

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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date: May 26, 2020

to: Holly Paz
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subject: The Period of Limitations for Adjustments Related to Section 965 for Partnerships

This memorandum responds to your request for assistance dated November 19, 2019. This advice may not be used or cited as precedent. This advice was coordinated with the branches 1 and 2 of the Associate Office of Chief Counsel (Procedure and Administration) and the Associate Office of Chief Counsel (International).

ISSUE¹

What is the period of limitations for adjustments related to section 965 of the Internal Revenue Code (Code) for: (1) partnerships subject to the partnership procedures under Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248 (TEFRA); (2) partnerships subject to the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015, Public Law 114-74 (BBA); (3) partnerships not subject to any consolidated procedures; and (4) taxpayers who are partners in partnerships not subject to TEFRA or BBA?²

¹ For purposes of this memorandum, when the memorandum refers to the date by which the IRS must make adjustments or assessments, for simplicity purposes, the memorandum is referring to the date the IRS must take the first action which would suspend or extend the period of limitations – for example, issuing a notice of final partnership administrative adjustment to the partners of a TEFRA partnership or issuing the notice of proposed partnership adjustment to a BBA partnership.

² For purposes of this issue, it is assumed that no partner is an S corporation.

SUMMARY

Provided no other extensions or suspensions of the period of limitations on making assessments (TEFRA and non-TEFRA/non-BBA partnerships) or adjustments (BBA partnerships) are applicable:

- For partnerships subject to TEFRA, assessments of tax related to adjustments to the partnership items of the partnership may be made:
 - For all partners and all partnership items, within three years from the date the partnership return is filed (or the due date, if later);
 - For a specific partner who has a net tax liability described in section 965(h)(6), within six years from the date the partner's return was filed (or due date, if later) for assessing the section 965 net tax liability.
- For partnerships subject to BBA, adjustments to the partnership-related items of the partnership may be made:
 - For all partnership-related items, within three years of the date the partnership return is filed (or due date, if later) or the date an administrative adjustment request is filed;
 - Within six years if any item of gross income required to be included under section 951(a) (which includes the section 965(a) inclusion amount) was omitted by the partnership.
- For partnerships not subject to BBA or TEFRA, assessments of tax may be made:
 - Within three years from the date the partner's return was filed (or the due date if later) for all items on the partnership return;
 - Within six years for the net tax liability described in section 965(h)(6).

LAW AND ANALYSIS

Section 965

As amended by the Tax Cuts and Jobs Act, Public Law 115-97 (TCJA), section 965 results in the imposition of a transition tax on the untaxed foreign earnings of specified foreign corporations (as defined in section 965(e)) (SFCs) that are deferred foreign income corporations (as defined in section 965(d)(1)) (DFICs). Section 965 applies with respect to the last taxable year of a DFIC beginning before January 1, 2018, and the amount included in income under section 965 is includible in the year of a United States shareholder (within the meaning of section 951(b) as in effect prior to amendment by TCJA) (U.S. shareholder) in which or with which such DFIC's year ends, provided the U.S. shareholder owns (within the meaning of section 958(a)) stock of the DFIC and is thus a section 958(a) U.S. shareholder of the DFIC. The tax resulting from section 965 can apply to section 958(a) U.S. shareholders in an SFC and United States persons (U.S. persons) who are interest holders in a domestic pass-through entity that is a section 958(a) U.S. shareholder of an SFC.

There are several steps in the calculation under section 965. First, under section 965(a), a DFIC's subpart F income is increased, and a section 958(a) U.S. shareholder's subpart F inclusion is correspondingly increased under section 951. The subpart F income is increased by the greater of the DFIC's accumulated post-1986 deferred foreign income as of November 2, 2017, or its accumulated post-1986 deferred foreign income as of December 31, 2017. I.R.C. § 965(a). Second, the amounts included by a section 958(a) U.S. shareholder under section 965(a) can be reduced by the aggregate foreign E&P deficit of the U.S. shareholder pursuant to section 965(b) and the regulations thereunder. Third, section 965(c) provides a deduction determined based on a U.S. shareholder's aggregate section 965(a) inclusion amounts and its aggregate foreign cash position (as defined in section 965(c)(3) and the regulations thereunder).

There are three broad categories of adjustments that could be made with respect to section 965 amounts, which are as follows:

- Section 965(a) inclusion. Adjustments to post-1986 earnings and profits, or to accumulated post-1986 deferred foreign income or specified E&P deficits of SFCs or pro rata shares thereof, could all lead to adjustments to a section 965(a) inclusion amount required to be reported by a section 958(a) U.S. shareholder, including a U.S. shareholder partnership. Such adjustments to amounts with respect to SFCs or a section 958(a) U.S. shareholder of SFCs would also result in corollary effects on section 965(a) inclusions required to be reported by direct and indirect partners of domestic pass-through entities that are U.S. shareholders of DFICs. All such adjustments to income items of a U.S. shareholder partnership resulting from adjustments to the DFIC would constitute adjustments to gross income required to be included under section 951(a). Section 965(a) inclusion amounts and underlying computations are required to be reported by a section 958(a) U.S. shareholder of a DFIC to the Internal Revenue Service (IRS) and to partners of the U.S. shareholder if it is a domestic pass-through entity. The corresponding section 965(a) inclusions of direct and indirect partners of such a partnership are required to be reported by such partners to the IRS based on amounts reported to the direct and indirect partners by the U.S. shareholder partnership.
- Section 965(c) deduction. Adjustments to cash positions of an SFC of a U.S. shareholder or to the U.S. shareholder's aggregate foreign cash position or its aggregate section 965(a) inclusion amounts could lead to adjustments to a section 965(c) deduction amount required to be reported by a section 958(a) U.S. shareholder, including a U.S. shareholder partnership. Such adjustments would also result in corollary adjustments to section 965(c) deductions at the level of direct and indirect partners of domestic pass-through entities that are section 958(a) U.S. shareholders of DFICs. Because the initial adjustments would be to deductions of the U.S. shareholder partnership, they would not constitute adjustments to gross income required to be included under section 951(a). Section 965(c) deduction amounts and underlying computations are required to be reported by a section 958(a) U.S. shareholder partnership of a DFIC to the

IRS and to partners of the U.S. shareholder partnership. The corresponding section 965(c) deductions of direct and indirect partners of such a partnership are required to be reported by such partners to the IRS.

- Foreign tax amounts.³ Adjustments to amounts of deemed paid foreign income taxes allowed as credits with respect to a section 965(a) inclusion (deemed paid credits), deemed paid credits disallowed under section 965(g), and amounts required to be included in income under section 78 (section 78 gross-up) (each a foreign tax amount) would be made with respect to the U.S. taxpayer with a section 965(a) inclusion that is required to report these amounts, including direct and indirect partners of domestic pass-through entities that are U.S. shareholders of DFICs, for which such amounts are determined based on the section 965(a) inclusion and other amounts required to be reported by the section 958(a) U.S. shareholder partnership. Adjustments to such amounts of the U.S. shareholder partnership would not constitute adjustments to gross income required to be included under section 951(a). The amounts necessary to compute foreign tax amounts are required to be reported by a section 958(a) U.S. shareholder partnership of a DFIC to the IRS and to partners of the U.S. shareholder partnership. The corresponding foreign tax amounts of direct and indirect partners of such a partnership are required to be reported by such partners to the IRS.

Section 965(k) provides a minimum period to assess the net tax liability under section 965. Under section 965(k), this period to assess will not expire before the date that is six years after the date of the filing of the U.S. person's return that is required to include the section 965(a) inclusion.

Sections 6501(e) and section 6501(c)(8)

Section 6501(e)(1)(C) provides that if the taxpayer omits from gross income an amount properly includible in income under section 951(a), the tax may be assessed at any time within six years after the return was filed. Thus, if the taxpayer omits from gross income a section 965(a) inclusion required to be included in income, the six-year limitation on assessment applies to the entire tax liability reportable on that return. The extended period for assessment under section 6501(e) is thus unlike the extended period for assessment under section 965(k), which applies only to a certain portion of the liability.

Additionally, section 6501(e)(1)(A) provides that if the taxpayer omits from gross income an amount properly includible in income, and such amount is greater than 25 percent of the amount of gross income stated in the return, or such amount is both attributable to specified foreign financial assets within the meaning of section 6038D and certain other conditions are met, the tax may be assessed at any time within six years after the return was filed. For purposes of section 6501(e)(1)(A), an amount is not considered omitted from gross income if the amount is disclosed in the return, or in a statement attached to

³ This memorandum does not discuss creditable foreign tax expenditures of a partnership (as defined in §1.704-1(b)(4)(viii)(b)).

the return, in a manner adequate to apprise the IRS of the nature and amount of the item.

Section 6501(c)(8)(A) provides that in the case of any information that is required to be reported pursuant to an election under section 1295(b) or under section 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of tax with respect to any tax return, event, or period to which such information relates is extended to three years after the date on which the information required to be reported is furnished. Section 6501(c)(8)(B) provides that if the failure to provide the information is due to reasonable cause, the assessment period extension will apply only to the item or items related to such failure. Of particular ongoing relevance to U.S. shareholders of controlled foreign corporations (as defined in section 957) (CFCs), which are SFCs pursuant to section 965(e)(1)(A), reporting with respect to such CFCs is required pursuant to section 6038(a)(4). Information required under section 6038 to be reported with respect to a CFC on a Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, can include financial statements and information about earnings and profits, previously taxed earnings and profits, and post-1986 undistributed earnings and foreign income taxes paid or accrued by the foreign corporation.

Because the items required to be reported under the statutes enumerated in section 6501(c)(8) do not always directly coincide with the section 965 amounts reported by taxpayers, errors in computations of or failures to report section 965 amounts generally would not result in a statute extension pursuant to section 6501(c)(8). However, if section 6501(c)(8)(A) otherwise applies to extend the statute of limitations for the entire return due to other errors in computations or failures to report, the IRS could potentially make an adjustment to a section 965 amount.

TEFRA⁴

The TEFRA partnership procedures apply to any partnerships required to file a return under section 6031(a) that do not meet the small partnership exception contained in section 6231(a)(1)(B). The TEFRA partnership procedures were repealed for tax years beginning on or after January 1, 2018. Under TEFRA, adjustments to partnership items must be made at the partnership level. I.R.C. § 6221. A partnership item is any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations provide that the item is more appropriately determined at the partnership level. I.R.C. § 6231(a)(3). Items of income, gain, loss, deduction, or credit of the partnership are partnership items. Treas. Reg. § 301.6231(a)(3)-1.

For partnerships subject to TEFRA, section 6229(a) provides a minimum period within which no partner's period of limitations on the assessment of tax attributable to

⁴ For purposes of this section, all references to sections under the Internal Revenue Code (Code) are references to the Code sections in effect prior to repeal by the BBA. Also, unless otherwise stated, it has been assumed that no extension has been agreed to and no special rules apply.

partnership items and affected items may expire. This minimum period affects the underlying partners' section 6501 period for assessment such that a partner's section 6501 period of limitations on assessing tax attributable to adjustments to partnership items cannot expire before the period in section 6229(a). Under section 6229(a), the IRS generally has three years from the date the partnership return was filed (or the due date, if later), to assess tax attributable to adjustments to the partnership items of a TEFRA partnership. I.R.C. § 6229(a). This period can be extended by agreement and under special rules for situations such as fraud and where the partnership has not filed a return. I.R.C. § 6229(b)-(c). The period is also suspended if the IRS issues a notice of final partnership administrative adjustment (FPAA). I.R.C. § 6229(d). One of the special situations described in section 6229(c) is if the partnership has a substantial omission of income, as described in section 6501(e)(1)(A). Accordingly, if the partnership has a substantial omission of income, as described above, the general three-year minimum period described in section 6229(a) is extended to six years.

Because section 6229 is a minimum period within which no partner's section 6501 period can expire, if the partner's section 6501 period of limitations is open for a reason unrelated to section 6229 (for example, under section 6501(c)(8) or (e)(1)(C)), assessments may be made against that partner for any tax attributable to partnership items and affected items. See Rhone-Poulenc Surfactants & Spec., LP v. Comm'r, 114 T.C. 533, 550-51 (2000). This would include if a partner's period of limitations on assessment was extended under section 965(k). In situations where a partner's period of limitations on assessment is open for a reason unrelated to section 6229, only partnership items and affected items that are covered by the open period of limitations may be adjusted. For example, if the partner extended his section 6501 period without limitation, any partnership item or affected item for that taxable year may be adjusted. However, if the partner's period of limitation was open only for a limited purpose then the only partnership items and affected items that can be adjusted are those that relate to the issue for which the period of limitations on assessment is open.

For example, if the partner's period of limitations on assessments was only open because of section 965(k), which extends the time to assess the net tax liability under section 965, the only partnership item adjustments that could be included in the FPAA issued to that partner would be those items that affect the net tax liability under section 965, even if those changes could have other tax effects on the partner. This is similar to how section 6229 interacts with the partner's section 6501 period. If the partner's section 6501 period is open because of the section 6229 minimum period, then only tax attributable to partnership items and affected items may be assessed and other unrelated items on the partner's return may not be adjusted.

If the partner has an open period of limitations on making assessments, an FPAA would be issued to the partner to make adjustments to any partnership items that affect a taxable year in which the partner has an open assessment period of limitations for tax attributable to partnership items and affected items. After the completion of the TEFRA partnership proceeding, computational adjustments are made to the returns of the

partners in the partnership to reflect the tax effects of the adjustments made during the TEFRA partnership proceeding. United States v. Woods, 571 U.S. 31, 39 (2013).

As discussed above, under section 965, the IRS may adjust section 965(a) inclusion amounts and section 965(c) deduction amounts reportable by a partnership. These are partnership items of the partnership. I.R.C. § 6231(a)(3); Treas. Reg. § 301.6231(a)(3)-1. These adjustments would occur for the taxable year for which those amounts are required to be reported by the partnership. Any adjustments to these partnership items would affect the corresponding section 965(a) inclusions and corresponding section 965(c) deductions and foreign tax amounts reported by the partners. These items reported by partners would be affected items, to the extent they are affected by any partnership items of the partnership. Treas. Reg. § 301.6231(a)(5)-1. The time to assess tax attributable to affected items is the same as the time to assess tax attributable to partnership items. See I.R.C. § 6229(a). Accordingly, the section 965(a) inclusion amount and section 965(c) deduction amount reported by the partnership may be adjusted for the taxable year for which those amounts are required to be reported so long as either the section 6229 minimum period applies or the partner reported an item that would be affected by those adjustments in a year in which the partner's period of limitations on assessment of those items is open. Once adjusted, any corresponding computational adjustments may be made to the partners.

BBA⁵

The centralized partnership audit regime enacted by the BBA applies to any partnership required to file a partnership return under section 6031(a) provided that the partnership has not made a valid election out of BBA for the taxable year under section 6221(b). Under BBA, any adjustment to a partnership-related item (PRI) must be determined at the partnership level. I.R.C. § 6221(a). A PRI is any item or amount with respect to the partnership that is relevant in determining the tax liability of any person under chapter 1. I.R.C. § 6241(2)(B). Any amount shown, or required to be shown, on the partnership's return or required to be maintained in the partnership's books and records is a PRI if the item is relevant in determining the liability of any person under chapter 1. Treas. Reg. § 301.6241-1(a)(6)(ii).

Under BBA, section 6235 provides the period in which adjustments (not assessments) to PRIs can be made.⁶ The section 6235 period of limitations on making adjustments can be extended by agreement or in special circumstances such as fraud and where the partnership has not filed a return for the taxable year. I.R.C. § 6235(b)-(c). One of

⁵ For purposes of this section, all references to sections under the Code are references to the Code sections in effect for tax years beginning on or after January 1, 2018. Also, unless otherwise stated, it is assumed that no administrative adjustment request has been filed, and no extension has been agreed upon. Finally, for simplicity, any reference to when the IRS must make any adjustments to a BBA partnership is a reference to the date described in section 6235(a), which is the last date on which the IRS may issue the notice of proposed partnership adjustment (NOPPA) to the partnership.

⁶ This is different than under TEFRA. As discussed above, under TEFRA, adjustments can be made at any time, provided that the period for assessing tax attributable to those adjustments is open.

those special circumstances described in section 6235(c) is if the partnership has a substantial omission of income, as described in section 6501(e)(1)(A). Accordingly, if the partnership has a substantial omission of income, as described above, the general three-year period to make adjustments is extended to six years.

Any tax attributable to an adjustment to a PRI is a tax liability for the adjustment year (if the partnership is paying the imputed underpayment) or the reporting year (if the partnership has elected to push out the adjustments to its partners). I.R.C. §§ 6226(b)(1), 6232(a); Treas. Reg. § 301.6226-3(a). The adjustment year is the year in which the adjustment becomes finally determined, and the reporting year is the year for which the partner is required to report any additional tax attributable to an adjustment to a PRI and not the year to which the adjustments relate. Treas. Reg. §§ 301.6241-1(a)(1); 301.6226-3(a). As section 6235 is a period of limitations on making adjustments to the partnership and not a period of limitations on making assessments, section 6235 does not affect the time to assess any tax attributable to an adjustment to a PRI. Likewise, because section 6235 is a period of limitations on making adjustments, a suspension or extension of the time to assess tax for the year to which the adjustments relate does not affect the period of limitations to make the adjustments under BBA.

As described above, section 965(k) provides a minimum period to assess the net tax liability under section 965 and, therefore, does not affect the period of limitations on making adjustments under section 6235.⁷ Even if section 965(k) extended a partner's period of limitations on assessment for a particular year with respect to a net tax liability under section 965, this would not extend the IRS's ability to make adjustments with respect to the partnership if the section 6235 period was closed.

As stated above, the period of limitations on making adjustments under section 6235 is extended in certain situations described in section 6235(b) (extensions by agreement) and (c) (special rules). Section 6235(c)(2) provides that the period of limitations on making adjustments under BBA is extended from three years to six years "if any partnership omits from gross income an amount properly includible therein and such amount is described in subparagraph (A) or (C) of section 6501(e)(1)."⁸ If this special rule applies, the IRS has six years to make adjustments to any of the PRIs for that taxable year, not just the ones that relate to amounts described in subparagraph (A) or (C) of section 6501(e)(1). Section 6501(e)(1)(A) generally applies if the taxpayer omits

⁷ Notwithstanding the statutory language, the Joint Committee print observes that, with respect to statutes of limitations for assessments, "[t]o the extent that such return was filed by a U.S. shareholder that is a domestic partnership, a commensurate extension of the period for making adjustments to a partnership return is intended." Joint Comm. on Taxation, JCS-1-18, General Explanation of Public Law 115-97, 366 (2018). However, a footnote notes that "[a] technical correction may be needed to reflect this intent." *Id.*

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from gross income an amount greater than 25 percent of the amount of gross income stated in the return, and section 6501(e)(1)(C) applies if the taxpayer omits from gross income an amount properly includible under section 951(a). Section 951(a) provides that U.S. shareholders in CFCs (and other SFCs that are treated as CFCs for purposes of section 951 pursuant to section 965(e)(2)) must include in their gross income their pro rata share of subpart F income, including amounts determined under section 965.

As stated above, section 6235(c)(2) gives the IRS a minimum of six years to adjust any PRI of the partnership for a taxable year if the partnership excludes an amount that is properly includible under section 951(a). Below is an analysis of each of the broad categories of adjustments discussed above:

- Section 965(a) inclusion amounts and section 965(a) inclusions. Section 965(a) inclusion amounts and section 965(a) inclusions are gross income required to be included under section 951(a). Accordingly, if any adjustments were needed to such amounts reported by a BBA partnership, the IRS would have six years under section 6235(c)(2) to make adjustments as opposed to three years.
- Section 965(c) deduction amounts and section 965(c) deductions. Because section 965(c) deduction amounts and section 965(c) deductions are not gross income, they are not required to be included under section 951(a). Therefore, if the partnership fails to properly include a section 965(c) deduction amount or section 965(c) deduction, such failure would not result in the application of the special rule under section 6235(c)(2) which would mean that the IRS would have three years to make adjustments to the partnership for that taxable year (assuming no other special rules applied).
- Foreign tax amounts. Foreign tax amounts are currently not items required to be reported by a section 958(a) U.S. shareholder partnership and, therefore, are not PRIs governed by BBA and section 6235. However, the partnership is required to report amounts necessary to determine foreign tax amounts, including section 965(a) inclusion amounts and section 965(c) deduction amounts.

Another situation in which the period of limitations on making adjustments to a BBA partnership is extended is for situations where the IRS has not been furnished information required to be provided under the sections listed in section 6501(c)(8). In this case, section 6235(c)(5) provides that the period of limitations on making adjustments shall not expire before the date that is determined under section 6501(c)(8).

As noted above, because the items required to be reported under the statutes enumerated in section 6501(c)(8) do not always directly coincide with the section 965 amounts that are reported, errors in computations of or failures to report section 965 amounts generally would not result in a statute extension pursuant to section 6235(c)(5), although if section 6235(c)(5) otherwise applied due to another error in computation or failure to report, the IRS could potentially make an adjustment to a section 965 amount.

As discussed above, under section 965, the IRS may adjust section 965(a) inclusion amounts and section 965(c) deduction amounts required to be reported by a partnership. These amounts would be PRIs of the partnership for the taxable year in which they are required to be reported as they are required to be shown on the return of the partnership or maintained and its books and records and are relevant in determining the liability of any person under chapter 1 (i.e. the corresponding section 965(a) inclusions, section 965(c) deductions, and foreign tax amounts reported by the partners). Treas. Reg. § 301.6241-1(a)(6)(ii). Accordingly, the section 965(a) inclusion amounts and section 965(c) deduction amounts required to be reported by the partnership may only be adjusted for the taxable year for which the items were reported or required to be reported if the section 6235 period of limitations on making adjustments is open for the partnership for that taxable year.

Non-TEFRA/Non-BBA Partnerships

There is not a unified method of examining partnerships not subject to either the TEFRA partnership procedures or the centralized partnership audit regime under the BBA. Accordingly, the relevant statute of limitations for making an assessment of tax, including a net tax liability under section 965, is the partner's applicable statute of limitations under sections 965(k) and 6501, as applicable, including any applicable suspensions or extensions.

Please call (202) 317-5216 if you have any further questions.