I so often come to conferences and other events with a set of preconceptions or incomplete information on a wide variety of issues. My interactions with my NADC colleagues, who are so deeply informed on so many issues, leads me to healthy re-examination, re-evaluation, and even at times a modification of my prior views.

Often, I find myself thinking, "I didn't see the issue that way before; I really just learned something." And it is remarkable how frequently those new angles prove to be useful once I get back to the office.

As the holidays approach, it strikes me that one quality I value in just about all of my colleagues at NADC: authentic engaging with others with differing views and working together to achieve mutual understanding.

Do you share this goal of collegiality? Is this a value that should be important in NADC? In what ways are we effective in meeting this goal, and in what ways could we improve?

There are probably some of you reading this who are skeptical that your feedback matters. Let me assure you that it does. I have just finished participating in our initial planning call for the April 2019 Spring Conference. Our first order of business was to review, in depth, the feedback received from members. We had 25 percent of you complete the feedback form, and we thank you. The forms, including your helpful suggestions, materially affected our choice of topics and other aspects of the upcoming event. Yes, your input matters, and, indeed, our success depends on it.

I am sure I am not alone in feeling that the past year was uniquely challenging, and next year looks to be the same. I am very pleased that I have you, my colleagues and friends, as continuing resources to face the upcoming tasks and provide the benefit of your wisdom, advice, and often a bit of humorous perspective to best serve our clients.

Happy holidays, and best wishes to you all. ■

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Shareholder Disputes in Closely-Held Entities: Implications for Attorney-Client Privilege

By Eric A. Baker, *Boardman & Clark LLP* [1]

Closely-held dealerships face a range of thorny corporate governance and legal issues. The issues these multi-faceted enterprises encounter often cross over multiple affiliated entities, frequently with diverse and inconsistent ownership interests between the affiliates. Adding to this complexity can be sporadic—and sometimes unanticipated—ownership changes resulting from multi-generation succession interspersed with non-family employee owners and even former relations and employees. Corporate structures that were initially simple, elegant, and rational, often become a complex bramble with latent legal hazards waiting for a triggering event, such as an ownership or management dispute.

One often overlooked pitfall in such settings is protecting and anticipating possible waiver of attorney-client privilege in the event of litigation among directors who are often the only owners or who represent a significant interest. With shifting and inconsistent appellate decisions in this area, dealership counsel should be constantly mindful of the potential dichotomy between corporate and individual constituent interests.

Divergent and Shifting Views on Corporate Entity Control of the Attorney-Client Privilege

When dissenting directors bring suit against the corporate entity or other directors or officers, courts have generally adopted one of two broad approaches to assess claims of attorney-client privilege against the dissidents' attempt to access or cite the entity's privileged communications. Some courts adopt an "entity client" rule, whereby the privilege belongs solely to the entity and waiver of such privilege is controlled by "management" (directors/owners with majority control), which is not a dissident shareholder or officer.[2] Other courts adopt a "joint client" approach, whereby the directors are the collective body that has responsibility to manage the corporation. Therefore, legal advice cannot be withheld from any director who represents the client.[3] In addition, several courts have limited the joint client rule in circumstances in which individual director's interests are manifestly adverse to the corporation, justifying restriction of access to the corporation's privileged communications.[4]

Although some commentators have deemed the entity client approach the majority view,[5] it appears that numerous jurisdictions have yet to sort through this thorny issue. Moreover, even in jurisdictions where the issue has been addressed, courts have grafted exceptions to justify desired end.

A decision of the Wisconsin Supreme Court demonstrates the difficulty in predicting how courts in various jurisdictions may decide specific fact patterns. In *Lane v. Sharp Packaging Systems, Inc.*,[6] a closely-divided (four to three) Wisconsin Supreme Court ultimately adopted the entity client rule in Wisconsin, in a case of first impression, noting that the "lawyer-client privilege belongs to [the corporate entity]."[7] Citing seminal decisions supporting the entity client theory, the court reasoned that the then-current board, as the "corporation's management," controlled "'the power to waive the corporate attorney-client privilege.'"[8] As such, "'[a] dissident director is by definition not 'management' and, accordingly, has no authority to pierce or otherwise frustrate the attorney-client privilege when such action conflicts with the will of 'management.'"[9]

The well-reasoned dissent, in turn, acknowledged fundamentals of the entity client rule: that the attorney-client privilege belongs to the corporate entity, and that only the entity may waive the privilege.[10] Advocating for the "joint client" approach, the dissent observed that "[t]he corporate entity must, of course, act through a person or persons to carry out its many functions, including waiving or asserting the attorney-client privilege."[11] The dissent then reasoned that "the directors are the collective body that has the responsibility to manage the corporation; and consistent with their joint obligations, the directors are the joint clients when legal advice is given to the corporate through one of its officers or directors."[12] The dissent concluded, "This legal information cannot be privileged against [the former director]. An attorney may not withhold legal advice from his or her own client."[13] The *Lane* dissent specifically noted the sometimes ill fit of corporate entity principles to closely-held enterprises, observing that "the line between the entity and the individuals who own or control the entity often becomes blurred," and further stating:

> The most significant or perhaps sole relevant interests in a closely held corporation might be those of the constituents, that is the shareholders and the directors. A closely held corporation may be a separate legal entity for purposes of its relation with outsiders, but with respect to its constituents… the fictional 'entity' may have little, if any, import. The court should look at the practical realities of the closely held corporation in determining attorney-client questions in the particular situation before the court.[14]

Highlighting the discord on this subject, the dissent noted that its assertion of the joint client approach "reach[ed] the same result… as that reached by the Delaware chancery courts," citing *Moore Bus. Forms, Inc. v. Cordant Holdings Corp.*, 1996 WL 307444, at *4 (Del. Ch. June 4, 1996) and *Kirby v. Kirby,* 1987 WL 14862, at *7 (Del. Ch. July 29, 1987).[15]

Although this issue appears settled in Wisconsin (for now),[16] the see-saw analysis in *Lane* demonstrates the unsteady footing on which clients and attorneys alike perch—whether in Wisconsin or in other jurisdictions—in seeking and conveying legal advice relating to sensitive intra-company issues in a closely-held enterprise. Subsequent cases in Delaware, New York, and Massachusetts, for example, demonstrate that even where jurisdictions have adopted the joint client approach, courts have entertained exceptions to limit director access to privileged communications where "sufficient adversity exists between the director and the corporation such that the director could no longer have a reasonable expectation that he was a client of the board's counsel."[17] On the other hand, dissident directors who are also shareholders may pierce the entity rule—restricting dissident access to privileged communications—by demonstrating good cause why the privilege should not apply.[18]

Managing Client and Constituent Relationships.

Counsel should be constantly vigilant of their obligations in representing the dealership enterprise, as opposed to personal constituent interests. This is often difficult in closely-held dealerships, where the enterprise's attorneys may interact with only one or two significant owners within a small ownership group. When multiple principals/directors have ownership stakes, constituents should be reminded, periodically and when potential conflicts surface, that the dealership legal counsel represents the enterprise's interests and that individuals should consult their personal attorneys (at their personal expense) to address any concerns that they have regarding their rights and obligations vis-à-vis the other owners and management.

Legal advice should focus on the best interests of the enterprise, as opposed to individual constituents, even when controlling owners or executive managers may be opposed. Such legal advice should account for the legitimate interests of dissident constituents.

The enterprise's attorney should avoid taking sides or getting caught in the middle of disputes among its owners. This is much easier said than done, and again requires constant vigilance. Where possible, the enterprise should consider forming independent special committees to investigate and consider conflicts of interest or improper dealing with the enterprise.

Legal fights over conflicts of interest and assertions of attorney-client privilege may distract ownership factions from working towards resolution of their disputes. Such fights also ratchet up litigation expenses and introduce peripheral risks that may hamper efforts to negotiate a resolution. Thinking through these pitfalls well in advance of any disagreement may minimize distractions. ■

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4. *Kalisman v. Friedman*, 2013 WL 1668205, at *5 (Del. Ch. April 17, 2013). *See also Barasch v. Williams Real Estate Co. Inc.*, 104 A.D. 3d 492-93 (N.Y. App. Div. 2013); *Chambers v. Gold Medal Bakery, Inc.*, 464 Mass. 383, 395 (2013).
5. 2 McLaughlin on Class Actions § 11:7 (15th ed.).
6. 2002 WI 28, 640 N.W.2d 788.
7. *Id.* ¶ 32-33.
8. *Id.* ¶ 34 (*quoting Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985)).
9. *Id.* (quoting *Milroy*, 875 F. Supp. at 649-50).
10. *Id.* ¶ 74.
11. *Id.*
12. *Id.* ¶ 80.
13. *Id.*
14. Id. ¶ 89 (internal citations omitted).
15. *Lane*, 2002 WI 28, ¶ 81 & n.4.
16. *Fouts v. Breezy Point Condo. Ass'n*, 2014 WI App 77, ¶¶ 16, 21, 851 N.W.2d 845.
17. *Kalisman v. Friedman,* 2013 WL 1668205, at *5 (Del. Ch. April 17, 2013). *See also Barasch v. Williams Real Estate Co. Inc.*, 104 A.D. 3d 492-93 (N.Y. App. Div. 2013); *Chambers v. Gold Medal Bakery, Inc.*, 464 Mass. 383, 395 (2013) (noting complexity of determining when director interests are adverse "particularly in the context of a close corporation").
18. *Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW,* 95 A.3d 1264, 1278 (Del. 2014); *Garner v. Wolfinbarger*, 430 F.2d 1093, 1104 (5th Cir. 1970)).

Eric Baker is a partner with Boardman & Clark LLP in Madison, Wisconsin. Eric's practice emphasizes the representation of automobile, agricultural equipment, heavy truck, and other equipment dealers, primarily in litigation as well as in regulatory and other matters.

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Charles


Ackerman

New Partnership Audit Rules

By Paul L. Charles, CPA and Joel E. Ackerman, CPA, MST
Richards, Witt & Charles, LLP, Garden City, NY

There has been little discussion about a very important change affecting the rules governing partnerships that were originally a part of the Bipartisan Budget Agreement of 2015. The new rules are effective for partnership tax years beginning after Dec. 31, 2017.

The new audit rules are designed specifically to assist the IRS audits of large partnerships by limiting the number of inquiries the IRS must make within a partnership. All partnerships (small and large) and entities treated as a partnership should evaluate the changes under the new law prior to filing 2018 tax returns. Legal documents are also affected and need to be addressed immediately.

Who will represent the partnership?

One of the most significant changes was the use of the term "Tax Matters Partner," which has now become "Partnership Representative." Previously, the Tax Matters Partner was responsible for making decisions on behalf of the partnership. The designation was only required if the partnership had a corporate partner or had more than 100 partners. The new law now requires the designation of a Partnership Representative each year regardless of the size or ownership structure of the partnership.

Partnerships should select this representative with diligence and prudence, since he or she will have wide-ranging authority to act on behalf of the partnership. The designee need not be a partner, and could be an entity, such as a management company, that has a substantial United States presence. If such a company is chosen, they must also designate one individual as the partnership representative. The point here is clearly to establish a point person, so the IRS does not have to send out multiple correspondence or make duplicate documents during the audit process.

The Partnership Representative will have the contractual right to work with the IRS during an audit. Because of the broad scope of responsibilities and the ability to act on behalf of all partners, it is vital for proper amendments to legal documents of who the Partnership Representative is, how he or she is appointed, and how that person will be replaced in the event the person is unable to perform the duties.

It is very important to spell out the scope of the duties of the position in the legal documents pertaining to the Partnership Representative. The entity should have all proper liability protection in place in the event of misfeasance or malfeasance. The representative must understand the sole authority and responsibilities entrusted to him or her; act on behalf of the partnership; retain experts to assist with the audit; provide notice for audit; and understand the totality of his or her decision-making powers. All other partners will have no right to participate in an audit, no right to the notices of the audit proceedings, and most importantly, they are bound by the actions of the partnership representative.

What happens when the partnership is audited?

When the IRS selects a partnership for audit, the exam will be performed at the partnership level. This is the same as in the past. However, under the new rules, the partnership (rather than the individual partners) will generally have the tax liability at the entity level if the IRS makes an audit adjustment.

Under this change taxes assessed to the partnership as the result of an audit are assessed in the tax year when the audit or judicial review is completed. This could be several years past the date the return was originally audited. New partners, therefore, could be financially liable for audit assessments for years prior to their admission into the partnership. Inversely, former partners would not be liable for taxes due to audit changes to the tax years in which they were an owner, unless specified in legally binding documentation.

The tax assessment from an audit will be at the highest Federal income tax rate for either individuals or corporations—currently 37 percent. Therefore, an assessment of $100,000 in income to the partnership would result in $37,000 in taxes.

Partnerships with fewer then 100 partners may opt-out of the new partnership audit rules. Qualifications require that each partner must be an individual, a C corporation, a foreign entity that would be treated as a C corporation if it were domestic, an S corporation, or any deceased partner estate. There could be a problem for partnerships that include disregarded entities, such as single-member LLCs. These entities are not allowed to elect out. It is very important that the partners are aware of this limitation if they decide to transfer their interests, by sale or by estate planning, to these disregarded entities.

With the new changes, the administrative burden of assessing and collecting taxes at the partner level was shifted from the IRS to the partnership. The IRS will no longer have to match and pursue thousands of different partners at large partnerships if there is an assessment.

Unfortunately, with the tidal wave of tax reform, this flew under the radar and, in most cases, has not been addressed. These changes, however, are very important and you should consult with your clients' tax counsel to ensure compliance. We recommend reviewing your clients' partnership agreements to incorporate these new rules. ■

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emurphy@dealercounsel.com

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Jami Farris, Editor
jamifarris@parkerpoe.com

Michael Charapp, Assistant Editor
mike.charapp@cwattorneys.com

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1800 M Street, NW, Suite 400 South, Washington, DC 20036
Phone: 202-293-1454 • Fax: 202-530-0659 • www.dealercounsel.com