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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9829]

RIN 1545-BN77

Election Out of the Centralized Partnership Audit Regime

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations regarding the implementation of certain portions of section 1101 of the Bipartisan Budget Act of 2015 (BBA), which was enacted into law on November 2, 2015. Section 1101 of the BBA repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level. This document provides final regulations for electing out of the centralized partnership audit regime. The final regulations affect partnerships for taxable years beginning after December 31, 2017.

DATES: Effective date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability Date: For dates of applicability, see §301.6221(b)-1(f).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under section 6221(b), Jennifer Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

## **Background**

This document contains final regulations to amend the Procedure and Administration Regulations (26 CFR part 301) under Subpart – Tax Treatment of Partnership Items to implement the rules for electing out of the centralized partnership audit regime enacted by section 1101 of the BBA, Public Law 114-74. Section 301.6221(b)-1 provides the rules regarding the ability of a partnership to elect out of the centralized partnership audit regime, including prescribing the time, form, and manner for making the election.

On June 14, 2017, the Treasury Department and the IRS published in the **Federal Register** (82 FR 27334) a notice of proposed rulemaking (REG-136118-15) proposing amendments to part 301 of title 26 of the Code of Federal Regulations (June 14 NPRM). The June 14 NPRM proposed rules under a number of provisions of the centralized partnership audit regime, including section 6221(b), regarding the election out of the regime. A public hearing regarding the proposed regulations was held on September 18, 2017. The IRS also received written public comments in response to the proposed regulations. After careful consideration of all written public comments and statements made during the public hearing, the portions of the proposed regulations relating to section 6221(b) are adopted as amended by this Treasury decision. The amendments to the proposed regulations are discussed in the next section.

## Summary of Comments and Explanation of Revisions

In response to the June 14 NPRM, the IRS received 32 written comments, and five statements were provided at the public hearing. Of the 32 written comments, 16 addressed the proposed regulations under section 6221(b). All comments (both written and provided orally at the public hearing) were considered and written comments are available for public inspection at [www.regulations.gov](http://www.regulations.gov) or upon request. This preamble addresses only the comments that addressed the proposed regulations under section 6221(b), which are the proposed regulations from the June 14 NPRM being finalized in this Treasury Decision. Comments, or any portion of a comment, which relate to other aspects of the proposed regulations in the June 14 NPRM will be addressed when final regulations regarding those provisions are published.

### 1. Election Out of the Centralized Partnership Audit Regime

The comments received with respect to proposed §301.6221(b)-1 (regarding the election out of the centralized partnership audit regime) cover three general areas: (1) determining the number of partners of the partnership for purposes of determining whether the partnership has 100 or fewer partners under section 6221(b); (2) determining what partners constitute eligible partners for purposes of determining whether the partnership is an eligible partnership under section 6221(b); and (3) the mechanics of making the election under section 6221(b).

#### A. Determining whether the partnership is eligible to elect out of the centralized partnership audit regime

Proposed §301.6221(b)-1(b)(1) provides that a partnership is eligible to elect out of the centralized partnership audit regime if the partnership has 100 or fewer partners

for the taxable year, and all of the partners are eligible partners. Proposed §301.6221(b)-1(b)(1)(i) provides that a partnership has 100 or fewer partners for the taxable year if it is required to furnish 100 or fewer statements under section 6031(b).

i. Determining the number of statements required to be furnished

Several comments suggested that statements furnished to certain types of partners should not be taken into account for purposes of determining whether the partnership is required to furnish 100 or fewer statements under section 6031(b) (the 100-or-fewer threshold). For example, one comment recommended that statements furnished to pass-through entities and disregarded entities should not count toward the 100-or-fewer threshold, and another comment recommended that spouses should count as a single partner for this purpose.

Section 6031(b) generally requires a partnership to furnish a statement to each person that is a partner in the partnership during the partnership taxable year regarding that partner's interest in the partnership for such year. If a pass-through entity or disregarded entity is a partner in the partnership, the partnership is required to furnish a statement under section 6031(b) to that pass-through entity or disregarded entity. See §1.6031(b)-1T(a)(1) (statements required to be furnished to every person who was a partner (within the meaning of section 7701(a)(2)) at any time during the taxable year). Additionally, if two individuals are partners in a partnership, the partnership is required to furnish a statement under section 6031(b) to each of those individuals, regardless of whether they are married to one another. Id. Even though a pass-through entity or a disregarded entity is not an eligible partner (and a partnership with such partners would not be eligible to make an election under section 6221(b) regardless of the number of its

partners), because the statute expressly provides that the 100-or-fewer threshold turns on the number of statements required to be furnished under section 6031(b), and section 6031(b) requires that the partnership furnish statements to all partners in the partnership during such taxable year regardless of whether the partner is a pass-through entity, a disregarded entity, or an individual who is married to another partner, these comments suggesting to the contrary were not adopted.

One comment suggested that the IRS should establish procedures to quickly address uncertainties regarding whether a statement was required to be issued under section 6031(b) for purposes of making an election under section 6221(b). The comment suggested that this could be accomplished through the private letter ruling process. Eligible partnerships can file an election out of the centralized partnership audit regime for taxable years beginning on or after January 1, 2018. Until the first partnership returns for taxable years subject to the new regime are filed and any elections out of the new regime are reviewed, it is difficult to determine whether a pre-filing procedure for providing legal determinations regarding section 6031(b) for purposes of making the election under section 6221(b) would be helpful or appropriate. Additionally, there is long-standing guidance regarding whether a partnership is required to furnish a statement under section 6031(b) to a particular person. Id. Therefore, because there is sufficient existing guidance regarding whether statements are required to be furnished under section 6031(b) and because the centralized partnership audit regime does not alter that existing guidance, the Treasury Department and the IRS have chosen not to adopt the suggestion to establish a pre-filing procedure specific to section 6221(b) in the final regulations. The IRS may reconsider whether a pre-filing

procedure would be helpful after gaining experience with the election out procedures under section 6221(b). If it becomes apparent that a pre-filing procedure might prove useful in the context of section 6221(b), the Treasury Department and the IRS will consider at that time whether to establish such a procedure in other guidance, forms, or instructions. Additionally, nothing in these regulations prohibits a partnership from utilizing existing procedures for requesting private letter rulings or other guidance from the IRS concerning section 6031(b).

Two comments were received with respect to Example 2 under proposed §301.6221(b)-1(b)(2)(iii). One comment suggested removing certain assumptions set forth in the example because those assumptions were not relevant to the conclusion reached in the example. Specifically, the comment suggested removing the following assumed facts – 1) that Spouse 1 and Spouse 2 have lived in a community property state at all times since they were married; and 2) that Spouse 1 acquired the partnership interest while married to Spouse 2. The comment suggested replacing those assumed facts with a statement that Spouse 2 only has a community property interest in the partnership. A second comment recommended that the regulations expressly state that one spouse's community property interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b).

The intent of Example 2 under proposed §301.6221(b)-1(b)(2)(iii) was to illustrate that whether a partnership is required to furnish a statement for purposes of section 6221(b) is determined by looking only to section 6031(b). The example was not intended to illustrate any principles of the various states' community property laws. For

these reasons, the two facts identified by the first comment were removed and replaced with a statement that, as a matter of state law, Spouse 2 has a community property interest in Spouse 1's partnership interest.

The second comment suggested that the regulations under section 6221(b) specifically address community property interests. The determination of whether a partnership is required to furnish a statement is governed by section 6031(b) and the regulations thereunder. Creating a specific rule potentially at odds with the existing rules under section 6031(b) in these regulations could result in confusion regarding the proper operation of existing section 6031(b) rules and is not necessary for implementation of section 6221(b). Accordingly, the second comment suggesting the regulations expressly state that one spouse's community property interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b) was not adopted.

#### ii. Constructive or de facto partnerships

Several comments were received regarding the statement in the preamble of the June 14 NPRM that noted the IRS' intention to carefully scrutinize whether two or more partnerships that have elected out under section 6221(b) should be recast under existing judicial doctrines and general federal tax principles as having formed one or more constructive or de facto partnerships for federal income tax purposes. The preamble also listed several factors the IRS would consider when examining such arrangements and noted that, if two or more partnerships were recast under those doctrines and principles, the constructive or de facto partnership would be subject to the centralized partnership audit regime because it would not have made a timely election

under section 6221(b). Several comments suggested rules to address those statements in the preamble, including suggesting that the final regulations should provide: 1) clear standards and safe harbors for when the IRS will determine if a constructive or de facto partnership exists and the effects of determining that two or more partnerships are constructively a single partnership; 2) a rule that any constructive or de facto partnership should be able to appeal that determination, including to the United States Tax Court; and 3) a reasonable amount of time for a constructive or de facto partnership to make an election under section 6221(b).

The statements in the preamble of the June 14 NPRM referencing the IRS's intention to carefully examine whether two or more partnerships should be recast or be treated as having formed one or more constructive or de facto partnerships for federal income tax purposes reference existing judicial doctrines and general federal tax principles existing outside the centralized partnership audit regime. These existing judicial doctrines and bodies of law under the Internal Revenue Code (Code) govern whether a partnership is in existence, which is not an issue specific to (or altered by) the centralized partnership audit regime. However, if the IRS were to invoke these existing judicial doctrines and bodies of law and recast two partnerships as one or determine a partnership existed where no return was filed, there would likely be consequences under the centralized partnership audit regime as outlined in the preamble to the June 14 NPRM. For that reason, the statements in the preamble to the June 14 NPRM were meant to alert taxpayers to these existing judicial doctrines and bodies of law and to the fact that they might be applicable. Nothing in the June 14 NPRM or in this Treasury Decision alters these existing judicial doctrines and bodies of law governing whether a



partnership is in existence. Accordingly, the final regulations do not adopt the comments requesting rules under the existing judicial doctrines and bodies of law governing whether a partnership is in existence.

Any application by the IRS of those existing judicial doctrines and bodies of law to two or more partnerships would require the IRS to follow all applicable due process requirements, including those under the centralized partnership audit regime. A taxpayer would have any applicable administrative review in accordance with IRS procedures and judicial review as provided by existing provisions of law.

With regard to the comment requesting a reasonable amount of time for a constructive or de facto partnership to make an election under section 6221(b), the time to make an election under section 6221(b) is specifically prescribed by statute. Section 6221(b)(1)(D)(i) expressly provides that an election under section 6221(b) is made on a timely filed return for the taxable year.

Finally, the United States Tax Court is a court of limited jurisdiction. See section 7442. The Treasury Department and the IRS do not have authority to confer jurisdiction on the United States Tax Court. As the IRS gains experience with the centralized partnership audit regime, the IRS may consider issuing sub-regulatory guidance covering elections under section 6221(b) in the context of constructive and de facto partnerships. The comments regarding constructive and de facto partnerships, however, were not adopted in these final regulations.

#### B. Eligible partners

Under section 6221(b)(1)(C), one of the criteria for a partnership to make an election under section 6221(b) is that each of the partners of the partnership is an

individual, C corporation, foreign entity that would be treated as a C corporation if it were a domestic entity, S corporation, or estate of a deceased partner. Proposed §301.6221(b)-1(b)(3) describes these partners as “eligible partners”. Proposed §301.6221(b)-1(b)(3)(ii) provides that some partners are not eligible partners, such as partnerships, trusts, disregarded entities, nominees or other similar persons that hold an interest on behalf of another person, and estates other than the estate of a deceased partner. In the case of an eligible partner that is an S corporation (S corporation partner), the statements required to be furnished by the S corporation partner under section 6037(b) for its taxable year ending with or within the partnership’s taxable year are treated as statements furnished by the partnership for purposes of determining whether the partnership is required to furnish 100 or fewer statements. Section 6221(b)(2)(A)(ii). The statement furnished to the S corporation partner by the partnership also counts towards the 100-or-fewer threshold. In addition, the partnership must disclose the names and taxpayer identification numbers (TIN) for each person with respect to whom the S corporation partner was required to furnish a statement under section 6037(b). Under section 6221(b)(2)(C), the Secretary is authorized by regulation or other guidance to prescribe rules similar to the rules for S corporation partners with respect to other types of persons not specifically described as eligible partners under section 6221(b)(1)(C).

The preamble to the June 14 NPRM explains that the Treasury Department and the IRS considered but did not adopt comments in response to Notice 2016-23, 2016-13 I.R.B. 490 (March 28, 2016) that suggested that the Treasury Department and the IRS exercise authority under section 6221(b)(2)(C) to expand the types of persons that are

eligible partners for purposes of the election out rules under section 6221(b). The June 14 NPRM explains that broadening the scope of the election out provisions to include additional types of partners or partnership structures would increase the administrative burden on the IRS because those structures and partners would need to be audited under the deficiency procedures. The preamble to the June 14 NPRM requested comments on any potential expansion of the election out rules, noting that comments are particularly helpful if they address the additional burdens that expansion of the rules would impose on the IRS, in addition to the decreased burden on taxpayers resulting from such an expansion.

In response to the June 14 NPRM, the Treasury Department and the IRS received many comments similar to the comments received in response to Notice 2016-23 requesting that the Treasury Department and the IRS exercise the discretionary authority provided in section 6221(b)(2)(C) to expand the definition of eligible partner. Comments suggested that partnerships, disregarded entities, trusts (including tax-exempt trusts, revocable trusts, charitable remainder trusts, grantor trusts, and nongrantor trusts), individual retirement accounts, nominees, qualified pension plans, profit-sharing plans, and stock bonus plans should be considered eligible partners for purposes of making an election under section 6221(b). Comments specifically suggested that because certain types of entities, such as trusts, are similarly situated to certain eligible partners, such as S corporations because those entities are audited and report items to their owners similarly, they should be included within the definition of eligible partner, and that excluding them could lead to treating similarly situated taxpayers differently. For example, one comment noted that a tax-exempt organization

organized as a C corporation is an eligible partner while a tax-exempt organization organized as a trust is not an eligible partner, even though both organizations are taxed the same way.

One comment suggested that all tiered partnerships should be eligible to make an election under section 6221(b) under rules similar to the rules that apply to S corporation partners, which would require counting the number of statements required to be furnished by each pass-through partner toward the 100-or-fewer threshold under proposed §301.6221(b)-1(b)(2). Another comment recommended that the IRS develop an administrable election out for tiered partnerships. The comments suggested that such rules could allow for tiered partnerships to be collapsed down to their ultimate beneficial owners and permit that collapsed structure to make an election out, provided there was a “manageable” number of ultimate beneficial owners and the beneficial owners were all eligible partners.

In addition, multiple comments suggested that the authority granted in section 6221(b)(2)(C) signified a congressional expectation that the Treasury Department and the IRS would expand the list of eligible partners under section 6221(b)(1)(C). Multiple comments also suggested that the General Explanations of Tax Legislation Enacted in 2015 prepared by the Joint Committee on Taxation supported an expansion of the section 6221(b)(1)(C) list. See Joint Comm. on Taxation, JCS-1-16, General Explanation of Tax Legislation Enacted in 2015, 59-60 (2016). Other comments observed that the differences between the election out rules under section 6221(b) and the small partnership exception under the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248 (TEFRA) – the increase from 10 to 100 partners and the

inclusion of S corporation partners – reflected an awareness that the IRS would face additional administrative burdens as a result of the election out rules.

Comments suggested that in some situations there would be minimal or no additional burdens imposed on the IRS resulting from an expansion of the definition of eligible partner. For example, comments suggested that, because there is only one additional layer of ownership beyond an entity that is disregarded as an entity separate from its owner for Federal tax purposes, adding those types of entities to the definition of eligible partner would not increase audit complexity or administrative burden for the IRS.

Some comments suggested that maintaining the current definition of eligible partner in proposed §301.6221(b)-1(b)(3) would actually lead to more administrative burden for the IRS. For example, one comment suggested that because some tiered partnerships are ultimately owned by members of the same affiliated group, it would be more burdensome to conduct separate examinations (one for the partnership under the centralized partnership audit regime and one for the consolidated group under the deficiency procedures), rather than examining all entities as part of the same proceeding. Another comment observed that in some cases, certain partnership structures that are relatively complex and therefore difficult to audit would be able to elect out, while other more simple structures, which are potentially less burdensome to audit, could not elect out. One comment suggested that by not expanding the types of entities that are eligible partners more partnerships will be subject to the centralized partnership audit regime, and the IRS and taxpayers will face additional burdens

because they have to apply the new audit rules, rather than applying longstanding rules familiar to both the IRS and to taxpayers.

Other comments noted the consequences to partnerships and partnership interests of not expanding the definition of eligible partner to include disregarded entities or trusts. For example, one comment suggested that not expanding the types of entities that are eligible partners would result in taxpayers transferring partnership interests from disregarded entities to eligible partners, leading to unnecessary filings and paperwork with limited effect on the ultimate taxpayers' liabilities. Another comment suggested that not expanding the types of entities that are eligible partners would cause a reduction in value of limited partnership interests because of the increased risks and burdens associated with an audit under the centralized partnership audit regime. Another comment noted that the centralized partnership audit regime shifts certain administrative functions from the IRS to taxpayers, functions that were typically performed by the IRS under TEFRA.

The Treasury Department and the IRS have carefully considered all of the comments suggesting an expansion of the definition of eligible partner, but have decided not to adopt these comments at this time. In making this determination, the Treasury Department and the IRS considered the burdens of the centralized partnership audit regime on taxpayers and have concluded that the interests of efficient tax administration outweigh those potential burdens. Accordingly, the final regulations do not expand the definition of eligible partner to include entities other than those entities expressly provided in section 6221(b)(1)(C). After gaining experience with the centralized partnership audit regime, the Treasury Department and the IRS will be in a

better position to reconsider any expansion of partnerships eligible to elect out of the regime.

Expanding the current definition of eligible partner would result in more partnerships electing out of the centralized partnership audit regime. In turn, this would result in more audits under the deficiency procedures for taxpayers owning interests in partnerships. When a partnership makes a valid election out of the centralized partnership audit regime under section 6221(b), the IRS must follow the deficiency procedures to audit, assess, and collect tax from the ultimate owners of that partnership. Under the partnership audit procedures enacted as part of TEFRA, the IRS conducted a unified examination of the partnership's items at the partnership level, but was still required to separately assess and collect tax from the ultimate owners of the partnership (sometimes through deficiency procedures).

The centralized partnership audit regime is designed to improve upon both the TEFRA rules and the deficiency procedures by providing for a centralized audit proceeding with respect to the partnership and mandating centralized assessment and collection of tax, penalties, and interest from the partnership. It follows then that rules designed to limit the number of partnerships that can elect out of the new regime is consistent with this objective.

Further, for each additional type of partner that is added to the list of eligible partners, the IRS will be required to follow deficiency procedures with respect to the indirect partners of that partner to assess and collect tax resulting from a partnership audit that could otherwise be assessed and collected against a single partnership under the centralized partnership audit regime. As noted in the preamble to the June 14

NPRM, the number of partnerships has grown substantially in recent years and is likely to continue to grow, compounding the audit and collection inefficiencies extant outside of the new regime for the IRS with each expansion of the eligible partner list. It would undermine the benefits of the new regime to expand the group of partnerships that are eligible to elect out of the new regime. Moreover, it would be unwise to do so at a time before the first returns for taxable years subject to the new regime have been filed.

There may be some situations where expanding eligible partners would not add significantly more complexity to an examination, even under the deficiency procedures. However, while this may occur in some instances, the rules under section 6221(b) are designed to be of general applicability to all partnerships, regardless of size and composition of partners. Section 6221(b)(1) sets the parameters for making an election out of the centralized partnership audit regime, and partnerships that meet these requirements are eligible to make an election under section 6221(b) regardless of how complex or simple their partnership structure is. While certain types of partnerships that elect out may present less audit burden than others, as the total number of partners increases, so too does the number and the complexity of deficiency proceedings. Therefore, any potential simplification of an audit for one particular partnership that might result from the expansion of the election out rules must be appropriately balanced against the increasing audit burden on the IRS if the total number of partnerships that can elect out is increased.

The Treasury Department and the IRS acknowledge that the new rules are a significant change in the way partnerships have been traditionally audited, particularly in the imposition of an imputed underpayment at the partnership level. Comments have



raised concerns that the imputed underpayment may not accurately reflect the tax liability that would have been owed had the partnership and the partners reported correctly in the reviewed year taking the partners' specific facts and circumstances into account. However, partnerships and partners have the means to mitigate those concerns by utilizing the modification procedures under section 6225 or making the election under section 6226 (the alternative to payment of the imputed underpayment).

As the Treasury Department and the IRS gain experience with the centralized partnership audit regime, the definition of eligible partner may be revisited. Section 6221(b)(2)(C) allows the Treasury Department and the IRS to expand the types of eligible partners through "other guidance," which includes sub-regulatory guidance that can be more easily tailored and adapted as the Treasury Department and the IRS gain experience with the new regime. Until that time, however, the list of eligible partners will remain the list specifically set forth by Congress in section 6221(b)(1)(C).

In addition to the comments about expanding the definition of eligible partner, one comment recommended clarifying the meaning and application of the phrase "a nominee or other similar person that holds an interest on behalf of another person" under proposed §301.6221(b)-1(b)(3)(ii)(E). The comment stated that the meaning of the quoted language was unclear. The intent of this provision was not to create a new concept that does not currently exist in the Code and regulations. Instead, the intent of the provision was to include in the list of ineligible partners situations where the partner holds an interest on behalf of another person. To remove the ambiguity, the quoted language was clarified to remove the word "nominee" as a separate clause and

provides instead that a partner is not an eligible partner if that partner holds an interest in the partnership on behalf of another person.

C. Making the election under section 6221(b)

Proposed §301.6221(b)-1(c) provides that an election out of the centralized partnership audit regime must be made on an eligible partnership's timely filed return, including extensions, for the taxable year to which the election applies, and, once made cannot be revoked without the consent of the IRS. Additionally, under proposed §301.6221(b)-1(c)(2), the election must include each partner's name, correct U.S. TIN, and Federal tax classification. If the election is being made by a partnership that has an S corporation as a partner, proposed §301.6221(b)-1(c)(2) provides that the election must also include each S corporation shareholder's name, correct U.S. TIN, and Federal tax classification. Proposed §301.6221(b)-1(c)(2) also provides that the election must include an affirmative statement that the partner is an eligible partner and any other information required by the IRS in forms, instructions, or other guidance. Under proposed §301.6221(b)-1(c)(3), if a partnership makes an election under section 6221(b), the partnership must notify its partners of the election within 30 days of making the election. Under proposed §301.6221(b)-1(e)(2), if the IRS determines that a purported election by a partnership is invalid, the IRS will notify the partnership in writing, and the provisions of the centralized partnership audit regime will apply to the partnership.

One comment suggested that the regulations clarify whether a "timely filed return" under proposed §301.6221(b)-1(c)(1) is limited to the partnership's original return or whether it also includes any amended returns filed before the due date of the

original return. The definition of whether a return is a timely filed return is covered by other provisions of the Code, and the proposed regulations do not modify the longstanding interpretation of those provisions. Under that longstanding interpretation, a return is timely filed if it is filed prior to the due date of the return (taking into account any applicable extensions), regardless of whether it is the original return filed by the partnership or a return filed subsequent to the original return but before the extended due date of the return. See Haggard Co. v. Helvering, 308 U.S. 389 (1940). Therefore, the comment requesting that the regulations clarify the phrase “timely filed return” in proposed §301.6221(b)-1(c)(1) was not adopted.

Two comments were received regarding the rule under proposed §301.6221(b)-1(c)(1) that requires consent of the IRS to revoke an election previously made by the partnership. One comment suggested that partnerships should have the ability to revoke the election under section 6221(b) without the consent of the IRS and suggested that such a rule could result in more partnerships revoking elections and therefore becoming subject to the centralized partnership audit regime. Section 6221(b) is silent as to whether a partnership may revoke its election.

The June 14 NPRM allows a partnership to request revocation of its election under section 6221(b) with consent of the IRS. IRS consent is necessary for this type of election revocation because of the potential for detrimental effects on tax administration. By making an election under section 6221(b), the partnership is representing to the IRS that the partnership seeks to elect out of the centralized partnership audit regime. If a partnership is able to unilaterally revoke the election, the partnership is changing that representation without the IRS’s knowledge which, under certain circumstances, could

be detrimental to tax administration. For example, a partnership could make an election under section 6221(b) and subsequently revoke the election at a time when the period of limitations on making partnership adjustments under section 6235 is close to expiring, or would have already expired, even though the individual partners' periods of limitations on assessment might still be open. If unilateral revocations were permissible, the IRS would have to obtain protective statute extensions creating unnecessary burden on both partners and the IRS. Because the partnership's unilateral revocation of an election under section 6221(b) could be detrimental to tax administration, it is necessary to require IRS consent prior to any revocation. While allowing revocation without consent could potentially result in more partnerships subject to the centralized partnership audit regime, there is no reason to believe that requiring consent significantly alters the number of potential revocations, except in situations where the revocation was clearly detrimental to tax administration. Accordingly, the comment suggesting that the partnership can revoke the election without the consent of the IRS was not adopted.

Another comment recommended that the IRS provide rules on how a partnership requests the consent of the IRS to revoke an election and the standards the IRS will use to grant or deny such requests. The Treasury Department and the IRS have determined that these procedures are more appropriately addressed in non-regulatory guidance. This will enable the IRS to more quickly adjust the process, respond to feedback, and fix any potential problems as it gains more experience with elections under section 6221(b). Accordingly, these final regulations do not adopt this comment.

Section 6221(b)(2)(B) provides that the IRS may provide an alternative form of identification for foreign partners. The June 14 NPRM does not provide for a form of alternative identification for foreign partners, but instead requires that all partners of an eligible partnership have a U.S. TIN. The preamble to the June 14 NPRM explains that partners in a U.S. partnership, including foreign partners, are required to have a U.S. TIN, so an alternative form of identification may be unnecessary. However, the June 14 NPRM requested comments regarding situations in which a foreign partner subject to the centralized partnership audit regime may not otherwise be required to have a U.S. TIN, other than for the election under section 6221(b), and requested recommendations for alternative identification procedures that could be used in such cases.

Two comments made suggestions regarding a possible alternative method for identifying foreign partners when the partnership discloses partner information to the IRS as part of an election under section 6221(b). One comment recommended that “in the case of foreign partners who are individuals, the final Regulations provide that the partnership can submit a completed Form W-8 in lieu of the foreign partner’s TIN.” Another comment suggested that all foreign partners should be required to have TINs for a partnership to be eligible to make an election under section 6221(b).

Consistent with the second comment, the final regulations retain the approach of the proposed regulations and require a partnership to provide a correct U.S. TIN for all partners (foreign and domestic) as part of a valid election under section 6221(b). Requiring a U.S. TIN for all partners of a partnership treats all partners the same, regardless of whether they are foreign or domestic, and ensures that the partners of the partnership can be easily identified. However, the Treasury Department and the IRS

intend to continue to study this issue and may, in the future, provide for alternative identification for foreign partners in forms, instructions, and other guidance. To account for any future forms of alternative identification for foreign partners, §301.6221(b)-1(c)(2) provides that a partnership must disclose the name and U.S. TIN, or alternative form of identification required by forms, instructions, or other guidance, for each partner of the partnership or each shareholder of an S corporation partner.

Another comment stated that the language in proposed §301.6221(b)-1(c)(2), which requires a partnership to provide information regarding “each shareholder of the S corporation”, was not clear because it did not specify whether the partnership was required to provide information regarding S corporation shareholders as of a specific date or whether information was required of any person who was a shareholder at any point during the S corporation’s taxable year. The IRS and Treasury Department agree that the language in proposed §301.6221(b)-1(c)(2) should be clarified. Section 6221(b)(2)(A)(i) provides that the S corporation shareholders the partnership must identify are those shareholders with respect to whom the S corporation partner is required to furnish statements under section 6037(b) for the taxable year of the S corporation ending with or within the partnership taxable year for which the election is being made. Accordingly, the final regulations in §301.6221(b)-1(c)(2) provide that, as part of a valid election, a partnership must disclose the required information about each person who was a shareholder in the S corporation partner at any time during the taxable year of the S corporation ending with or within the partnership’s taxable year.

Regarding the requirement that a partnership making an election under section 6221(b) include an affirmative statement that each partner is an eligible partner, a

comment was received recommending that the affirmative statement should appear on the bottom of the form for making the election or be a return attachment that could be signed by anyone eligible to sign the partnership return. This comment and recommendation concerns forms and instructions that will be prescribed by the IRS, and therefore the comment is outside the scope of these regulations. However, the IRS will consider this comment when creating the forms and instructions necessary to implement the election out of the centralized partnership audit regime.

Two comments addressed the requirement that the partnership notify its partners of any election made under section 6221(b) within 30 days of making the election. Proposed §301.6221(b)-1(c)(3) requires a partnership that makes an election under section 6221(b) to notify its partners within 30 days of making the election. One comment requested that the final regulations clarify whether the partnership has to notify shareholders of an S corporation partner that the partnership has made the election. Under TEFRA, the term “partner” was defined to include both direct and indirect partners. See section 6231(a)(2) (prior to amendment by the BBA). Section 1101(a) of the BBA repealed the partnership audit procedures under TEFRA, including the definition of partner. As a result, the only operative definition of the term “partner” in the Code is located in section 7701(a)(2). Under that definition, shareholders of an S corporation partner are not partners in the partnership making the election under section 6221(b) because they are not members of the partnership. Therefore, the partnership does not have to provide notice to the shareholders of an S corporation partner because those shareholders are not “its partners” within the meaning of §301.6221(b)-1(c)(3). Accordingly, because the regulation is clear that the partnership only has to provide

notice to its partners, this comment recommending that the regulation be clarified on this point was not adopted. Further, it would be burdensome for the partnership making the election to have to notify both the S corporation and the S corporation shareholders. It should be sufficient that the partnership notify its partner, the S corporation. Whether and how the S corporation wishes to notify its shareholders is something that is left to the S corporation and its shareholders to determine.

Two comments suggested that the IRS should add a checkbox to the statements required to be furnished by the partnership under section 6031(b) indicating that the partnership has made an election under section 6221(b). The checkbox would serve as the notification of the election as required by §301.6221(b)-1(c)(3). This comment was not adopted because the regulations intentionally do not prescribe the method a partnership must use to notify its partners of the election. Under the regulations, the partnership has the flexibility to notify its partners in the manner that is in the best interests of the partnership and its partners. At this point, the Treasury Department and the IRS have considered the method the partnership notifies its partners to be a business decision of the partnership. Section 6221(b) requires only that the partnership notify its partners in the manner prescribed by the Treasury Department and the IRS. Accordingly, the Treasury Department and the IRS have refrained from regulating more specifically on this issue, and therefore this comment was not adopted. However, the proposed regulations are amended in the final regulations to make clear that the manner of notification is left to the partnership to determine.

One comment recommended that the final regulations include a mechanism for allowing the partnership to make corrections to the election to cure any compliance



errors. The Treasury Department and the IRS determined that these procedures, if needed, are more appropriately addressed in sub-regulatory guidance, which is more routinely updated and can be improved based upon experience. Under §301.6221(b)-1(e) and as explained more fully in the preamble to the June 14 NPRM, an election under section 6221(b) may be relied upon unless challenged by the IRS. That includes situations where the election is not fully compliant with all applicable rules. As provided under §301.6221(b)-1(e)(2), the IRS will notify the partnership if the IRS determines the partnership's election is invalid. Nothing in these regulations prohibits the partnership from working with the IRS if an election is deficient to correct any minor errors. By not providing a correction procedure in the regulations, the IRS and the partnership have more flexibility to address any errors in an election that may not be afforded if the regulations provided for rules for some situations but not others. Accordingly, the comment to include a correction procedure in the regulations was not adopted.

Finally, one comment recommended that the final regulations place a reasonable restriction on the time the IRS has to determine whether an election under section 6221(b) is invalid. The comment suggested that a period of 180 days from the filing of the return would be a reasonable time. This comment was not adopted because this would effectively impose a significant shortening of the period of limitations on when the IRS would be able to examine a partnership's return and make adjustments. Limiting the time within which the IRS may review the validity of an election would effectively force the IRS to decide within that specified time period whether it intended to review the election, even if the IRS had no intention at that time of ultimately examining the partnership's return.

Section 6221(b) did not provide a specific period of limitations for a determination that an election under section 6221(b) is invalid. Nevertheless, the period for determining an election purportedly made under section 6221(b) is invalid is not unlimited. The period of limitations on making adjustments under section 6235 limits the time within which the IRS may make a partnership adjustment, which will also serve as a practical limitation on when the IRS must decide whether to determine an election under section 6221(b) is invalid. If a purported election is determined to be invalid by the IRS, the partnership would be subject to the centralized partnership audit regime, and no partnership adjustment could be made by the IRS after the period prescribed in section 6235. For the reasons state above, the comment to establish a separate period for evaluating elections was not adopted.

In addition to addressing the comments received in response to the June 14 NPRM, this Treasury Decision also makes editorial, non-substantive changes to the proposed regulations under section 6221(b).

### **Special Analyses**

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory impact assessment is not required.

It is hereby certified that these rules will not have a significant economic impact on a substantial number of small entities. Although these rules may affect a substantial number of small entities, the economic impact is not substantial because these rules merely provides guidance on the statutory requirements for making an election out of the centralized partnership audit regime. These rules reduce the existing burden on

partnerships to comply with the statutory requirements by providing clear rules and guidance regarding the statutory requirements for partnerships desiring to make an election out of the centralized partnership audit regime under section 6221(b). For the reasons stated, the final rules will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

#### **Statement of Availability of IRS Documents**

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at [www.irs.gov](http://www.irs.gov).

#### **Drafting Information**

The principal author of these final regulations is Jennifer M. Black of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

#### **List of Subjects in 26 CFR Part 301**

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

#### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 301.6221(b)-1 is added to read as follows:

§301.6221(b)-1 Election out for certain partnerships with 100 or fewer partners.

(a) In general. The provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) do not apply for any partnership taxable year for which an eligible partnership under paragraph (b) of this section makes a valid election in accordance with paragraph (c) of this section. For rules regarding deficiency procedures, see subchapter B of chapter 63 of the Internal Revenue Code and §§301.6211-1 through 301.6215-1.

(b) Eligible partnership--(1) In general. Only an eligible partnership may make an election under this section. A partnership is an eligible partnership for purposes of this section if--

(i) The partnership has 100 or fewer partners as determined in accordance with paragraph (b)(2) of this section, and

(ii) Each statement the partnership is required to furnish under section 6031(b) for the partnership taxable year is furnished to a partner that was an eligible partner (as defined in paragraph (b)(3) of this section) for the partnership's entire taxable year.

(2) 100 or fewer partners--(i) In general. Except as provided in paragraph (b)(2)(ii) of this section, a partnership has 100 or fewer partners if the partnership is required to furnish 100 or fewer statements under section 6031(b) for the taxable year.

(ii) Special rule for S corporations. For purposes of this paragraph (b)(2), a partnership with a partner that is an S corporation (as defined in section 1361(a)(1)) must take into account each statement required to be furnished by the S corporation to its shareholders under section 6037(b) for the taxable year of the S corporation ending with or within the partnership's taxable year.

(iii) Examples. The following examples illustrate the provisions of this paragraph (b)(2). For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During its 2020 partnership taxable year, Partnership has four partners each owning an interest in Partnership. Two of the partners are Spouse 1 and Spouse 2 who are married to each other during all of 2020. Spouse 1 and Spouse 2 each own a separate interest in Partnership. The two other partners are unmarried individuals. Under section 6031(b), Partnership is required to furnish a separate statement (that is, Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.) to each individual partner, including separate statements to Spouse 1 and Spouse 2. Therefore, for purposes of this paragraph (b)(2), Partnership has four partners during its 2020 taxable year.

Example 2. The facts are the same as in Example 1 of this paragraph (b)(2)(iii), except Spouse 2 does not separately own an interest in Partnership during 2020 and Spouse 1 and Spouse 2 live in a community property state, State A. Spouse 1 acquired the partnership interest in such a manner that by operation of State A law, Spouse 2 has a community property interest in Spouse 1's partnership interest. Because Spouse 2's community property interest in Spouse 1's partnership interest is not taken into account for purposes of determining the number of statements Partnership is required to furnish under section 6031(b), Partnership is required to furnish a statement to Spouse 1, but not to Spouse 2. Therefore, for purposes of this paragraph (b)(2), Partnership has three partners during its 2020 taxable year.

Example 3. At the beginning of 2020, Partnership, which has a taxable year ending December 31, 2020, has three partners - individuals A, B, and C. Each individual owns an interest in Partnership. On June 30, 2020, Individual A dies, and A's

interest in Partnership becomes an asset of A's estate. A's estate owns the interest for the remainder of 2020. On September 1, 2020, B sells his interest in Partnership to Individual D, who holds the interest for the remainder of the year. Under section 6031(b), Partnership is required to furnish five statements for its 2020 taxable year – one each to Individual A, the estate of Individual A, Individual B, Individual C, and Individual D. Therefore, for purposes of this paragraph (b)(2), Partnership has five partners during its 2020 taxable year.

Example 4. During its 2020 taxable year, Partnership has 51 partners - 50 partners who are individuals and S, an S corporation. S and Partnership are both calendar year taxpayers. S has 50 shareholders during the 2020 taxable year. Under section 6031(b), Partnership is required to furnish 51 statements for the 2020 taxable year – one to S and one to each of Partnership's 50 partners who are individuals. Under section 6037(b), S is required to furnish a statement (that is, Schedule K-1 (Form 1120-S), Shareholder's Share of Income, Deductions, Credits, etc.) to each of its 50 shareholders. Under paragraph (b)(2)(ii) of this section, the number of statements required to be furnished by S under section 6037(b), which is 50, is taken into account to determine whether partnership has 100 or fewer partners. Accordingly, for purposes of this paragraph (b)(2), Partnership has a total of 101 partners (51 statements furnished by Partnership to its partners plus 50 statements furnished by S to its shareholders) and is therefore not an eligible partnership under paragraph (b)(1) of this section. Because Partnership is not an eligible partnership, it cannot make the election under paragraph (a) of this section.

Example 5. During its 2020 taxable year, Partnership has two partners, A, an individual, and E, an estate of a deceased partner. E has 10 beneficiaries. Under section 6031(b), Partnership is required to furnish two statements, one to A and one to E. Any statements that E may be required to furnish to its beneficiaries are not taken into account for purposes of this paragraph (b)(2). Therefore, for purposes of this paragraph (b)(2), Partnership has two partners.

(3) Eligible Partners--(i) In general. For purposes of paragraph (b)(1)(ii) of this section, the term eligible partner means a partner that is an individual, a C corporation (as defined by section 1361(a)(2)), an eligible foreign entity described in paragraph (b)(3)(iii) of this section, an S corporation, or an estate of a deceased partner. An S corporation is an eligible partner regardless of whether one or more shareholders of the S corporation are not an eligible partner.

(ii) Partners that are not eligible partners. A partner is not an eligible partner under paragraph (b)(3)(i) of this section if the partner is —

- (A) A partnership,
- (B) A trust,
- (C) A foreign entity that is not an eligible foreign entity described in paragraph (b)(3)(iii) of this section,
- (D) A disregarded entity described in §301.7701-2(c)(2)(i),
- (E) An estate of an individual other than a deceased partner, or
- (F) Any person that holds an interest in the partnership on behalf of another person.

(iii) Eligible foreign entity. For purposes of this paragraph (b)(3), a foreign entity is an eligible partner if the foreign entity would be treated as a C corporation if it were a domestic entity. For purposes of the preceding sentence, a foreign entity would be treated as a C corporation if it were a domestic entity if the entity is classified as a per se corporation under §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8), is classified by default as an association taxable as a corporation under §301.7701-3(b)(2)(i)(B), or is classified as an association taxable as a corporation in accordance with an election under §301.7701-3(c).

(iv) Examples. The following examples illustrate the rules of this paragraph (b)(3). For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During the 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, D, is a partnership. Because D is a partnership, D is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1) of this section and, therefore, cannot make the election under paragraph (a) of this section for its 2020 taxable year.

Example 2. During its 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, S, is an S corporation. S has ten shareholders. One of S's shareholders is a disregarded entity, and one is a qualified small business trust. S is an eligible partner under paragraph (b)(3)(i) of this section even though S's shareholders would not be considered eligible partners if those shareholders held direct interests in Partnership. See paragraph (b)(3)(i) of this section. Accordingly, Partnership meets the requirements under this paragraph (b)(3) for its 2020 taxable year.

Example 3. During its 2020 taxable year, Partnership has two equal partners, A, an individual, and C, a disregarded entity, wholly owned by B, an individual. C is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1) of this section and, therefore, is ineligible to make the election under paragraph (a) of this section for its 2020 taxable year.

(c) Election--(1) In general. An election under this section must be made on the eligible partnership's timely filed return, including extensions, for the taxable year to which the election applies and include all information required by the Internal Revenue Service (IRS) in forms, instructions, or other guidance. An election is not valid unless the partnership discloses to the IRS all of the information required under paragraph (c)(2) of this section and, in the case of a partner that is an S corporation, the shareholders of such S corporation. An election once made may not be revoked without the consent of the IRS.

(2) Disclosure of partner information to the IRS. A partnership making an election under this section must disclose to the IRS information about each person that was a partner at any time during the taxable year of the partnership to which the election applies, including each partner's name and correct U.S. taxpayer identification number (TIN) (or alternative form of identification required by forms, instructions, or other guidance), each partner's Federal tax classification, an affirmative statement that the partner is an eligible partner under paragraph (b)(3)(i) of this section, and any other information required by the IRS in forms, instructions, or other guidance. If a partner is



an S corporation, the partnership must also disclose to the IRS information about each shareholder of the S corporation that was a shareholder at any time during the taxable year of the S corporation ending with or within the partnership's taxable year, including each shareholder's name and correct TIN (or alternative form of identification as prescribed by forms, instructions, or other guidance), each shareholder's Federal tax classification, and any other information required by the IRS in forms, instructions, or other guidance.

(3) Partner notification. A partnership that makes an election under this section must notify each of its partners of the election within 30 days of making the election in the form and manner determined by the partnership.

(d) Election made by a partnership that is a partner—(1) In general. The fact that a partnership has made an election under this section does not affect whether the provisions of subchapter C of chapter 63 apply to any other partnership, including a partnership in which the partnership making the election is a partner. Accordingly, the provisions of subchapter C of chapter 63 that apply to partners in a partnership that has not made an election under this section apply, to the extent provided in the regulations under subchapter C of chapter 63, to partners (that are themselves partnerships that have made an election under this section) in their capacity as partners in the other partnership.

(2) Examples. The following examples illustrate the rules of paragraph (d)(1) of this section. For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During its 2020 taxable year, Partnership, a calendar year taxpayer, has two partners. One partner, A, is also a calendar year partnership. A files a valid

election under this section with its timely filed partnership return for its 2020 taxable year. Partnership does not file an election under this section. Notwithstanding A's valid election under this section, with respect to A's interest in Partnership, A is subject to the rules applicable to partners in a partnership subject to the rules under subchapter C of chapter 63, including the consistency requirements of section 6222 and the regulations thereunder.

Example 2. The facts are the same as Example 1 of this paragraph (d)(2). The IRS mails to Partnership a notice of final partnership adjustment under section 6231 with respect to Partnership's 2020 taxable year. Partnership timely elects the alternative to payment of imputed underpayment under section 6226 and the regulations thereunder. Partnership must provide A with a statement under section 6226 reflecting A's share of the adjustments for Partnership's 2020 taxable year. A is subject to the rules applicable to partners in a partnership subject to the rules under subchapter C of chapter 63 with respect to A's interest in Partnership.

(e) Effect of an election--(1) In general. An election made under this section is an action taken under subchapter C of chapter 63 by the partnership for purposes of section 6223. Accordingly, the partnership and all partners are bound by an election of the partnership under this section unless the IRS determines that the election is invalid. See §301.6223-2 for the binding nature of actions taken by a partnership under subchapter C of chapter 63.

(2) IRS determination that election is invalid. If the IRS determines that an election under this section for a partnership taxable year is invalid, the IRS will notify the partnership in writing and the provisions of subchapter C of chapter 63 will apply to that partnership taxable year.

(f) Applicability date. These regulations are applicable to partnership taxable years beginning after December 31, 2017.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

Approved: December 22, 2017.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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