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# Ins and Outs of IRS Audits of Partnerships and S Corporations

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# Topics

- **Handling Audits: Science and Art**
- **Types of Entities**
- **Statutes of Limitations**
- **Audit Process and Audit Issues**
- **Judicial Review**
- **Tips and Traps**
- **Hot Topics**

# TEFRA Overview

- As with any effort to simplify the Code, the TEFRA provisions created a complex process with new problems and traps for the unwary. The Tax Court calls these rules “distressingly complex and confusing.”

# Purpose of TEFRA

- Pre-TEFRA
  - Audits were only conducted at the partner level; if the IRS wanted to audit a partnership item, the IRS had to audit each partner individually.
  - Created duplication of effort and administrative difficulties.
  - Also led to inconsistencies in how partners were treated
- TEFRA was designed to address these problems by allowing an audit of partnership items to be conducted at the partnership level. The TEFRA provisions are incorporated in Sections 6221-6234 of the Code.

# TEFRA Defined Terms

- Partnership
- Partner
- Partnership Items
- Nonpartnership Items
- Affected Item
- Computational Adjustment
- Notice Partners

# TEFRA Defined Terms

## Partnership

- The TEFRA rules apply to audits of all partnerships, unless
  - The partnership has 10 or fewer partners; and
  - All the partners are individuals, C corporations, or an estate of a deceased partner.
  - TRAP: A disregarded entity is counted as a partner and causes the partnership to be a TEFRA partnership. Rev. Rul. 2004-88, 2004-2 C.B. 165.

### I.R.C. § 6231(a)(1)

- A small partnership (10 or fewer partners) can elect to be subject to TEFRA procedures by filing Form 8893.

# TEFRA Defined Terms

## Partner

- A “partner” is any actual partner in the partnership and “any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership.” I.R.C. § 6231(a)(2)
  - *Historic Boardwalk Hall LLC v. Comm’r*, 694 F.3d 425 (3d Cir. 2012) – historic rehabilitation tax credits; bona partner in enterprise?
  - *Castle Harbour* cases (D. Conn. and 2d Cir.)

# TEFRA Defined Terms

## Partner

- The definition of partner includes:
  - Pass-thru partners:
    - “A partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership with respect to which proceeding under this subchapter are conducted.” I.R.C. § 6231 (a)(9).
    - A disregarded entity is also a pass-thru partner. Rev. Rul. 2004-88, 2004-2 C.B. 165.
  - Indirect partners:
    - “a person holding an interest in a partnership through one or more pass-thru partners.” I.R.C. § 6231 (a)(9).
    - Thus, indirect partners include S corporation shareholders, partners, LLC members, trust beneficiaries, and subtrusts.

# TEFRA Defined Terms

## Partnership Items

- “Partnership items” are those item that are “required to be taken into account for the partnership’s taxable year under any provision of subtitle A to the extent regulations prescribed by the secretary provide that, for purposed of this subtitle, such item is more appropriatelly determined at the partnership level than at the partner level.” I.R.C. § 6231(a)(3).
- A TEFRA partnership audit can address only partnership items. Nonpartnership items are determined at the individual partner level.

# TEFRA Defined Terms

## Partnership Items

- Partnership items include all such items reported on IRS Form 1065 and Schedule K-1, such as:
  - A partner's distributive share of the partnership's income, gain, loss, deduction, or credit;
  - Partnership liabilities; and
  - Guaranteed payments.

Treas. Reg. § 301.6231(a)(3)-1(a)

**1065** U.S. Return of Partnership Income

Form Department of the Treasury Internal Revenue Service

For calendar year 2012, or tax year beginning 2012, ending 2012

OMB No. 1545-0099

Information about Form 1065 and its separate instructions is at www.irs.gov/form1065.

**2012**

A Principal business activity Name of partnership

B Principal product or service Print or type: Number, street, and room or suite no. If a P.O. box, see the instructions.

C Business code number City or town, state, and ZIP code

D Employer identification number

E Date business started

F Total assets (see the instructions)

G Check applicable boxes: (1)  Initial return (2)  Final return (3)  Name change (4)  Address change (5)  Amended return (6)  Technical termination - also check (1) or (2)

H Check accounting method: (1)  Cash (2)  Accrual (3)  Other (specify) \_\_\_\_\_

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year \_\_\_\_\_

J Check if Schedules C and M-3 are attached

Caution. Include only trade or business income and expenses on lines 1a through 22 below. See the instructions for more information.

Income	1a	Gross receipts or sales	1a	
	b	Returns and allowances	1b	
	c	Balance. Subtract line 1b from line 1a	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4	
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5	
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6	
Deductions	7	Other income (loss) (attach statement)	7	
	8	Total income (loss). Combine lines 3 through 7	8	
	9	Salaries and wages (other than to partners) (less employment credits)	9	
	10	Guaranteed payments to partners	10	
	11	Repairs and maintenance	11	
	12	Bad debts	12	
	13	Rent	13	
	14	Taxes and licenses	14	
	15	Interest	15	
	16a	Depreciation (if required, attach Form 4562)	16a	
	b	Less depreciation reported on Form 1125-A and elsewhere on return	16b	
	17	Depletion (Do not deduct oil and gas depletion.)	17	
	18	Retirement plans, etc.	18	
	19	Employee benefit programs	19	
	20	Other deductions (attach statement)	20	
21	Total deductions. Add the amounts shown in the far right column for lines 9 through 20.	21		
22	Ordinary business income (loss). Subtract line 21 from line 8	22		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than general partner or limited liability company member manager) is based on all information of which preparer has any knowledge.

Signature of general partner or limited liability company member manager \_\_\_\_\_ Date \_\_\_\_\_

May the IRS discuss this return with the preparer shown below (see instructions)?  Yes  No

Paid Preparer Use Only

Print/Type preparer's name \_\_\_\_\_ Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check  if self-employed PTIN \_\_\_\_\_

Firm's name \_\_\_\_\_ Firm's EIN \_\_\_\_\_

Firm's address \_\_\_\_\_ Phone no. \_\_\_\_\_

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11390Z Form 1065 (2012)

Schedule K-1 (Form 1065) 2012

Department of the Treasury Internal Revenue Service

For calendar year 2012, or tax year beginning 2012, ending 2012

Partner's Share of Income, Deductions, Credits, etc.

See back of form and separate instructions.

**Part I Information About the Partnership**

A Partnership's employer identification number \_\_\_\_\_

B Partnership's name, address, city, state, and ZIP code \_\_\_\_\_

C IRS Center where partnership filed return \_\_\_\_\_

D  Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**

E Partner's identifying number \_\_\_\_\_

F Partner's name, address, city, state, and ZIP code \_\_\_\_\_

G  General partner or LLC member-manager  Limited partner or other LLC member

H  Domestic partner  Foreign partner

I What type of entity is this partner? (see instructions)

J If this partner is a retirement plan (R/ASEP/Keogh/etc.), check here (see instructions)

J Partner's share of profit, loss, and capital (see instructions):

Beginning	Ending
Profit %	%
Loss %	%
Capital %	%

K Partner's share of liabilities at year end:

Nonrecourse \$ \_\_\_\_\_

Qualified nonrecourse financing \$ \_\_\_\_\_

Recourse \$ \_\_\_\_\_

L Partner's capital account analysis:

Beginning capital account \$ \_\_\_\_\_

Capital contributed during the year \$ \_\_\_\_\_

Current year increase (decrease) \$ \_\_\_\_\_

Withdrawals & distributions \$ \_\_\_\_\_

Ending capital account \$ \_\_\_\_\_

Tax basis  GAAP  Section 704(b) book

Other (explain) \_\_\_\_\_

M Did the partner contribute property with a built-in gain or loss?

Yes  No

If "Yes," attach statement (see instructions)

<input type="checkbox"/> Final K-1 <input type="checkbox"/> Amended K-1		<b>Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items</b>	
1	Ordinary business income (loss)	15	Credits
2	Net rental real estate income (loss)		
3	Other net rental income (loss)	16	Foreign transactions
4	Guaranteed payments		
5	Interest income		
6a	Ordinary dividends		
6b	Qualified dividends		
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)	17	Alternative minimum tax (AMT) items
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)	18	Tax-exempt income and nondeductible expenses
11	Other income (loss)		
			19 Distributions
12	Section 179 deduction		
13	Other deductions		
		20	Other information
14	Self-employment earnings (loss)		
*See attached statement for additional information.			
For IRS Use Only			

# TEFRA Defined Terms

## Partnership Items

- Partnership items also include:
  - The partnership's statute of limitations. *Slovacek v. United States*, 36 Fed. Cl. 250 (1996); *Weiner v. United States*, 389 F.3d 152 (5<sup>th</sup> Cir. 2004); *Kaplan v. United States*, 133 F.3d 469 (7<sup>th</sup> Cir. 1998); *Blak Investments v. Comm'r*, 133 T.C. 431 (2009) (period of assessment of tax attributable to partnership items remain open under section 6501(c)(10) with respect to listed transaction if the taxpayer has not made the requisite disclosure of participation).
  - The determination of who is a partner of the partnership. *Blonien v. Comm'r*, 118 T.C. No. 34 (2002); *Katz v. Comm'r* 335 F.2d 1121 (10<sup>th</sup> Cir. 2003)
    - Are the facts relevant to the analysis determinable at the partnership level or the partner level.
    - TP says partner level because TP does not want to give the IRS that line of attack

# TEFRA Defined Terms

## Nonpartnership Items

- A “nonpartnership item” is an item that is not a partnership item. I.R.C. § 6231(a)(4).
- Nonpartnership items are addressed at the partner level, often after the partnership-level proceeding ends.
- *Example:* A purchases a partnership interest in Partnership X for \$5,000. The Amount A paid for the partnership interest is a nonpartnership item and would not be audited at the partnership level.

# TEFRA Defined Terms

## Affected Items

- An “affected item” is any item to the extent such item is affected by a partnership item. I.R.C. § 6231(a)(5); Treas. Reg. § 301.6231(a)(5)-1(a).
- Affected items include items on a partner’s return that are computed in part based on partnership items.
- *Examples:*
  - Partner’s outside basis – the amount of a partner’s outside basis is affected by a partner’s distributive share of partnership items. Treas. Reg. § 301.6231(a)(5)-1(b).
  - Miscellaneous itemized deductions – the amount allowed is based on adjusted gross income, which is affected by a partner’s distributive share of partnership items. Treas. Reg. § 301.6231(a)(5)-1(a).

# TEFRA Defined Terms

## Computational Adjustment

- A “computational adjustment” is the change in tax liability that properly reflects the correct treatment of a partnership item. I.R.C. § 6231(a)(6).
- Computational adjustments are the bridge between the partnership-level proceeding and the partner’s tax liability. They are tax assessments or abatements.

# TEFRA Defined Terms

## Computational Adjustment

- There are two categories of computational adjustments:
  - Affected items that do not require partner level determinations. The adjustments are mechanical. When no partner level determinations are required, the computational adjustments directly assessed. Treas. Reg. § 301.6231(a)(6)-1(a)(2).
    - *Example:* Partnership A underreported its income by \$100. Corporation B has a 50% interest in Partnership A, and B's income increased by \$50. B is in the 35% tax bracket, and a computational adjustment is made that increases B's tax liability by \$17.50. This amount plus interest is assessed.
  - Affected items that do require partner-level determinations. These can be assessed against the partner only through normal deficiency procedures. Treas. Reg. § 301.6231(a)(6)-1(a)(3).
    - *Exception:* Penalties require partner-level determination but fall outside of the normal deficiency procedures and can be directly assessed.

# TEFRA Defined Terms

## Notice Partners

- Certain rights are provided to “notice partners.” I.R.C. § 6231(a)(8).
  - A notice partner includes:
    - Any direct partner in a partnership with 100 or fewer partners.
    - A direct partner in a partnership with more than 100 partners who holds at least 1% interest in the partnership.
    - Direct partners who hold a 5% aggregate interest and form a “notice group.”
    - Indirect partners who are treated as direct partners under the regulations (by their request or the Service’s exercise of discretion).
    - *Tip:* Most partners will be – or can be, in the case of indirect partners – notice partners.
- I.R.C. § 6223(a),(b),(c); Treas. Reg. § 301.6223(b)-1(a).
- The TMP is required to forward notice to any direct partner who is not a notice partner (*i.e.*, a direct partner who has less than 1-percent interest in a partnership with more than 100 direct partners).
  - If an indirect partner is not entitled to notice from the IRS, the pass-thru partner is required to forward any notice to the indirect partners. I.R.C. § 6223(h).

# The Tax Matters Partner (TMP)

## Overview

- Who can be in the TMP and for how long?
- What is the role of the TMP?
- How long does the TMP's authority survive?

# TMP

## Who Can be the TMP?

- The TMP must be a partner with the authority to bind the partnership.
  - General partnership: any partner
  - Limited partnership: a general partner
  - LLC: a member-manager or, if none, any member
  - *Trap*: Limited partners, non-managing members, and non-partners may not be the TMP. But a disregarded entity can be the TMP, if it has the authority to bind the partnership under state law.

I.R.C. §6231(a)(7); Treas. Reg. §301.6231(a)(7)-1, -2; Rev. Rul. 2004-88, 2004-2 C.B. 165.

# TMP

## Sample TMP Provision - Delegation

- Example 8 from Addendum (Delegation of TMP Role to ineligible TMP):
  - The General Partner delegates to [ineligible TMP] in its capacity as Tax Agent, to the extent permitted under the Code and applicable Treasury regulations, its authority as Tax Matters Partner of the Partnership, and [ineligible TMP] accepts this delegation.
  - To the extent that the Internal Revenue Service does not recognize the general partner's delegation of its authority as tax matters partner to the Tax Agent pursuant to this Agreement or otherwise refuses to treat the Tax Agent as the Tax Matters Partner, the General Partner will execute and discharge its duties and obligations as Tax Matters Partner in accordance with the advice, and at the direction, of the Tax Agent.

# TMP

## What is the Role of the TMP?

- The TMP is the IRS's single point liaison during audits and the single representative for litigation.
  - The TMP plays a notice role and keeps other partners informed of the audit proceedings. I.R.C. § 6223(g).
  - The TMP may file suit on behalf of the partners. I.R.C. § 6226(a).
  - The TMP may file a partnership-level refund claim on behalf of the partnership. I.R.C. § 6227(c).
  - The TMP may extend the statute of limitations on behalf of the partnership. I.R.C. § 6229(b)(1)(B).
- *Tip and Trap:* The TMP's role is limited unless expanded contractually by the partnership or LLC agreement.

# TMP

## Contractual Role

- Drafting Considerations:
  - Should restrictions be imposed on the TMP's statutory duties?
  - Should the TMP's authority be expanded and, if so, to what extent and with what restrictions?
  - Are the TMP's interests aligned with the other partners or does the GP have a 0% economic interest (e.g. 0% GP).

# TMP

## Sample Provisions

- Example 1 from Addendum (Limited to statutory and regulatory authority and restrictions imposed):
  - The tax matters partner shall promptly notify the Members if any tax return or report of the company is audited or is any adjustments are proposed by any government body. In addition, the tax matters partner shall promptly furnish to the members all notices concerning administrative or judicial proceedings relating to federal income tax matters as required under the Internal Revenue Code. During the pendency of any such administrative or judicial Proceeding, the tax matters partner shall furnish to the members periodic reports, not less often than monthly, concerning the status of any such Proceeding.
  - Without the consent of a majority of the Board of Managers, the tax matters partner shall not extend the statute of limitations, file a request for administrative adjustment, file suit concerning any tax refund or deficiency relating to any Company administrative adjustment, or enter into any settlement agreement relating to any Company item of income, gain, loss, deduction or credit for any fiscal year of the Company.

# TMP

## Sample Provisions

- Example 3 from Addendum (Very broad authority):
  - The Tax Matters Member is authorized to take such actions, including making tax elections, and to execute and file all tax returns, statements and forms on behalf of the Company that might be permitted or required by the applicable provisions of the Internal Revenue Code or Treasury Regulations issued thereunder.
  - The Tax Matters Member shall have full and exclusive power and authority on behalf of the Company to represent the Company (at the Company's expense) in connection with all examinations of the Company's affairs by tax authorities, including resulting administrative and judicial proceedings, and to expend Company funds for professional services and costs associated therewith. Such power and authority shall include, without limitation, the power and authority to extend the statute of limitations and file a request for administrative adjustment.

# TMP

## Sample Provisions

- Example 4 from Addendum (Broad with consultation requirement):
  - The General Partner has the right at its discretion to make all elections for the partnership provided for in the Code, including, but not limited to, the election provided for in Code Section 754, provided that, upon the written request of any Limited Partner to make the election in Code Section 754, the General Partner will not unreasonably refuse to make such election.
  - The General Partner is hereby designated as the “Tax Matters Partner” pursuant to the requirements of Code Section 6231(a)(7) and in such capacity shall represent the partnership in any disputes, controversies, or proceedings with the United States Internal Revenue Service or any other taxing authority. The General Partner agrees, subject to confidentiality or regulatory compliance considerations, to consult with the ABC Limited Partner in good faith with respect to such disputes, controversies or proceedings.

# TMP

## Sample Provisions

- Example 5 from Addendum (Broad with restrictions on tax controversies):
  - The Tax Matters Partner is authorized to take such actions, including making tax elections, and to execute and file all tax returns, statements and forms on behalf of the Partnership which may be permitted or required by the applicable provisions of the Internal Revenue Code or Treasury Regulations issued thereunder.
  - Without first obtaining approval of the Majority Interest of the Partners, the Tax Matters Partner shall not, with respect to Partnership tax matters, (i) enter into a settlement agreement with respect to any tax matter which purports to bind Partners, (ii) intervene in any action pursuant to the Internal Revenue Code Section 6226(b)(5), (iii) enter into an agreement extending the statute of limitations, or (iv) file a petition pursuant to Internal Revenue Code 6226(a) or 6228. If an audit of any of the Partnership's tax returns shall occur, the Tax Matters Partner shall not settle or otherwise compromise assertions of the auditing agent which may be adverse to any Partner as compared to the position taken on the Partnership's tax returns without the prior written consent of each affected Partner.

# TMP

## Sample Provisions

- Example 6 from Addendum (Significant restrictions imposed on the TMP):
  - The Tax Matters Member shall take no action without the authorization of a Supermajority Interest, other than such action as may be required by Law.
  - The Tax Matters Member shall not enter into any extension of the period of limitations for making assessments on behalf of the Members without first obtaining the consent of a Supermajority Interest. The Tax Matters Member shall not bind any Member to a settlement agreement without obtaining the consent of such member.

# TMP

## How Long does its Authority Survive?

- A TMP's designation as TMP for a specific taxable year remains in effect until:
  - He dies, is incapacitated, resigns, or liquidates;
  - The partnership items of the TMP become nonpartnership items (special enforcement conversion of partnership items, such as bankruptcy or criminal proceedings; but not a regular conversion event, such as a settlement under section 6231(b)(1)(C)); or
  - A designation of a successor TMP or revocation of the TMP's designation is made pursuant to applicable regulations.

Treas. Reg. § 301.6231(a)(7)-1(I). Thus, a TMP's designation for a specific taxable year typically survives the disposition of the TMP's partnership interest.

- However, the designation of the TMP for one year does not automatically carryover to the next year. A TMP designation is made on a year by year basis and is made through the designation on the partnership's tax return. Treas. Reg. § 301.6231(a)(7)-1(a), (c).

# S Corporations

- **Requirements**
  - Entity must be a domestic corporation
  - Entity must have only allowable shareholders (U.S. citizen or permanent resident, certain trusts, and estates). Shareholder cannot be a partnership, corporation, or non-resident alien individual.
  - 100 or fewer shareholders
  - One class of stock
  - Not be an ineligible corporation (certain financial institutions, insurance companies, domestic international sales corporations)
- **Election – Form 8832**
  - IRS agents ask for this form

Form **8832**(Rev. January 2012)  
Department of the Treasury  
Internal Revenue Service**Entity Classification Election**

OMB No. 1545-1016

<b>Type or Print</b>	Name of eligible entity making election	Employer identification number
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code.	
▶ Check if: <input type="checkbox"/> Address change <input type="checkbox"/> Late classification relief sought under Revenue Procedure 2009-41 <input type="checkbox"/> Relief for a late change of entity classification election sought under Revenue Procedure 2010-32		
<b>Part I Election Information</b>		

**1 Type of election** (see instructions):

- a  Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.  
b  Change in current classification. Go to line 2a.

**2a** Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

- Yes. Go to line 2b.  
 No. Skip line 2b and go to line 3.

**2b** Was the eligible entity's prior election an initial classification election by a newly formed entity that was effective on the date of formation?

- Yes. Go to line 3.  
 No. Stop here. You generally are not currently eligible to make the election (see instructions).

**3** Does the eligible entity have more than one owner?

- Yes. You can elect to be classified as a partnership or an association taxable as a corporation. Skip line 4 and go to line 5.  
 No. You can elect to be classified as an association taxable as a corporation or to be disregarded as a separate entity. Go to line 4.

**4** If the eligible entity has only one owner, provide the following information:

- a Name of owner ▶ \_\_\_\_\_  
b Identifying number of owner ▶ \_\_\_\_\_

**5** If the eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and employer identification number of the parent corporation:

- a Name of parent corporation ▶ \_\_\_\_\_  
b Employer identification number ▶ \_\_\_\_\_

# Form 1120S

**Form 1120S** U.S. Income Tax Return for an S Corporation  
 OMB No. 1545-0130  
 Department of the Treasury Internal Revenue Service  
 Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.  
 Information about Form 1120S and its separate instructions is at [www.irs.gov/form1120s](http://www.irs.gov/form1120s).  
 2012  
 For calendar year 2012 or tax year beginning 2012, ending 2012

**A** S election effective date: Name, Employer identification number, TYPE OR PRINT, Number, street, and room or suite no., Date incorporated, City or town, state, and ZIP code, F Total assets (see instructions)

**G** Is the corporation electing to be an S corporation beginning with this tax year?  Yes  No  
**H** Check if: (1) Final return (2) Name change (3) Address change (4) Amended return (5) S election termination or revocation  
**I** Enter the number of shareholders who were shareholders during any part of the tax year

**Caution.** Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.

Income	1a	Gross receipts or sales	1a	
	b	Returns and allowances	1b	
	c	Balance. Subtract line 1b from line 1a	1c	
	2	Cost of goods sold (attach Form 1125-A)	2	
	3	Gross profit. Subtract line 2 from line 1c	3	
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)	4	
Deductions (see instructions for limitations)	5	Other income (loss) (see instructions—attach statement)	5	
	6	<b>Total income (loss).</b> Add lines 3 through 5	6	
	7	Compensation of officers	7	
	8	Salaries and wages (less employment credits)	8	
	9	Repairs and maintenance	9	
	10	Bad debts	10	
	11	Rents	11	
	12	Taxes and licenses	12	
	13	Interest	13	
	14	Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	14	
	15	Depletion (Do not deduct oil and gas depletion.)	15	
	16	Advertising	16	
	17	Pension, profit-sharing, etc., plans	17	
	18	Employer benefit programs	18	
Tax and Payments	19	Other deductions (attach statement)	19	
	20	<b>Total deductions.</b> Add lines 7 through 19	20	
	21	<b>Ordinary business income (loss).</b> Subtract line 20 from line 6	21	
	22a	Excess net passive income or LIFO recapture tax (see instructions)	22a	
	b	Tax from Schedule D (Form 1120S)	22b	
	c	Add lines 22a and 22b (see instructions for additional taxes)	22c	
	23a	2012 estimated tax payments and 2011 overpayment credited to 2012	23a	
	b	Tax deposited with Form 7004	23b	
	c	Credit for federal tax paid on fuels (attach Form 4136)	23c	
	d	Add lines 23a through 23c	23d	
24	Estimated tax penalty (see instructions). Check if Form 2220 is attached <input type="checkbox"/>	24		
25	<b>Amount owed.</b> If line 23d is smaller than the total of lines 22c and 24, enter amount owed	25		
26	<b>Overpayment.</b> If line 23d is larger than the total of lines 22c and 24, enter amount overpaid	26		
27	Enter amount from line 26 <b>Credited to 2013 estimated tax</b> <b>Refunded</b>	27		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

May the IRS discuss this return with the preparer shown below (see instructions)?  Yes  No

**Sign Here**  
 Signature of officer, Date, Title, Preparer's name, Preparer's signature, Date, Check  if self-employed, Firm's name, Firm's EIN, Phone no.

Schedule K-1 (Form 1065) 2012  
 OMB No. 1545-0099  
 Department of the Treasury Internal Revenue Service  
 For calendar year 2012, or tax year beginning 2012, ending 2012

**Partner's Share of Income, Deductions, Credits, etc.**  
 See back of form and separate instructions.

**Part I Information About the Partnership**  
 A Partnership's employer identification number  
 B Partnership's name, address, city, state, and ZIP code  
 C IRS Center where partnership filed return  
 D Check if this is a publicly traded partnership (PTP)

**Part II Information About the Partner**  
 E Partner's identifying number  
 F Partner's name, address, city, state, and ZIP code  
 G General partner or LLC member-manager / Limited partner or other LLC member  
 H Domestic partner / Foreign partner  
 I What type of entity is this partner? (see instructions)  
 J Partner's share of profit, loss, and capital (see instructions):  
 Beginning Ending  
 Profit % %  
 Loss % %  
 Capital % %  
 K Partner's share of liabilities at year end:  
 Nonrecourse \$  
 Qualified nonrecourse financing \$  
 Recourse \$

**Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items**

1 Ordinary business income (loss)	15 Credits
2 Net rental real estate income (loss)	
3 Other net rental income (loss)	16 Foreign transactions
4 Guaranteed payments	
5 Interest income	
6a Ordinary dividends	
6b Qualified dividends	
7 Royalties	
8 Net short-term capital gain (loss)	
9a Net long-term capital gain (loss)	17 Alternative minimum tax (AMT) items
9b Collectibles (20% gain) (loss)	
9c Unrecaptured section 1250 gain	
10 Net section 1201 gain (loss)	18 Tax-exempt income and nondeductible expenses
11 Other income (loss)	
12 Section 179 deduction	19 Distributions
13 Other deductions	
14 Self-employment earnings (loss)	20 Other information

\*See attached statement for additional information.

**L** Partner's capital account analysis:  
 Beginning capital account \$  
 Capital contributed during the year \$  
 Current year increase (decrease) \$  
 Withdrawals & distributions \$  
 Ending capital account \$

Tax basis  GAAP  Section 704(b) book  
 Other (explain)

**M** Did the partner contribute property with a built-in gain or loss?  
 Yes  No  
 If "Yes," attach statement (see instructions)

For IRS Use Only

# Limited Liability Companies

- **Multi-Member LLC**
  - **Who is the TMP**
- **Single Member LLC**
  - **Flow through entity**

# Statutes of Limitation Overview

- Partner-Level
- Partnership-Level

# Statutes of Limitation

## Partner-Level

- Tax at the partner-level shall be assessed “within 3 years after the return was filed.” I.R.C. § 6501(a).
- The statute of limitations can be extended by agreement. I.R.C. § 6501(c)(4).
- IRS Form 872p extends the period of limitations for assessing tax attributable to partnership items. I.R.C. § 6501(b)(3).

# Statutes of Limitation

## Partner-Level – 6 Year Rule

- The partner-level limitations period becomes six years when there is a substantial omission of gross income. I.R.C. § 6501(e).
  - Does an overstatement of basis result in an omission of income?
  - This was a common issue in recent tax shelter cases and resolved recently by the U.S. Supreme Court favorably to taxpayers in *Home Concrete & Supply LLC v. United States*, 109 A.F.T.R.2d 2012-661 (2012). The Supreme Court held that an overstatement of basis was not a substantial omission from gross income.
  - This result was changed by Treasury regulations that were finalized in 2010. The regulation provide that an overstatement of basis is an omission of gross income. Treas. Reg. §§ 301.6501(e)-1, 301.6229(c)(2)-1.

# Statutes of Limitation Partnership-Level

- “Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of (1) the date on which the partnership return for the taxable year was filed or (2) the last day for filing such return for such year (determined without regard to extensions).” I.R.C. § 6229(a).
  - It is now settled that this provision may not shorten – but may extend – the partner-level period of limitations. See, e.g., *Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm’r*, 114 T.C. 533 (2000); *Curr-Spec Partners, L.P. v. Comm’r* 579 F.3d 391 (5<sup>th</sup> Cir. 2009); *AD Global Fund, LLC v. United States*, 481 F.3d 1351 (Fed. Cir. 2007).
  - *Tip*: An assessment of tax attributable to a partnership item is timely as long as either the partner-level or partnership-level period of limitations remain open.

# Statutes of Limitation

## Partnership-Level

- The partnership-level statute of limitations can also be extended by agreement.
  - By the TMP for all partners.
  - By any partner for that partner.

I.R.C. § 6229(b)(1)

# Partnership Refund Claims - AARs

- An Administrative Adjustment Request (AAR) is the equivalent of a refund claim for partnerships but is subject to different procedural requirements.

See I.R.M. 4.31.4 (describing AAR procedures).

# AARs Overview

- Statutes of Limitations
- Who can file?
- Judicial Review

# AARs

## Statutes of Limitation

- General Rule for Refund Claims:
  - A claim for refund must be filed within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever is later. I.R.C § 6511(a). This period may be extended by agreement. I.R.C. § 6511 (c)(1).
- Special Rules for AARs:
  - Regular refund procedures are inapplicable.
  - A partner must file an AAR within 3 years after the partnership return is filed. I.R.C. § 6227(a)(1).
  - If the limitations period for the assessment of the partnership items is extended by agreement, the limitations for filing an AAR is also extended for the same period plus 6 months. I.R.C. § 6227(b).
  - A partner may extend the limitations period for the assessment of the partnership items and thereby extend the limitations period for the filing of the AAR. I.R.C. §§ 6227(b), 6229(b)(1).
  - *Trap:* The time when the tax is paid has no impact on when an AAR may be filed.

# AARs

## Statutes of Limitation

- *Trap*: The time for filing an AAR is governed by when the partnership return is filed, not when the partner's return is filed.
  - *McFerrin v. United States*, 492 F. Supp. 2d 695 (S.D. Tex. 2007) (an AAR was untimely when it was filed more than three years after the partnership's return was filed but less than three years after the partner's return was filed).
  - *Example*:
    - 4/15/11: Partnership's 2010 return filed.
    - 10/15/11: Partner's 2010 return is filed.
    - 9/30/14: The partner files an AAR within three years of when his return was filed but more than three years from when the partnership's return was filed. The AAR is untimely filed.

# AARs

## Who Can File?

- TMP can file an AAR on behalf of the partnership. I.R.C. § 6227(c).

# AARs

## Who Can File?

- If Form 1065X is filed, the partners do not need to file anything else, even in the case of multi-tiered entities.
- The TMP can request “substitute return” treatment. I.R.C. § 6227(c)(1).
  - That allows the IRS to treat any changes as corrections of mathematical or clerical errors and to make assessments without partnership-level proceeding. I.R.C. § 6230(b)(1).
  - If not treated as a substitute return, the IRS can conduct a partnership-level audit, allow credits or refund from the AAR to all partners, or simply do nothing. I.R.C. § 6227(c)(2).

# AARs – Form 1065X

**Form 1065X**  
(January 2012)  
Department of the Treasury  
Internal Revenue Service

**Amended Return or Administrative Adjustment Request (AAR)**  
(For use by filers of Forms 1065, 1065-B, and 1066)  
▶ See separate instructions.

OMB No. 1545-0099  
For tax year ending  
▶  
(Enter month and year.)

---

**Please Type or Print**

Name

Number, street, and room or suite no. (if a P.O. box, see instructions.)

City or town, state, and ZIP code

Employer identification number

Telephone number (optional)

Enter name and address used on original return (if same as above, write "Same")

---

Internal Revenue Service Center where original return was filed ▶

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### TEFRA/NonTEFRA Determination

**A** Has the partnership made an election to be treated as an electing large partnership (ELP) under the provisions of section 775?  Yes  No  
If "Yes," the partnership is not subject to TEFRA. Enter the date of the election ▶ \_\_\_\_\_, go to item E, and check the "Not subject to TEFRA" box. Do not complete items B through D.

You must determine if the partnership is subject to the rules for consolidated audit proceedings (TEFRA proceedings) under sections 6221 through 6234. See instructions for details.

**B** Did the partnership have 10 or fewer partners at all times during the tax year? (Note. A husband and wife are considered one partner for TEFRA purposes.)  Yes  No

**C** At all times during the partnership's tax year, were all partners U.S. citizens, resident aliens, C corporations, or estates of deceased partners?  Yes  No

If the answers to questions B and C are "Yes," the partnership is not subject to TEFRA proceedings. A partnership that is not subject to TEFRA cannot file an Administrative Adjustment Request. See instructions for details.

**D** If the partnership is not otherwise subject to TEFRA, has the partnership filed Form 8893, Election of Partnership Level Tax Treatment, or its equivalent, to make an election to be treated as a TEFRA partnership?  Yes  No

If the answer to question D is "Yes," enter the tax year that the election to be treated as a TEFRA partnership was originally filed with the partnership return ▶ \_\_\_\_\_

**E** The partnership is  Subject to TEFRA  Not subject to TEFRA

**F** Check the applicable box (see instructions):  Amended Return  Administrative Adjustment Request (AAR)

**G** If you are a Tax Matters Partner (TMP) or a Partner With Authority (PWA) filing an AAR on behalf of the pass-through entity, are you requesting substituted return treatment? (see instructions)  Yes  No

**H** Check the applicable box to identify the type of pass-through entity:  Partnership  Electing Large Partnership (ELP)  
 Real Estate Mortgage Investment Conduit (REMIC)

**I** Partnerships and ELPs, enter the number of Schedules K-1 being filed with this return . . . . . ▶ \_\_\_\_\_

---

**Fill in applicable items and use Part III to explain any changes**

<b>Part III</b> Amended or Administrative Adjustment Request (AAR) Items for Partnerships Filing Form 1065 Only (ELPs and REMICs, use Part II)		(a) As originally reported on Schedule K or its previously adjusted	(b) Net change — increase or (decrease) — explain in Part III	(c) Correct amount
<b>Income (Loss)</b>	<b>1</b> Ordinary business income (loss) . . . . .	<b>1</b>		
	<b>2</b> Net rental real estate income (loss) . . . . .	<b>2</b>		
	<b>3</b> Other net rental income (loss) (see instructions) . . . . .	<b>3</b>		
	<b>4</b> Guaranteed payments . . . . .	<b>4</b>		
	<b>5</b> Interest income . . . . .	<b>5</b>		
	<b>6a</b> Ordinary dividends . . . . .	<b>6a</b>		
	<b>b</b> Qualified dividends . . . . .	<b>6b</b>		
	<b>7</b> Royalties . . . . .	<b>7</b>		
	<b>8</b> Net short-term capital gain (loss) . . . . .	<b>8</b>		
	<b>9a</b> Net long-term capital gain (loss) . . . . .	<b>9a</b>		
	<b>b</b> Collectibles (28%) gain (loss) . . . . .	<b>9b</b>		
<b>c</b> Unrecaptured section 1250 gain (see instructions) . . . . .	<b>9c</b>			
<b>10</b> Net section 1231 gain (loss) . . . . .	<b>10</b>			
<b>11</b> Other income (loss) (see instructions) . . . . .	<b>11</b>			

For Paperwork Reduction Act Notice, see instructions. Cat. No. 54882S **Form 1065X** (1-2012)

# AARs

## Who Can File?

- Any partner can file an AAR (its own amended return, e.g., 1120X, with Form 8082 attached) on its own behalf. I.R.C. § 6227(d).
- The partner can file an AAR even if the TMP has already filed an AAR for the same tax year. FSA 587 (Feb. 2, 1993); CCA 200908031 (Nov. 5, 2008).
- The partner may not request substitute return treatment. I.R.C. § 6227(c).
- *Tip:* A partner should seriously consider filing its own AAR to protect its right to seek judicial review.



# S Corporation Refund Claims

- **What do you file administratively?**
  - Form 1120x?
  - Form 843?
  - All of the above?

Form <b>1120X</b> (Rev. January 2011) Department of the Treasury Internal Revenue Service	<b>Amended U.S. Corporation Income Tax Return</b>	OMB No. 1545-0132 For tax year ending _____ (Enter month and year.)
Please Type or Print	Name	Employer identification number
	Number, street, and room or suite no. (If a P.O. box, see instructions.)	
	City or town, state, and ZIP code	Telephone number (optional)

Enter name and address used on original return (if same as above, write "Same.")

Internal Revenue Service Center  
where original return was filed**Fill in applicable items and use Part II on the back to explain any changes**

<b>Part I</b>	Income and Deductions (see instructions)	(a) As originally reported or as previously adjusted	(b) Net change — include or disclose — explain in Part II	(c) Correct amount
1	Total income . . . . .	1		
2	Total deductions . . . . .	2		
3	Taxable income. Subtract line 2 from line 1 . . . . .	3		
4	Total tax . . . . .	4		

**Payments and Credits (see instructions)**

5a	Overpayment in prior year allowed as a credit . . . . .	5a		
b	Estimated tax payments . . . . .	5b		
c	Refund applied for on Form 4466 . . . . .	5c		
d	Subtract line 5c from the sum of lines 5a and 5b . . . . .	5d		
e	Tax deposited with Form 7004 . . . . .	5e		
f	Credit from Form 2439 . . . . .	5f		
g	Credit for federal tax on fuels and other refundable credits . . . . .	5g		
6	Tax deposited or paid with (or after) the filing of the original return . . . . .	6		
7	Add lines 5d through 6, column (c) . . . . .	7		
8	Overpayment, if any, as shown on original return or as later adjusted . . . . .	8		
9	Subtract line 8 from line 7 . . . . .	9		

**Tax Due or Overpayment (see instructions)**

10	Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury" . . . . .	10	
11	Overpayment. Subtract line 4, column (c), from line 9 . . . . .	11	
12	Enter the amount of line 11 you want: <b>Credited to 20</b> Estimated tax <b>Refunded</b> <b>12</b>	12	

**Sign Here**

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

<b>Paid Preparer Use Only</b>	Print/type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name	Firm's EIN	Phone no.		
	Firm's address				

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11530Z

Form **1120X** (Rev. 1-2011)

Form <b>843</b> (Rev. August 2011) Department of the Treasury Internal Revenue Service	<b>Claim for Refund and Request for Abatement</b>	OMB No. 1545-0024
▶ See separate instructions.		

Use Form 843 if your claim or request involves:

- (a) a refund of one of the taxes (other than income taxes or an employer's claim for FICA tax, RRTA tax, or income tax withholding) or a fee, shown on line 3,
- (b) an abatement of FUTA tax or certain excise taxes, or
- (c) a refund or abatement of interest, penalties, or additions to tax for one of the reasons shown on line 5a.

Do not use Form 843 if your claim or request involves:

- (a) an overpayment of income taxes or an employer's claim for FICA tax, RRTA tax, or income tax withholding (use the appropriate amended tax return),
- (b) a refund of excise taxes based on the nontaxable use or sale of fuels, or
- (c) an overpayment of excise taxes reported on Form(s) 11-C, 720, 730, or 2290.

Name(s)	Your social security number
Address (number, street, and room or suite no.)	Spouse's social security number
City or town, state, and ZIP code	Employer identification number (EIN)
Name and address shown on return if different from above	Daytime telephone number

1	Period. Prepare a separate Form 843 for each tax period or fee year. From _____ to _____	2	Amount to be refunded or abated: \$ _____
3	Type of tax or fee. Indicate the type of tax or fee to be refunded or abated or to which the interest, penalty, or addition to tax is related. <input type="checkbox"/> Employment <input type="checkbox"/> Estate <input type="checkbox"/> Gift <input type="checkbox"/> Excise <input type="checkbox"/> Income <input type="checkbox"/> Fee		
4	Type of penalty. If the claim or request involves a penalty, enter the Internal Revenue Code section on which the penalty is based (see instructions). IRC section: _____		
5a	Interest, penalties, and additions to tax. Check the box that indicates your reason for the request for refund or abatement. (If none apply, go to line 6.) <input type="checkbox"/> Interest was assessed as a result of IRS errors or delays. <input type="checkbox"/> A penalty or addition to tax was the result of erroneous written advice from the IRS. <input type="checkbox"/> Reasonable cause or other reason allowed under the law (other than erroneous written advice) can be shown for not assessing a penalty or addition to tax.		
b	Date(s) of payment(s) ▶ _____		
6	Original return. Indicate the type of fee or return, if any, filed to which the tax, interest, penalty, or addition to tax relates. <input type="checkbox"/> 706 <input type="checkbox"/> 709 <input type="checkbox"/> 940 <input type="checkbox"/> 941 <input type="checkbox"/> 943 <input type="checkbox"/> 945 <input type="checkbox"/> 990-PF <input type="checkbox"/> 1040 <input type="checkbox"/> 1120 <input type="checkbox"/> 4720 <input type="checkbox"/> Other (specify) ▶ _____		
7	Explanation. Explain why you believe this claim or request should be allowed and show the computation of the amount shown on line 2. If you need more space, attach additional sheets.		

Signature. If you are filing Form 843 to request a refund or abatement relating to a joint return, both you and your spouse must sign the claim. Claims filed by corporations must be signed by a corporate officer authorized to sign, and the officer's title must be shown.

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature (title, if applicable. Claims by corporations must be signed by an officer.)	Date				
Signature (spouse, if joint return)	Date				
<b>Paid Preparer Use Only</b>	Print/type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name	Firm's EIN	Phone no.		
	Firm's address				

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 10100R

Form **843** (Rev. 8-2011)

# AARs

## Judicial Review

- If the IRS does not allow in full an AAR filed by the TMP, the TMP can file a petition for judicial review. I.R.C. § 6228(a)(1).
  - Suit can be filed in the Tax Court, a district court, or the Court of Federal Claims.
  - The petition must be filed at least six months, but no later than two years, after filing the AAR. I.R.C. § 6228(a)(2)(A).
  - *Trap*: The two year period for filing suit based on when the AAR was filed, not when it is disallowed.

# AARs

## Judicial Review

- The other partners are allowed to participate in the suit filed by the TMP, as long as they have an interest in the outcome. I.R.C. § 6228(a)(4).
- *Trap*: If only the TMP files an AAR and TMP does not file suit, not other partner may file suit. The partner must have filed its own AAR to seek judicial review. I.R.C § 6228(a)(1).

# AARs

## Judicial Review

- If a partner files an AAR on its own behalf and the TMP does not file an AAR or a suit, the partner can file a regular refund suit. I.R.C. § 6228(b)(2)(A).
  - The partner's suit is a regular refund suit, rather than a petition under the TEFRA procedures. I.R.C. § 6228(b)(2)(A)(ii).
  - The period for filing suit is at least six months, and not later than two years, after the AAR was filed. I.R.C. § 6228(b)(2)(B)(i).

# Audit Process Overview

- SB/SE:
  - Audits partnership with \$10 million or less in assets.
  - Conducted about 5,150 partnership audits in 2011.
  - Plans to increase partnership audits in 2014.
- LB&I:
  - Audit partnership with more than \$10 million in assets.
  - In 2011, almost 200,000 passthrough entities had more than \$10 million in assets.
  - LB&I audited about 150 partnership audits in 2011, which was an increase of 20% over 2010.
- Most likely audit areas:
  - Adjustments to partnerships in real estate and construction industries with two partners and a reported loss;
  - Loss limitations; and
  - Distributions of partnership assets.

# Audit Process Overview

- Notice Requirements
- Partners' Right to Participate
- Summary Report and Closing Conference
- Appeals
- Administrative Settlements

# Audit Process

## Notice Requirements

- The IRS must give notice to all partners of the beginning and end of a partnership audit – sort of.
  - Notice of the Beginning of the Audit at the Partnership Level (NBAP) – at 120 days before the FPAA is mailed to the TMP.
  - Notice of the Final Administrative Adjustment (FPAA) resulting from the partnership audit – within 60 days of when the FPAA was mailed to the TMP.

I.R.C. § 6223(a).

# Audit Process - NBAP



-2-

Refer To: [REDACTED]  
 Date: 07-02-2012  
 Taxpayer ID number: [REDACTED]  
 Name of Partnership: [REDACTED]  
 Partnership ID number: [REDACTED]  
 Tax Year Ended: DECEMBER 2010  
 Contact Person: [REDACTED]  
 Employee ID Number: [REDACTED]  
 Contact Hours: [REDACTED]  
 Telephone Number (not toll-free): [REDACTED]

## Notice of beginning of administrative proceeding

We're starting our audit of your partnership's federal tax return.

By law, we're required to notify you that we're beginning our audit of your partnership's federal tax return. As a partner, you may already be aware of this audit, which we'll conduct with your partnership's Tax Matters Partner.

### What you need to do:

During the audit, most of our communication will be directly with your partnership's Tax Matters Partner. It's your responsibility to regularly communicate with your Tax Matters Partner to stay informed about the audit's progress. Our records show that the most recent address for the partnership where you can contact your Tax Matters Partner is:

[REDACTED]

Keep in mind that the results of the audit will apply to all partners, even if you choose to stay uninformed, or your Tax Matters Partner doesn't keep you updated. Please contact your Tax Matters Partner if you'd like to participate in this audit.

### If you're the Tax Matters Partner:

As a Tax Matters Partner, you're required to keep all partners informed of any IRS proceedings and related court cases. Additionally, you must provide us with the name, address, profits interest, and Taxpayer Identification number for each person who was a partner during the tax year that we're auditing. If you haven't already provided this information, or if it needs to be updated, please send it to the IRS address shown on this letter. The responsibilities of the Tax Matters Partner are set forth in Treasury Regulation (26 C.F.R.) Section 301.6223(g)-1.

### If you're a pass-thru partner:

All pass-thru partners, including estates, trusts, S corporations, partnerships, or nominees of another person, are required to send a copy of this notice to anyone who holds an interest in your entity. You must send a copy within 30 days of receiving this notice. For more information on the responsibilities of pass-thru partners, see Treasury Regulation (26 C.F.R.) Section 301.6223(h)-1.

### What to expect:

Because you're a partner, your own return may be affected if we make any adjustments to the partnership's return as a result of the audit. Your share of interest in the partnership will determine how much your return may be affected by any adjustments. We'll notify you if we make any partnership-related adjustments.

### Additional Information:

- Visit [www.irs.gov](http://www.irs.gov) and search for "tax matters partner." You can also find the following online:
  - Publication 1, Your Rights as a Taxpayer
  - Publication 541, Partnerships
- Keep this notice for your records.

If you have any questions, you may write or call the IRS contact person whose name, address and telephone number are listed at the top of this letter. If you write, please enclose a copy of this letter, and include your telephone number with the most convenient time for us to call you. If our number is outside of your local calling area, there may be a long distance charge.

Sincerely,

Enclosure:  
Copy of this Letter

# Audit Process - FPAAs

Internal Revenue Service  
15 New Sudbury Street, Stop 41100, Boston, MA 02203

## Department of the Treasury

Refer To:  
SE:SE:TS:NAA:1:JH  
Taxpayer Identifying Number:

Name of Partnership:

Partnership Identifying Number:

Tax Year Ended:  
December 31, 2000

Date FPAAs Mailed to Tax Matters Partner:

APR 06 2005

Person in Contact:

Contact Hours:  
8:00 AM - 4:30 PM (Monday - Friday)  
Contact Telephone Number:

Date: APR 06 2005

### NOTICE OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENT

The law requires us to send a Notice of Final Partnership Administrative Adjustment (FPAAs) to the partnership named above, for the tax year shown above, and to each partner who is entitled to receive this notice.

We are proposing adjustments to the partnership items of the partnership and tax year shown above. We will send the examination report outlining these adjustments to the Tax Matters Partner (TMP) of the partnership. (The TMP is the partner designated by the partnership to deal with the IRS.) He/she is also authorized to act for the partners who are not entitled to receive this notice. Any partner who wants a copy of the examination report should request it from the TMP. If the TMP is unable to provide you with a copy of the examination report, please contact the person named in the heading of this letter.

#### Taxable Years Ending Before August 6, 1997:

The adjustments to the partnership items reported on the partnership tax return may cause an increase or decrease to the tax liability on your individual return. Form 870-P, *Agreement to Assessment and Collection of Deficiency in Tax for Partnership Adjustments*, is a summary of the proposed adjustments to the partnership return. You can compute your share of the proposed adjustments by multiplying each adjusted partnership item by your percentage interest for that partnership item.

#### Taxable Years Ending After August 5, 1997:

The adjustments to the partnership items reported on the partnership tax return may cause an increase or decrease in the tax liability on your individual return. The adjustments may include partnership level determinations regarding penalties and additions to tax that relate to adjustments to partnership items. Form 870-PT, *Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts*, is a summary of the proposed adjustments to the partnership return. You can compute your share of the proposed adjustments by multiplying each adjusted partnership item by your percentage interest for that partnership item.

Letter 1830 (DO) (Rev. 3-2001)  
Catalog Number 61242U

You have three options available to you:

#### 1. If you agree with the adjustments:

Sign and return the enclosed Form 870-P/Form 870-PT. When you sign Form 870-P/Form 870-PT, you are agreeing to pay any additional tax and interest resulting from the adjustments to the partnership return. For tax years ending after August 5, 1997, you are also agreeing to any partnership level determination as to penalties, additions to tax and additional amounts that relate to adjustments to partnership items, if any. In addition, you are waiving your rights to participate in any administrative or judicial proceeding affecting partnership items and in partnership level determinations as to penalties, additions to tax and additional amounts that relate to adjustments to partnership items for the tax year in question. This is a binding settlement only if you sign and return Form 870-P/Form 870-PT and we sign on behalf of the Commissioner of Internal Revenue Service. When we sign the agreement form, the one-year extension of the period of limitations on assessments will begin under Internal Revenue Code section 6229(f). Once the agreement is signed by both parties, you may not file a claim to change the items in question or claim a refund/credit based on a readjustment.

Note: If you are the TMP of the partnership, see the section of this letter entitled, "For the Tax Matters Partner of the Partnership".

#### 2. If you do not agree with the adjustments:

If you are the TMP of the partnership and want to contest the adjustments in court, you must file a petition within 90 days from the date of this letter. During this 90-day period, no other partner may file a petition for judicial review. You can file your petition for readjustment of partnership items with:

1. the United States Tax Court;
2. the United States Court of Federal Claims; or
3. the District Court of the United States, in the district of the partnership's principal place of business.

A petition filed by the TMP precludes all other actions. If the TMP doesn't file a petition by the 90th day from the date the FPAAs was mailed, any partner or any 5 percent group entitled to receive this notice may petition one of these courts. A "5 percent group" includes any group of partners who together have an interest of five percent or more in profits of the partnership. The petition must be filed after the 90th day, but on or before the 150th day from the date the FPAAs was mailed to the TMP. If more than one petition is filed in Tax Court, the first petition filed will go forward. All other petitions (even those filed earlier in one of the other courts) will be dismissed. If no one files a petition in Tax Court, the first petition filed in one of the other courts will go forward and subsequent petitions will be dismissed.

Petitions filed with the United States Tax Court must be mailed to:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

Attach a copy of this letter to the petition. The time in which you must file a petition with the court is fixed by law and the court cannot consider your case if your petition is filed late. If this letter is addressed to both a husband and wife and both want to petition the Tax Court, both must sign the petition or each must file a separate signed petition.

Letter 1830 (DO) (Rev. 3-2001)  
Catalog Number 61242U

DEPARTMENT OF THE TREASURY - INTERNAL REVENUE SERVICE		
Form <b>870-PT</b> (08/2001)	<b>Agreement for Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts</b>	IN REPLY REFER TO: SE:S:E:TS: NAA:1:JH
Taxpayer(s) name(s), address and ZIP code: [REDACTED]	Name of Partnership: [REDACTED]	Tax Year(s) Ended: December 31, 2000
Taxpayer Identifying Number: [REDACTED]	Taxpayer Identifying Number: [REDACTED]	
	Name of Tax Matters Partner: [REDACTED]	
<b>Offer of Agreement to Partnership Items and Partnership Level Determinations as to Penalties, Additions to Tax, and Additional Amounts</b> <b>&amp;</b> <b>Waiver of Restrictions on Assessment for Partnership Items, Penalties, Additions to Tax, and Additional Amounts</b>		
<p>Under sections 6224(c) and 7121 of the Internal Revenue Code of 1986, the Commissioner of the Internal Revenue Service and the undersigned taxpayer(s) agree to the determination of partnership items and partnership level determinations as to penalties, additions to tax and additional amounts that relate to adjustments to partnership items as shown on the attached schedule of adjustments.</p> <p>The undersigned taxpayer(s), in accordance with section 6224(b) and 6213(d), also waives the restrictions provided by sections 6225(a) and 6213(a) and consents to the assessment and collection of any deficiency attributable to adjustments to partnership items, penalties, additions to tax and additional amounts that relate to adjustments to partnership items, as set forth in the attached schedule of adjustments; plus any interest provided by law.</p> <p>This agreement is conditional and will not become effective or final until this agreement form is returned to the Commissioner and is signed on his or her behalf. The one-year extension of the period of limitations on assessment under section 6229(f) will not begin to run until the date the Commissioner's representative signs this form on the Commissioner's behalf.</p> <p>If this part of this agreement form is signed for the Commissioner, the treatment of partnership items and partnership level determinations as to penalties, additions to tax and additional amounts that relate to adjustments to partnership items under this agreement will not be reopened in absence of fraud, malfeasance, or misrepresentation of fact. In addition, no claim for an adjustment of partnership items, refund or credit based on any change in the treatment of partnership items or partnership level determinations as to penalties, additions to tax and additional amounts may be filed or prosecuted.</p>		
Signature of taxpayer		Date Signed
Signature of taxpayer		Date Signed
By (Signature and title)		Date Signed
FOR INTERNAL REVENUE USE ONLY	Date accepted for Commissioner Office	Signature Title
(See Instructions For Signing Agreement)		Form <b>870-PT</b> (08/2001)

# Audit Process

## Notice Requirements

- The TMP provides other notices to other partners. These notice requirements mostly arise at the conclusion of the audit.
  - Closed conference with the examining agent;
  - Proposed adjustments, rights of appeal, and requirements for filing of a protest;
  - Time and place of any Appeals conference;
  - Acceptance by the IRS of any settlement offer;
  - Consent to extend the period of limitations for all partners.
  - Filing of an AAR on behalf of the partnership;
  - Filing by the TMP or any other partner of any petition for judicial review;
  - Filing of any appeal with respect to a judicial determination; and
  - Final judicial redetermination.

Treas. Reg. § 301.6223(g)-1(b)

# Audit Process

## Notice Requirements

- Notice must be given to the TMP to the other partners with 30 days of taking the action or receiving the information. Treas. Reg. § 301.6223(g)-1(b)(3).
- The noticed should be sent by certified mail, return receipt requested, so that the TMP has proof of mailing, should a question arise later.
- The TMP is required to comply with these regulatory notice requirements, even if the partnership agreement imposes less stringent notice requirements.

# Audit Process

## Partner's Right to Participate

- Any partner, including an indirect partner, has the right to participate in the administrative proceeding. I.R.C. § 6224(a); Treas. Reg. § 301.6224(a)-1(a).
- The IRS and the TMP will determine the time and place for all administrative proceedings. Arrangements will generally not be changed merely for the convenience of another partner. Treas. Reg. 301.6224(a)-1(a).
- Fast-track settlement is not available for the TEFRA partnership proceeding. Ann. 2011-5.

# Audit Process

## Summary Report and Closing Conference

- When the audit ends, the IRS will issue a Summary Report that includes both the information relating to the Closing Conference and the proposed adjustments. I.R.M. § 4.31.2.2.6.3 (Oct. 1, 2010).
- The Closing Conference will be scheduled 30 days or more after the issuance of the final Summary Report. I.R.M. § 4.31.2.2.7 (June 1, 2004)
- The TMP must transmit the final Summary Report to the other partners and advise them as to when and where the Closing Conference will be held. Treas. Reg. § 301.6223(g)-1(b).
- Although the TMP may waive the Closing Conference, it will be held if another partner requests it. The TMP cannot waive the other partner's right to the closing conference. Treas. Reg. § 301.6224(b)-1; I.R.M. § 4.31.2.2.7 (June 1, 2004).

# Audit Process

## IRS Appeals

- 60-Day Letter
  - Standard IRS procedure is to send a 60-day letter to the TMP providing partners with the opportunity to go to Appeals. I.R.M. 4.31.2.4.2.2 (Oct. 1, 2010).
  - The TMP must send the 60-day letter to all notice partners within 30 days of receiving it. Treas. Reg. § 301.6223(g)-1(b).
  - The 60-day letter will again set forth the proposed adjustments and advise as to the rights to appeal and file a protest.

# Audit Process

## Appeals

- *Protests and Appeals Conference*
  - Any notice partner may file a protest and request an Appeals conference.
  - The Service will combine all of the protests received and forward them to Appeals, and there will be a consolidated Appeals conference to discuss all protests.
  - Any notice partner is entitled to attend the IRS Appeals conference if it does not agree with the IRS's findings.

I.R.C § 6224(a); Treas. Reg. § 301.6223(g)-1(b)(1); I.R.M. §§ 8.19.1.6.8.4(4), 8.19.1.6.12(2), 8.19.3.5(1).

# Audit Process

## Administrative Settlements

- Any partner can settle with the IRS by signing Form 870-P, Settlement Agreement for Partnership Adjustments. I.R.C. § 6224(c)(1).
- If the IRS enters into a settlement agreement with any partner, the IRS must offer the same terms to any other partner who requests them. I.R.C. § 6224(c)(2).
- The TMP may not bind other partners to a settlement agreement except for certain non-notice partners. I.R.C. § 6224(c)(3)(B).

## Audit Process – Recent Development

- Partnerships may now settle and pay tax on behalf of their partners.
  - I.R.M. 4.31.2.2.9 (10/1/10): **Securing Agreements for Tax Assessments at the Partnership Level**
    - (1) Some partnerships request to settle and pay tax deficiencies on behalf of their partners. When such a request is made, local counsel must be consulted.
    - (2) The details of a partnership level settlement are explained in a Form 906, Closing Agreement on Final Determination Covering Specific Matters. A partnership level agreement can only be secured when the adjustments passing through to all underlying partners will result in a deficiency. If any partner is subject to a refund, then a partnership level agreement cannot be secured. All partners must be adjusted individually.
    - (3) The highest effective tax rate should be used when calculating the amount of tax owed. The partnership must also pay all additions to tax including interest and penalties.
    - (4) The Form 906 should be executed in the field before sending a copy to the CTF.

# Audit Process – You Know the Drill

- **Information Document Requests**
  - Sometimes preferred
- **Taxpayer Interviews**
  - Can they ever go well?
- **Summons**
  - Enforcement
  - Third Party Summons
- **Statute of Limitation Extensions**
  - Do you provide them?
- **Statutory Notice of Deficiency/FPAA**

Form <b>4564</b> (Rev. September 2006)	Department of the Treasury — Internal Revenue Service		Request Number
<b>Information Document Request</b>			1
To: (Name of Taxpayer and Company Division or Branch)		Subject	
[REDACTED]		To Shareholder	
		EIN number	Submitted to:
		Date of Previous Requests (month/year)	
Please return Part 2 with listed documents to requester identified below			
Description of documents requested			
1. The plan document for the [REDACTED]			
2. Any and all Payroll Deduction Billing statements for the period under audit.			
3. Any and all cancelled checks showing [REDACTED]			
4. Any and all policy illustrations [REDACTED]			
5. Any and all marketing and/or sales documents provided to you related to [REDACTED]			
6. [REDACTED]			
7. [REDACTED]			
8. Any and all correspondence related to [REDACTED]			
9. [REDACTED]			
10. Any and all written legal and/or tax advice you secured with respect to your involvement in the [REDACTED]			
11. Copies of your Corporate Income Tax Returns, form 1120, for years 2003 through 2006.			
12. Copies of the Individual Income Tax Returns, form 1040, as filed by all related shareholders for years 2003 through 2006.			
Information Due By: Please call by 11/19/2007			
		At Home Appointment <input type="checkbox"/>	Mail in <input type="checkbox"/>
From:	Name and Title of Requester	Employee ID number	Date (month/year)
	Office Location		11/05/2007
			Telephone Number
			[REDACTED]
Catalog Number 251456K	www.irs.gov	Part 1 - Taxpayer's File Copy	Form <b>4564</b> (Rev. 9-2006)

## Corrected Report

Form <b>4549-A</b> (Rev. May 2008)		Department of the Treasury-Internal Revenue Service <b>Income Tax Discrepancy Adjustments</b>		Page <u>1</u> of <u>2</u>
Name and Address of Taxpayer [REDACTED]		Taxpayer Identification Number [REDACTED]	Return Form No.: 1040	
		Person with whom examination changes were discussed.	Name and Title: [REDACTED]	
		Period End 12/31/2004	Period End 12/31/2006	Period End 12/31/2007
<b>1. Adjustments to Income</b>				
a. Sch E-Inc/Loss-Partnership/S Corps-Passive/Non-Passive	43,819.00	46,207.00	32,012.00	
b. Other Income	26,441.00	73,256.00	101,901.00	
c. Tuition & fees ded.	4,000.00			
d. Itemized Deductions	3,793.00	2,389.00	2,679.00	
e. Exemptions		1,672.00	4,534.00	
f.				
g.				
h.				
i.				
j.				
k.				
l.				
m.				
n.				
o.				
p.				
<b>2. Total Adjustments</b>	76,053.00	123,522.00	141,126.00	
<b>3. Taxable Income Per Return or as Previously Adjusted</b>	47,762.00	99,015.00	178,824.00	
<b>4. Corrected Taxable Income</b>	123,815.00	222,537.00	319,950.00	
Tax Method	SCHEDULE D	SCHEDULE D	SCHEDULE D	
Filing Status	Joint	Joint	Joint	
<b>5. Tax</b>	24,421.00	53,394.00	84,778.00	
<b>6. Additional Taxes / Alternative Minimum</b>				
<b>7. Corrected Tax Liability</b>	24,421.00	53,394.00	84,778.00	
<b>8. Less</b>		150.00		
a. Residential Energy Credit				
Credits				
b.				
c.				
d.				
<b>9. Balance (Line 7 less total of Lines 8a thru 8d)</b>	24,421.00	53,244.00	84,778.00	
<b>10. Plus</b>				
Other				
Taxes				
c.				
d.				
<b>11. Total Corrected Tax Liability (Line 9 plus Lines 10a thru 10d)</b>	24,421.00	53,244.00	84,778.00	
<b>12. Total Tax Shown on Return or as Previously Adjusted</b>	6,290.00	17,704.00	39,059.00	
<b>13. Adjustments to:</b>				
a.				
b.				
c.				
<b>14. Deficiency-Increase in Tax or (Overassessment) - Decrease in Tax (Line 11 less Line 12 adjusted by Lines 13a through 13c)</b>	18,131.00	35,540.00	45,719.00	
<b>15. Adjustments to Prepayment Credits-Increase (Decrease)</b>				
<b>16. Balance Due or (Overpayment) - (Line 14 adjusted by Line 15) (Excluding interest and penalties)</b>	18,131.00	35,540.00	45,719.00	

## Corrected Report

Form <b>4549-A</b> (Rev. May 2008)		Department of the Treasury-Internal Revenue Service <b>Income Tax Discrepancy Adjustments</b>		Page <u>2</u> of <u>2</u>
Name of Taxpayer [REDACTED]		Taxpayer Identification Number [REDACTED]	Return Form No.: 1040	
		Period End 12/31/2004	Period End 12/31/2006	Period End 12/31/2007
<b>17. Penalties/ Code Sections</b>				
a. IRC 6662A	7,985.57	12,969.81	14,818.23	
b.				
c.				
d.				
e.				
f.				
g.				
h.				
i.				
j.				
k.				
l.				
m.				
n.				
<b>18. Total Penalties</b>	7,985.57	12,969.81	14,818.23	
Underpayment attributable to negligence: (1981-1987) A tax addition of 50 percent of the interest due on the underpayment will accrue until it is paid or assessed.				
Underpayment attributable to fraud: (1981-1987) A tax addition of 50 percent of the interest due on the underpayment will accrue until it is paid or assessed.				
Underpayment attributable to Tax Motivated Transactions (TMT). Interest will accrue and be assessed at 120% of underpayment rate in accordance with IRC 6621(c).				
	0.00	0.00	0.00	
<b>19. Summary of Taxes, Penalties and Interest:</b>				
a. Balance due or (Overpayment) Taxes - (Line 16, Page 1)	18,131.00	35,540.00	45,719.00	
b. Penalties (Line 18) - computed to 04/18/2011	7,985.57	12,969.81	14,818.23	
c. Interest (IRC § 6601) - computed to 09/14/2011	11,633.13	12,246.54	9,875.05	
d. TMT Interest - computed to 09/14/2011 (on TMT underpayment)	0.00	0.00	0.00	
e. Amount due or refund - (sum of Lines a, b, c and d)	37,749.70	60,756.37	70,212.28	
<b>Other Information:</b>				
Internal Revenue Code Section 6404(g) does not apply per I.R.C. 6404(g)(2)(E).				
This Report Supersedes the Report Issued 10/9/2009				
Examiner's Signature: Name [REDACTED]	Employee ID: [REDACTED]	Office: [REDACTED]	Date: 08/15/2011	
The Internal Revenue Service has agreements with state tax agencies under which information about federal tax, including increases or decreases, is exchanged with the states. If this change affects the amount of your state income tax, you should amend your state return by filing the necessary forms.				
You may be subject to backup withholding if you underreport your interest, dividend, or patronage dividend income you earned and do not pay the required tax. The IRS may order backup withholding (withholding of a percentage of your dividend and/or interest payments) if the tax remains unpaid after it has been assessed and four notices have been issued to you over a 120-day period.				

Form <b>870-S</b>		Department of the Treasury - Internal Revenue Service		In Reply Refer to:	
<b>Agreement to Assessment and Collection of Deficiency in Tax for S Corporation Adjustments</b>					
Taxpayer(s) Name(s), Address and Zip Code:		Name of S Corporation		Tax Year(s) Ended:	
[Redacted]		[Redacted]		200712	
Taxpayer Identifying Number:		Name of Tax Matters Person			
[Redacted]					

**Offer of Agreement for Subchapter S Items**

Under the provisions of section 6224(c) of the Internal Revenue Code, the Commissioner of Internal Revenue and the undersigned taxpayer(s) agree to the determination of subchapter S items of the S corporation for the year(s) shown on the attached schedule of adjustments. The undersigned taxpayer(s), in accordance with section 6224(b), also waive(s) restrictions on assessment and collection of any deficiency attributable to subchapter S items (with interest as required by law) provided in section 6625(a).

This agreement is conditional, and will not become effective or final until this agreement form is returned to Internal Revenue and is signed for the Commissioner. The one-year extension of the period of limitations on assessment under section 6229(f) will not begin to run until the date the Commissioner's representative signs this for the Commissioner.

If this agreement form is signed for the Commissioner, the treatment of subchapter S items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no claim for an adjustment of subchapter S items or for a refund or credit based on any change in the treatment of subchapter S items may be filed or prosecuted.

Signature of Taxpayer:	Date:
Signature of Taxpayer:	Date:
By (Signature and Title):	Date:

(See Instructions for Signing on Next Page)

For Internal Revenue Use Only	Date Accepted for Commissioner:	Signature:
	Office:	Title:

RGS Ver. 10.20.00

Form **870-S**

Form <b>4605-A</b>		Department of the Treasury - Internal Revenue Service		Page of	
<b>Examination Changes - Partnerships, Fiduciaries, S Corporations, and Interest Charge Domestic International Sales Corporations (Unagreed and Excepted Agreed)</b>					

Name and address	Employer Identification Number	Form Number	
[Redacted]	[Redacted]	1120S	
Person Examination Changes Were Discussed With	Name	Title	
[Redacted]	[Redacted]	[Redacted]	
1. Adjustments to ordinary, distributable net, or taxable income.	Period End: 12/31/2004	Period End: 12/31/2005	Period End: 12/31/2006
a. Employee benefit programs	43,819.00		46,207.00
b. Insurance expenses		41,701.00	
c.			
d.			
e.			
f.			
g.			
2. Total adjustments to ordinary, distributable net, or taxable income.	43,819.00	41,701.00	46,207.00
3. Ordinary, distributable net, or taxable income as reported.	79,229.00	142,403.00	122,071.00
4. Corrected ordinary, distributable net, or taxable income.	123,048.00	184,104.00	168,278.00
5. Other adjustments			
a. Portfolio income (loss) - qualified dividends			
(1) Adjustment	0.00	0.00	
(2) As Reported	1,019.00	938.00	
(3) Corrected	1,019.00	938.00	
b. Portfolio income (loss) dividends			
(1) Adjustment	0.00	0.00	0.00
(2) As Reported	1,343.00	1,327.00	36.00
(3) Corrected	1,343.00	1,327.00	36.00

Remarks

Examiner's Signature:	Employee ID:	Area Office:	Date:
Name [Redacted]	[Redacted]	[Redacted]	10/06/2009

# Judicial Review Overview

- Notice of Final Administrative Adjustment – FPAA
- Judicial Review of S Corporation Items
- Choice of Forum
- Right to Participate in the Action
- Scope of Judicial Review
- Final Determination
- Adjustment to Partners' Tax Liabilities

# Judicial Review

## FPAA

- If any partner does not settle the disputed issues with Appeals, then Appeals will issue a FPAA (Notice of Final Administrative Adjustment).
- A FPAA is the equivalent of a statutory notice of deficiency for partnerships, but only partnership items are adjusted and no deficiency is proposed.
- The FPAA is mailed to the TMP and to all notice partners. I.R.C. § 6223(a)(2).

# Judicial Review of S Corporation Items

- **S corporation does not receive notice of IRS adjustments**
- **Shareholders contest the adjustments along with other adjustments on their individual returns**

# Judicial Review

## Choice of Forum

- The TMP may file a petition in Tax Court within 90 days after the FPAA is mailed. I.R.C. § 6226(a)(1).
- If the TMP does not file suit, any notice partner may file a petition in the next 60 days. I.R.C. § 6226(b)(1).
- Either the TMP or a notice partner may also file suit in the U.S. District Court or the U.S. Court of Federal Claims. I.R.C. § 6226(a)(2), (3).
  - If multiple petitions are filed within the 90-150 day period, the first action brought to the Tax Court will go forward.
  - If multiple petitions are filed, but none in the Tax Court, the first action brought forward shall go forward.
  - The other actions are dismissed.
- *Trap*: These are the only time periods for filing suit. Unlike non-partnership proceeding, the partners may not wait to pay the tax and then file a refund suit.

# Judicial Review

## Choice of Forum

- There are deposit requirements for suits filed in the Court of Federal Claims or District Court, but not in the Tax Court. I.R.C. § 6226(e).
  - The deposit is made by the partner filing the petition.
    - The deposit equals the amount by which the partner's tax liability would increase if the partner's return were made consistent with partnership return as adjusted by FPAA.
    - A pass-thru partner is required to deposit an amount based on the tax liability of all indirect partners who own interests through the pass-thru partner. Treas. Reg. § 301.6226(e)-1(a)(1).
  - The restriction on assessment under section 6225 lapses if the only petition is filed in district court or the Court of Federal Claims. Thus, the Service may immediately assess all non-petitioning partners if a petition is not filed in Tax Court.

# Judicial Review

## Right to Participate in the Action

- Any person who was a partner at any time during that tax year is allowed to participate in the action, as long as the partner had an interest in the outcome. I.R.C. § 6226(c), (d).
- To participate, the partner files a notice of election to participate with the court. See T.C. Rule 245(b), RCFC App. F, Rule 4(a), (b).
- Partners who participate in the suit in the Court of Federal Claims or a district court, but did not file a petition, are not required to make a deposit. See I.R.C. § 6226(e)(1).

# Judicial Review

## Scope of Judicial Review

- The court has jurisdiction to determine any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. I.R.C. § 6226(f).
  - Thus, the court may consider the reasonable cause and good faith defense to penalties, taking into account the state of mind of the general partner or managing member. *106 Ltd. v. Comm'r*, 684 F.3d 84 (D.C. Cir. 2012); *New Millennium Trading, LLC v. Comm'r*, 131 T.C. 275 (2008).
- But the suit may not cover non-partnership items. See I.R.C. § 6226(f).
  - Thus, the court may not consider partnership-level penalty defenses. Treas. Reg. § 301.6226(f)-1(a); Treas. Reg. § 301.6221-1(d).

# Judicial Review

## Scope of Judicial Review

- Suit may also cover partnership items other than those raised in FPAA. Treas. Reg. § 301.6226(f)-1(a).
- Example:
  - The Internal Revenue Service issues an FPAA adjusting the depreciation of ABC Partnership.
  - A petition for judicial review is filed. During the judicial proceeding, partner B raises an issue relating to the treatment of intangible drilling costs (IDCs).
  - The court has jurisdiction to determine both the depreciation and IDC issues.

Treas. Reg. § 301.6226(f)-1(b).

# Judicial Review Final Determination

- The court's determination concluded the partnership proceedings for all partners, subject to appeal. I.R.C. § 6226(f).
- The right to appeal is limited to the TMP, notice partners, and 5-percent group. I.R.C. § 6226(g).

# Judicial Review

## Adjustment to Partners' Tax Liabilities

- Once the court's decision had become final, the IRS can assess the partners. I.R.C. § 6225(a).
- The IRS does not have to issue a partner-level notice of deficiency and provide another opportunity to challenge the assessment except for certain affected items requiring deficiency notices. I.R.C. § 6230(a)(1).
- The IRS simply mails a notice of computational adjustment to each partner.

# Judicial Review of S Corporation Items

- Shareholder Receives Notice of Deficiency
  - Tax Court
- Refund Forum – Full Pay
  - District Court
  - Court of Federal Claims
- Each shareholder can contest his or her adjustments individually in court.

# Judicial Review

## Penalties – partner level

- The IRS can simply assess the penalty amount, without providing the notice of deficiency. Treas. Reg. § 301.6231(a)(6)-1(a)(3).
- To contest the penalty, the partner must pay the penalty and then file a refund claim. I.R.C. § 6230(c)(1)(C); Treas. Reg. § 301.6221-1(c).
- The refund claim must be filed within in 6 month from when the notice of computational adjustment was mailed to the partner. I.R.C. § 6230(c)(2).
- A partner may raise only partner-level defenses to the penalty. Treas. Reg. § 301.6221-1(c), (d).
- *Tip:* If the primary issue in the case is the penalty and defenses to that penalty are at the partner-level, you should consider accepting the partnership-level adjustments. Then you can spend your resources defending the penalty.

# Substantive Audit Issues

- What is the meaning of a partnership provision. Here special allocations of “items of ordinary income and capital gain”.
  - Are short term capital gains “items of ordinary income”
  - *Imprimis LLC v. United States* (U.S. Court of Federal Claims)
- Was entity a “partner” so that it is entitled to historic rehabilitation tax credits.
  - Third Circuit found that Pitney Bowes was not a bona fide partner because it lacked a meaningful stake in either the success or failure of the partnership.
  - *Historic Boardwalk Hall, LLC v. Comm’r* (3d Cir. 2012)

# Top Tips

- Most partners will be notice partners.
- The TMP's role may be expanded contractually by the partnership or LLC agreement.
- An assessment of tax attributable to a partnership item is timely as long as either the partner-level or partnership-level period of limitations remains open.
- A partner should seriously consider filing its own AAR to protect its right to seek judicial review.
- If the primary issue in a case is the penalty and the defenses to that penalty are at partner-level, you should consider accepting the partnership-level adjustments. Then, you can spend your resources defending the penalty.

# Top Traps

- A disregarded entity is counted as a partner and causes the partnership to be a TEFRA partnership.
- The TMP may not be an officer of the GP entity.
- The time for filing an AAR is governed by when the partnership's return is filed, not when the partner's return is filed or when the tax is paid.
- The two-year period for filing suit is based on when the AAR was filed, not when it is disallowed.
- Suit must be filed within 90-150 days of receiving the an FPAA. Unlike in a non-partnership proceeding, the partners may not wait to pay the tax and then file a refund suit.

# Hot Issues

- Is a partner's outside basis a partnership item?
  - *Petaluma FX Partners LLC*
  - *United States v. Gary Woods*
- Is an entity a partner (equity interest) or a lender?
  - *Castle Harbour cases*
- Legislative proposals to subchapter K and subchapter S