TAX SECTION
State Bar of Texas

OFFICERS:

Lora G. Davis (Chair)
Davis Stephenson, PLLC
100 Crescent Court, Suite 440
Dallas, TX 75201
214-396-8801
lora@davisstephenson.com

Daniel G. Baucum (Chair-Elect)
Daniel Baucum Law PLLC
8150 N. Central Expwy, 10th Floor
Dallas, Texas 75206
214-969-7333
dbaucum@baucumlaw.com

Henry Talavera (Secretary)
Polsinelli
2950 N. Harwood St., Ste. 2100
Dallas, Texas 75201
214-661-5538
htalavera@polsinelli.com

Robert C. Morris (Treasurer)
Norton Rose Fulbright US LLP
1301 McKinney, Suite 5100
Houston, Texas 77010
(214) 651-8404
robert.morris@nortonrosefulbright.com

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January 25, 2021

Via Federal eRulemaking Portal at *www.regulations.gov*

Internal Revenue Service
CC:PA:LPD:PR (REG-123652-18)

RE: ***Comments Regarding Proposed Regulations on the Centralized Audit Regime***

Ladies and Gentlemen:

On behalf of the Tax Section of the State Bar of Texas ("Tax Section"), I am pleased to submit the enclosed response to the request of the United States Department of the Treasury (the "Treasury Department") and the Internal Revenue Service (the "Service") for comments pertaining to proposed regulations, appearing in the Notice of Proposed Rulemaking (REG-123652-18) issued on November 24, 2020 (the "Proposed Regulations"), regarding the centralized partnership audit regime.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

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1414 Colorado Street, Austin, TX 78701
(512) 427-1463 or (800) 204-2222

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THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Treasury Department and the Service for the time and thought that have been put into preparing the Proposed Regulations, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

Lora G. Davis, Chair
State Bar of Texas, Tax Section

Enclosure

COMMENTS ON PROPOSED REGULATIONS ON PARTNERSHIP CENTRALIZED AUDIT REGIME

These comments on the Proposed Regulations ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafters of these Comments were Lee S. Meyercord, Co-Chair of the Partnership and Real Estate Tax Committee of the Tax Section of the State Bar of Texas, and Jackson Oliver, member of the Partnership and Real Estate Tax Committee of the Tax Section of the State Bar of Texas. The Committee on Government Submissions of the Tax Section has approved these Comments. Mary A. McNulty, past Chair of the Tax Section of the State Bar of Texas and member of the Partnership and Real Estate Tax Committee of the Tax Section of the State Bar of Texas, also reviewed the Comments and provided substantive suggestions.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact Persons:

Lee S. Meyercord
Partner
Thompson & Knight LLP
1722 Routh Street, Suite 1500
Dallas, TX 75201
(214) 969-1315
Lee.Meyercord@tklaw.com

Jackson Oliver
Associate
Thompson & Knight LLP
1722 Routh Street, Suite 1500
Dallas, Texas 75201
(214) 969-1530
Jackson.Oliver@tklaw.com

Date: January 25, 2021

I. INTRODUCTION

These Comments are provided in response to Treasury's and the IRS's request for comments on the Proposed Regulations. The Proposed Regulations relate to the centralized partnership audit regime (the "Centralized Audit Rules") that was enacted in the Bipartisan Budget Act of 2015 (the "BBA").[1] The Centralized Audit Rules replaced the partnership audit procedures in the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA")[2] with a centralized partnership audit regime that allows the IRS to make partnership adjustments, assessments, and collections at the partnership level.

Under Section 6241(11) of the Internal Revenue Code (the "Code"), if there are partnership-related items that involve special enforcement matters, the Secretary may issue regulations providing that the Centralized Audit Rules do not apply to such items or that such items are subject to special rules. The Proposed Regulations propose rules addressing special enforcement matters and make clarifying amendments to previously issued final regulations.

II. PARTNER-LEVEL STATUTE OF LIMITATIONS

A. Background

TEFRA allows partnership adjustments if either the partnership or partner-level statute of limitations is open.[3] By contrast, the statute of limitations for partnership adjustments under the Centralized Audit Rules is determined exclusively at the partnership level; the partner's statute of limitations is not taken into account.[4] Section 6235(a) sets forth the partnership-level limitations period and provides that no partnership adjustment may be made after the later of:

(1) the date which is 3 years after the latest of—

(A) the date the partnership return was filed,

[1] P.L. 114-74. Unless otherwise noted, references in these Comments to "Section" mean provisions of the Internal Revenue Code.

[2] P.L. 97-248.

[3] Section 6229 (repealed 2015). Section 6229(a) provided that the statute of limitations for adjustment of partnership items "shall not expire before" the date that is 3 years after the later of the date the partnership return was filed or the last day for filing such return. Courts concluded that the "shall not expire before" language made clear that Section 6229(a) was not an exclusive statute of limitations, and an assessment of tax attributable to a partnership item was timely as long as the period of limitations remained open under either Section 6501 (relating to a partner's statute of limitations) or Section 6229 (relating to a partnership's statute 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 (5th Cir. 2009), *cert. den.*, 130 S. Ct. 3321 (2010); *AD Global Fund, LLC v. United States*, 481 F.3d 1351 (Fed. Cir. 2007); *Andantech LLC v. Comm'r*, 331 F.3d 972 (D.C. Cir. 2003); *Schumacher Trading Partners II v. United States*, 72 Fed. Cl. 95 (2006); *Grapevine Imports, Ltd. v. United States*, 71 Fed. Cl. 324 (2006); *Russian Recovery Fund, Ltd. v. United States*, 108 A.F.T.R.2d 2011-7182 (Fed. Cl. 2011).

[4] Section 6235(a).

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(B) the due date of the return, or

(C) the date on which the partnership filed an administrative adjustment request ("AAR") under Section 6227, or

(2) if the partnership requests a modification of an imputed underpayment under Section 6225(c), 270 days (plus any agreed extension) after the date the information is submitted, or

(3) if the partnership does not request modification of the imputed underpayment, 330 days (plus any agreed extension) after the date of the notice of proposed partnership adjustment ("NOPPA").[5]

The statute of limitations on partnership adjustments may be extended by agreement.[6] In addition, an adjustment may be made at any time if the partnership files a false or fraudulent return or no return.[7] The limitations period in (1) above is extended from three years to six years if the partnership makes a substantial omission from gross income.[8]

B. Proposed Regulation

Proposed Regulation Section 301.6241-7(f) allows the IRS to make partnership adjustments after the partnership-level statute of limitations has expired if the *partner's* statute of limitations is open and either (1) the partner has control over the partnership (as determined under Sections 267(b) and 707(b)); or (2) the partner has extended the partner's statute of limitations under Section 6501 and the extension expressly states that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

C. Discussion

The Proposed Regulations appear inconsistent with Congress's clear directive in the Centralized Audit Rules to determine the statute of limitations for partnership adjustments exclusively at the partnership level. Section 6221(a) specifies that "[a]ny adjustment to a partnership-related item shall be determined, and any tax attributable thereto shall be assessed and collected, and the applicability of any penalty, addition to tax, or additional amount which relates

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[5] *See also* Section 6232(b) (no assessment may be made before the 90th day after the notice of final partnership adjustment ("FPA") is mailed and—if a petition is filed in the Tax Court—the decision of the court has become final).

[6] Section 6235(b).

[7] Section 6235(c)(1), (3).

[8] Section 6235(c)(2).

to an adjustment to any such item shall be determined, *at the partnership level*...."[9] Thus, the partner's statute of limitations is irrelevant to partnership adjustments.

We respectfully suggest that the IRS should not extend the statute of limitations for partnership adjustments beyond what Congress has prescribed. Statutes of limitations are strictly construed in accordance with their express terms.[10] For example, in *Brockamp*, the Supreme Court found that the statutory limitations period for tax refund claims did not contain an implied equitable exception because the statute "sets forth its limitations in a highly detailed technical manner, that linguistically speaking, cannot easily be read as containing implicit exceptions."[11] Likewise, Section 6235 contains detailed limitations for the time period in which partnership adjustments may be made. Unlike TEFRA, the statutory language of Section 6235 nowhere suggests that the statute of limitations for partnership adjustments may be determined at the *partner* level.[12] Section 6235 sets forth explicit exceptions to its general time limits, and those specific exceptions do not include whether a controlling partner's statute of limitations is open or a partner has agreed to extend its statute of limitations.[13]

1. *Legislative History Does Not Support Determining the Statute of Limitations at the Partner Level*

The legislative history of Section 6235 further confirms that Congress intended the statute of limitations for partnership adjustments to be determined exclusively at the partnership level.[14] When Congress revised certain provisions of the Centralized Audit Rules after their enactment, it chose not to add a partner-level statute of limitations, even though it addressed other statute of limitations issues.[15] As part of the Tax Technical Corrections Act of 2018 ("TTCA"), Congress

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[9] Section 6221(a) (emphasis added).

[10] *Badaracco v. Comm'r*, 464 U.S. 386, 391–92 (1984) ("…even were we free to do so, there is no need to twist § 6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy….").

[11] *United States v. Brockamp*, 519 U.S. 347, 350 (1997).

[12] *Lamie v. U.S. Trustee*, 540 U.S. 526, 542 (2004) ("If Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent.").

[13] *See* Section 6235(b) (extension by agreement) and Section 6235(c) (fraud).

[14] The legislative history summarizes the statute of limitations rules and never suggests an exception if the partner's statute of limitations is open or the partner agreed to an extension. STAFF OF THE JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX LEGISLATION ENACTED IN 2015 (JCS-1-16), at 75–76 (2016). Instead, the legislative history makes clear that it is the *partnership* that "may consent to an extension of time within which a partnership adjustment may be made." *Id*. at 75. Further, the legislative history reiterates that under the Centralized Audit Rules, any partnership adjustments are "determined at the *partnership level*" and "[a]ny tax attributable to these items is assessed and generally is collected at the *partnership level*." *Id*. at 62 (emphasis added).

[15] Corrections were made to the Centralized Audit Rules by the Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, § 411, 129 Stat. 2241 (2015), effective as if included in the BBA. Additional corrections and modifications were made by the TTCA included in the Consolidated Appropriations Act, 2018, Pub. L. No. 115-66, Div. U, Title II, 132 Stat. 348 (2018), effective as if included in the BBA.

explicitly addressed special statutes of limitations for taxes imposed by a chapter other than Chapter 1 in the same Section of the Code that includes special enforcement provisions.[16] The TTCA also fixed a statute of limitations glitch that would have allowed the IRS to issue a NOPPA to revive an otherwise closed statute of limitations.[17] Despite Congress's focus on statute of limitations issues in the technical corrections, Congress declined to enact any provision to alter the rule in Section 6235 that the statute of limitations for partnership adjustments is determined exclusively at the partnership level.

2. *Preamble Does Not Support Departing from the Statute*

The preamble to the Proposed Regulations suggests that IRS resource issues in partner-level audits and tiered partnership structures present "special enforcement considerations" under Section 6241(11)(B)(vi) that justify application of a partner-level statute of limitations for partnership adjustments in certain circumstances. Specifically, the preamble states that Proposed Regulation Section 301.6241-7(f) is necessary because certain "partnership issues may only become apparent at a future date or during an examination of a partner, which can frustrate the IRS's ability to allocate resources and examine taxpayers timely, especially in situations where the partnership structure includes many related and controlled entities."[18] Therefore, the preamble argues for a partner-level statute of limitations to carry out the results of audits of complex multi-tiered partnership structures.[19]

We respectfully suggest that the "special enforcement considerations" in the preamble do not warrant extending the statute of limitations by regulation, particularly when such regulation appears inconsistent with the statute and its related legislative history. We respectfully note that the statute and related legislative history do not suggest that control or a partner's agreement to extend its statute of limitations should result in a longer limitations period for partnership adjustments. As courts have recognized, "[s]tatutes of limitation frequently involve some hardship, but the alleviation of that hardship is a matter of policy for the Congress."[20]

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[16] *See* Section 6241(9).

[17] Prior to the amendment by the TTCA, the time period when a NOPPA must be issued was not specified. The TTCA amended Section 6231(b)(1) to provide that any NOPPA must be issued within the three-year period in Section 6235(a)(1). TTCA, Pub. L. No. 115-66, Div. U, Title II, 132 Stat. 348 (2018). Therefore, the NOPPA must be issued within three years of the later of the date the partnership return was filed, the date the return was due, or the date the partnership filed an AAR. Section 6231(b)(1). As a result, the IRS cannot issue a NOPPA to revive an otherwise closed statute of limitations. STAFF OF THE JOINT COMM. ON TAX'N, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE HOUSE AMENDMENT TO THE SENATE AMENDMENT TO H.R. 1625 (JCX-6-18), at 40 (2018).

[18] Preamble to Prop. Treas. Reg. Section 301.6241-7(f), 85 Fed. Reg. 74,940 (Nov. 24, 2020).

[19] Preamble to Prop. Treas. Reg. Section 301.6241-7(f), 85 Fed. Reg. 74,940 (Nov. 24, 2020).

[20] *Kreiger v. United States*, 539 F.2d 317, 322 (3d Cir. 1976); *see also Rothensies v. Electric Storage Battery Co.,* 329 U.S. 296, 300 (1946) (citing *Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 314 (1937)) (Statutes of limitations "…are by definition arbitrary, and their operation does not discriminate between the just and unjust claim, or the [a]voidable and unavoidable delay.").

In addition, the issues surrounding multi-tiered partnership structures were a significant impetus for enacting the Centralized Audit Rules, and Congress chose not to enact a partner-level statute of limitations despite its familiarity with the issues presented by such structures.[21] Proposed Regulation Section 301.6241-7(f) is not limited to tiered partnerships, but rather applies any time a partner controls a partnership or any time a partner (even a direct partner) extends its period of limitations and includes partnership adjustments in that extension. Thus, the application of Proposed Regulation Section 301.6241-7(f) extends well beyond the tiered partnership structures that present the "special enforcement considerations" discussed in the Preamble.

C. Recommendation

We respectfully recommend that the Proposed Regulations be amended to strike Proposed Regulation Section 301.6241-7(f).

III. EFFECTIVE DATE OF RULE THAT QSUBS ARE NOT ELIGIBLE PARTNERS

A. Background and Proposed Regulation

Partnerships with fewer than 100 partners may generally elect out of the Centralized Audit Rules if all of the partners are "eligible partners" (*e.g.*, individuals or corporate partners).[22] Proposed Regulation Section 301.6221(b)-1(b)(3)(ii)(G) provides that a qualified subchapter S subsidiary ("QSub") is not an eligible partner for purposes of the election out of the Centralized Audit Rules. This provision is proposed to be effective for partnership tax years ending after November 20, 2020.[23]

B. Discussion

The parent of a QSub, an S corporation, is deemed to directly own all of the assets, liabilities, and other tax items of its QSub subsidiaries. The proposed regulations therefore treat a QSub like a disregarded entity and not an eligible partner. While IRS Notice 2019-06 foreshadowed this treatment, it also notified taxpayers that the regulations would nevertheless allow certain partnerships with a QSub partner to make the election out of the Centralized Audit Rules.[24] However, the Proposed Regulations do not allow any partnerships with a QSub partner to elect out. As a result, at the time the Proposed Regulations were published in the Federal Register, the opportunity for partnerships with QSub partners to restructure in order to retain the ability to opt out of the Centralized Audit Rules was already foreclosed.

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[21] STAFF OF THE JOINT COMM. ON TAX'N, DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2016 BUDGET PROPOSAL (JCS-2-15), at 264 – 66 (2015) (Explaining that the Centralized Audit Rules are intended to address several of the difficulties under TEFRA including those that arise "in the case of tiered partnerships or partnerships with other types of passthrough partners.").

[22] Section 6221(b)(1).

[23] Prop. Reg. Section 301.6221(b)-1(f).

[24] Notice 2019-06, 2019-3 I.R.B. 350.

C. Recommendation

We respectfully recommend that Proposed Regulation Section 301.6221(b)-1(f) be amended to provide that (b)(3)(ii)(G) is effective for partnership tax years ending after the date the regulations are finalized and published in the Federal Register. This will allow partnerships with QSub partners sufficient time to restructure if they would like to be eligible to elect out of the Centralized Audit Rules for the tax year when the Proposed Regulations become effective.

IV. PARTNERSHIP ADJUSTMENTS IN PARTNER-LEVEL AUDIT

A. Proposed Regulation

Proposed Regulation Section 301.6241-7(b) allows the IRS to make an adjustment to a partnership-related item during the audit of a partner (as opposed to the partnership) if the partnership-related item is based in whole or in part on information provided by the partner. The Proposed Regulations illustrate this provision with a lengthy example (the "Example").[25]

This provision is proposed to be effective retroactively, as it applies to partnership tax years beginning after December 20, 2018.[26]

B. Discussion

We respectfully suggest that the scope of this rule is unclear because there is no clear indication of when the IRS can trigger this provision and avoid the Centralized Audit Rules with no notice to the partnership. The only apparent limitation is that the treatment of the partnership-related item must be "based in whole or in part on information provided by the person whose return is being examined."[27] We respectfully note that the "in part" language is vague and could be construed to encompass a wide variety of partnership-related items. As explained above, making partnership adjustments in a partner-level audit appears inconsistent with Congress's clear directive that partnership adjustments be determined "at the partnership level."[28] Therefore, we respectfully suggest that any departure from the Centralized Audit Rules should be as narrowly prescribed as possible, and should be available only in circumstances where there is a clear justification for the departure.

The Example addresses the sale of a partnership interest by A to B. A originally acquired its partnership interest by contributing an asset to the partnership.[29] When auditing A, the IRS adjusts the basis of the partnership asset. First, we respectfully note that it is unclear why the partnership adjustment is made in the Example. Proposed Regulation Section 301.6241-7(h)(2) provides that any partnership adjustments that are made outside of the Centralized Audit Rules are

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[25] Prop. Reg. Section 301.6241-7(b)(2).

[26] Prop. Reg. Section 301.6241-7(j)(2).

[27] Prop. Reg. Section 301.6241-7(b)(1)(iii).

[28] Section 6221(a) (emphasis added).

[29] Prop. Reg. Section 301.6241-7(b)(2).

not binding on any person that is not a party to the proceeding. In the Example, only A was a party to the proceeding, and A is no longer a partner in the partnership. Therefore, under Proposed Regulation Section 301.6241-7(h)(2), the partnership adjustment is not binding on any of the partners in the partnership.

Second, assuming the partnership adjustment is binding on the partners in the partnership (contrary to Proposed Regulation Section 301.6241-7(h)(2)), the Example does not explain how a Section 754 election would interact with the adjustment to the partnership asset made during A's audit. If a Section 754 election was in effect when A sold its interest to B, the partnership's basis in the asset would have been adjusted to fair market value under Section 743 as to B. This adjustment recognizes that A was taxed on the gain on the sale of its partnership interest and that B should not be taxed again on the same gain. We respectfully suggest that, when auditing A, the IRS should not be able to adjust the basis of the asset at the partnership level and "undo" the Section 754 election. The adjustment at the partner level results in additional gain that is taxed to A. The Section 754 election already adjusted the basis of the asset at the partnership level to its fair market value as to B.

We respectfully suggest further that the retroactivity of Proposed Regulation Section 301.6241-7(b) is unnecessary because the partnership-level statute of limitations has not run for tax years beginning after December 20, 2018. Therefore, the IRS can open a partnership-level audit to make the adjustment to the partnership-related item if warranted.

C. Recommendations

We respectfully recommend that the Proposed Regulations be amended to strike Proposed Regulation Section 301.6241-7(b) because it appears inconsistent with the purpose of the Centralized Audit Rules. If Proposed Regulation Section 301.6241-7(b) is retained, we respectfully recommend that the Example be revised to (i) clarify that the partnership did not have a Section 754 election in effect and that if it did, the partnership's basis in the asset would not be adjusted and (ii) include a description of the application of Proposed Regulation Section 301.6241-7(h)(2) in connection with the Example. We also respectfully recommend that Proposed Regulation Section 301.6241-7(b), if retained, not be retroactive but be subject to the same effective date of the other special enforcement matters under Proposed Regulation Section 301.6241-7(j)(1).

V. NON-INCOME ADJUSTMENTS THAT DO NOT RESULT IN AN IMPUTED UNDERPAYMENT

A. Background and Proposed Regulation

Section 6225(a)(2) provides that adjustments that do not result in an imputed underpayment shall be taken into account by the partnership in the adjustment year. Proposed Regulation Section 301.6225-3(b)(8) provides that non-income adjustments (*i.e.*, adjustments to non-income items, such as partnership assets, liabilities, and capital accounts) are taken into account by adjusting the item on the partnership's adjustment year return but only to the extent the item would appear on the adjustment year return without regard to the adjustment. The Proposed Regulations provide an example in which the IRS conducts an audit in 2022 of a partnership's 2020 tax year

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and adjusts the basis of a partnership asset by $10. The example includes this positive adjustment and a negative adjustment to credits when determining whether an imputed underpayment results. Because the adjustments do not result in an imputed underpayment, "the partnership takes into account the $10 adjustment to Asset on its 2022 return by reducing its basis in Asset by $10."[30]

B. Discussion

In the example, the non-income adjustment is included as a positive adjustment under Treasury Regulation Section 301.6225-1(d)(2)(iii)(A) in determining whether there is an imputed underpayment. Including this non-income adjustment in the imputed underpayment determination as a positive adjustment could result in the recognition of gain on an asset before the asset has been disposed of or sold. We respectfully suggest such a result is inconsistent with general federal income tax principles that gain or loss on an asset is not taken into account until there has been a realization event that results in the recognition of gain or loss.[31]

In addition, we respectfully note that treating the basis adjustment as a positive adjustment may lead to double taxation under Proposed Regulation Section 301.6241-7(b). Consider for example a partner-level audit in which the IRS determines that a partner's basis in a contributed asset was $30 rather than $50, and therefore there is an additional $20 of gain on the partner's sale of her partnership interest. Under Proposed Regulation Section 301.6241-7(b), the IRS can also adjust the partnership's basis in the contributed asset from $50 to $30. This $20 non-income adjustment is treated as a positive adjustment that would give rise to an imputed underpayment because there are no negative adjustments that could offset the positive adjustment. As a result, the partner would pay tax on the $20 of additional gain on the sale of the partnership interest, and the partnership would pay tax on the $20 basis adjustment in an imputed underpayment. We respectfully suggest that the IRS and Treasury consider either (i) excluding non-income adjustments from the computation of the imputed underpayment entirely or (ii) treating the amount of the adjustment as zero. Either approach avoids both the acceleration of gain when there has been no realization and recognition event and the potential double taxation under Proposed Regulation Section 301.6241-7(b).

We also respectfully note that it is not clear whether the positive adjustment in the example only corrects the asset's basis in 2022 or whether the partnership must also realize and recognize gain on the $10 positive adjustment in 2022 (the adjustment year). We respectfully suggest that requiring the partnership to realize and recognize gain on the $10 basis adjustment in the adjustment year would be inconsistent with general federal income tax principles that do not tax gain or loss until there has been a realization event that results in the recognition of gain or loss.[32]

C. Recommendations

We respectfully recommend that the Proposed Regulations be revised to provide that non-income adjustments are not taken into account in determining whether there is an imputed

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[30] Prop. Reg. Section 301.6225-3(d)(Ex. 3).

[31] Section 1001(a), (c).

[32] *Id*.

underpayment. Further, we respectfully recommend that when these non-income adjustments are made in the adjustment year, the item is corrected but gain is not recognized until the partnership would otherwise recognize gain. We also respectfully recommend that the cross-references in the example be revised to refer to Treasury Regulation Section 301.6225-1(d)(2) and 301.6225-1(f) in their entirety. In addition, we respectfully recommend that the Proposed Regulations include examples illustrating how adjustments to other non-income items like partnership liabilities and capital accounts are taken into account.

VI. CHAPTER 1 PENALTIES AND TAXES IMPOSED ON THE PARTNERSHIP

A. Proposed Regulation

Proposed Regulation Section 301.6241-7(g) allows the IRS to make adjustments outside of the Centralized Audit Rules to any Chapter 1 tax, penalties, additions to tax, or additional amounts imposed on the partnership and for which the partnership (as opposed to the partners) are liable. This provision also allows the IRS to adjust any partnership-related item as part of that determination.[33]

B. Discussion

Congress intended for the Centralized Audit Rules to apply to all Chapter 1 taxes, which include all normal taxes and surtaxes (Sections 1 through 1400Z-2). Such Chapter 1 taxes, penalties, and additions to tax are imposed on partners, not partnerships.[34] Additionally, Treasury Regulation Section 301.6241-6 already addresses taxes outside of Chapter 1. Thus, we respectfully suggest that the purpose and scope of this provision are unclear.

C. Recommendations

We respectfully recommend that Proposed Regulation Section 301.6241-7(g) be amended to make its purpose and scope clearer and that examples be added.

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[33] Prop. Reg. Section 301.6241-7(g).

[34] *See, e.g.*, Section 701 (expressly states that "[a] partnership as such shall not be subject to the income tax imposed by this chapter…" and instead the "…partners shall be liable for income tax only in their separate or individual capacities.").