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October 8, 2021

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments Concerning BBA Special Enforcement Matters

Dear Commissioner Rettig:

Enclosed please find comments on the Proposed Regulations with respect to the BBA Special Enforcement Matters. These comments are submitted on behalf of the Section of Taxation and have not been reviewed or approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Julie A. Divola
Chair, Section of Taxation

Enclosure

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Mark Mazur, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Natasha Goldvug, Attorney-Advisor, Department of the Treasury
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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments Concerning the Proposed Regulations Regarding BBA Special Enforcement Matters

These comments ("**Comments**") are submitted on behalf of the American Bar Association Section of Taxation (the "**Section**") and have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments for the Administrative Practice Committee was exercised by Rochelle Hodes. Significant contributions were made by Gregory Armstrong, Andrew Brewster, Matthew Cooper, Mitchell Horowitz, Oliver Jackson, Samuel Lapin, Clint Massengill, Lee Meyercord, Mary I. Slonina, and Kevin Stults of the Administrative Practice Committee, as well as Ira Aghai, Ossie Borosh, Matthew Lay, and Sandy Xu of the Partnerships and LLCs Committee. These Comments have been reviewed by John Colvin of the Committee on Governmental Submissions, and Kurt Lawson, Vice Chair for Government Relations.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of, one or more specific issues addressed by these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section's diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: October 8, 2021

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Executive Summary

These Comments are in response to proposed regulations published on November 24, 2020 (the "**Proposed Regulations**"),[1] under section 6241(11),[2] which was enacted as part of the technical corrections[3] to the Bipartisan Budget Act of 2015 (as amended, the "**BBA**").[4] Specifically, these comments include the below-listed recommendations.

With respect to the special enforcement matters:

- We recommend withdrawing Prop. Treas. Reg. § 301.6241-7(b), although we also offer several clarifications as alternatives.
- We recommend withdrawing Prop. Treas. Reg. § 301.6241-7(f) and (g).
- We recommend revising Prop. Treas. Reg. § 301.6241-7(c), (d), and (e) to conform more closely to the special enforcement regulations adopted pursuant to the Tax Equity and Fiscal Responsibility Act of 1982 ("**TEFRA**").[5]
- We recommend applying the regulations under Prop. Treas. Reg. § 301.6241-7 to "items" rather than "adjustments."

With respect to the "cease-to-exist" rules:

- We recommend providing guidance on section 6232(f) before finalizing the proposed changes to Treas. Reg. § 301.6241-3.
- We recommend clarifying the circumstances under which doubts about collectability may result in a determination that the partnership ceases to exist.
- We recommend retaining the existing definition of when adjustments take effect.
- We recommend eliminating the proposed change to the definition of former partners.
- We recommend that the Internal Revenue Service (the "**Service**") add regulatory language, confirming that a partnership that ceases to exist still can request modification of the imputed underpayment, push out the adjustments, and/or pay the imputed underpayment.

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[1] Notice of Proposed Rulemaking, Treatment of Special Enforcement Matters, 85 Fed. Reg. 74,940 (Nov. 20, 2020).

[2] Unless otherwise specified, all "**section**" and "**§**" references are to the Internal Revenue Code of 1986, as amended (the "**Code**" or "**I.R.C.**"), all "**Treas. Reg. §**" references are to the Treasury Regulations promulgated thereunder, and all "**Prop. Treas. Reg. §**" references are to the proposed regulations promulgated thereunder, all as in effect (or, in the case of proposed regulations which remain outstanding, as proposed) as of the date of these Comments.

[3] Tax Technical Corrections Act of 2018 ("**TTCA**"), contained in the Consolidated Appropriations Act of 2018, Pub. L. No. 115-141, Division U, Title II, 132 Stat. 348, 1171.

[4] Pub. L. No. 114-74, 129 Stat. 584 (2015).

[5] Pub. L. No. 100-647, 96 Stat. 324.

With respect to the rules governing adjustments to an item that is not an item of income, gain, loss, deduction or credit:

- We recommend disregarding adjustments to non-income items in computing the imputed underpayment.
- We recommend removing the non-imputed underpayment adjustment rule in Prop. Treas. Reg. § 301.6225-3(b)(8).

We recommend removing the non-704(b) item rule in Treas. Reg. § 301.6225-1(d)(2)(iii)(B).

With respect to imputed underpayment computations in the administrative adjustment request context:

- We recommend removing the requirement to include an imputed underpayment computation with an administrative adjustment request.
- We recommend adopting a dedicated form for computing an imputed underpayment.
- We recommend that net negative adjustments to the credit grouping be allowed to reduce the imputed underpayment.

We recommend clarifying the rules relating to adjustments to a partnership's imputed underpayment and chapter 1 taxes and penalties for which the partnership is liable.

Lastly, we recommend applying the Proposed Regulations prospectively after they are finalized.

Background

I. Overview of the BBA

The BBA provides rules under subchapter C of chapter 63 of the Code for a centralized partnership audit regime. These rules generally are effective for partnership taxable years beginning on or after January 1, 2018. They replace the TEFRA and electing large partnership audit rules. Section 6241(11) provides the Secretary of the Treasury (the "**Secretary**") with authority to publish regulations to address special enforcement matters under the BBA.

Like its predecessor, the TEFRA partnership audit rules, the BBA centralized partnership audit regime rules provide the Service with streamlined procedures to audit income tax items of partnerships. Prior to the enactment of TEFRA in 1982, the Service could adjust partnership items only by examining the tax return of each partner and assessing and collecting any tax due from that partner under the deficiency procedures set forth in subchapter B of chapter 63 of the Code (the "**deficiency procedures**"). Litigation and collection under the deficiency procedures was a partner-by-partner

endeavor.[6] The TEFRA rules generally applied to partnerships other than small partnerships,[7] while the deficiency procedures continued to apply to non-TEFRA partnerships.

Both TEFRA and the BBA allow the Service to determine adjustments at the partnership level, eliminating the need to examine each individual partner to determine the correct treatment of partnership (or partnership-related) items. Despite allowing the Service to make adjustments to partnership items at the entity level, TEFRA still required the Service to assess and collect any tax due from each partner. The new BBA regime provides that any tax due is also assessed and collected at the partnership-level, though the partnership can shift the tax liability to the ultimate partners by making a "push out" election under section 6226.

Both TEFRA and the BBA provide that their respective procedures apply to the exclusion of the Code's usual deficiency procedures.[8] Which set of procedural rules apply (*i.e.,* deficiency, TEFRA, or BBA) determines whether examination, assessment, and collection is at the partnership level or the partner level. It also determines which rights, protections, and deadlines apply, including how to adjust already-filed partnership returns, the period of limitations to make adjustments and assessments, restrictions on adjustments and assessments, and how to seek redress in court.

Proceeding under the incorrect procedures can have severe consequences. If the Service or a taxpayer uses the wrong set of procedures, any adjustment or assessment of tax will be null and void. In addition, once the Service or the taxpayer realizes its error, the opportunity to make an adjustment or assessment under the correct procedures will be foreclosed if the applicable period of limitations under the correct procedure has expired.

Section 6221(a) provides that the BBA applies to "any adjustment to a partnership-related item." A "partnership-related item" is broadly defined in section 6241(2)(B) as follows:

> (i) Any item or amount with respect to the partnership (without regard to whether or not such item or amount appears on the partnership's return and including an imputed underpayment and any item or amount relating to any transaction with, basis in, or liability of, the partnership) which is relevant (determined without regard to [the BBA]) in determining the tax liability of any person under chapter 1, and

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[6] *See* Arthur B. Willis, John S. Pennell & Philip F. Postlewaite, Partnership Taxation ¶ 20.01 [2] (6th ed. 1999).

[7] *See* I.R.C. § 6231(a)(1)(B) prior to its amendment by the BBA. A small partnership is defined as a partnership with 10 or fewer partners each of whom is an individual (but not a nonresident alien), a C corporation, or an estate of a deceased partner. For purposes of the preceding sentence, spouses (and their estates) are treated as one partner. A small partnership can elect to apply the rules under TEFRA.

[8] *See* I.R.C. § 6211(c), as well as I.R.C. § 6211(c), prior to its amendment by the BBA.

(ii) any partner's distributive share of any item or amount described in clause (i).

Under the BBA, the tax due at the partnership level is referred to as the "imputed underpayment" (sometimes "**IU**"). Under section 6225 and the regulations thereunder, the imputed underpayment generally is determined by appropriately netting[9] all partnership adjustments, multiplying that amount by the highest rate of tax applicable to individuals or corporations for the reviewed year, and increasing or decreasing, as appropriate, the product by adjustments to credits. The regulations provide a seven-step process for computing the imputed underpayment, including rules for grouping and subgrouping adjustments and netting. Certain modifications may be requested, or in the case of an administrative adjustment request ("**AAR**")[10] applied, to reduce the imputed underpayment.

Neither the statute nor the legislative history defines the term "appropriately netting," although the Joint Committee on Taxation's ("**JCT**") explanation provides examples.[11] Further, nothing in the JCT explanation states that appropriate netting requires that *every* adjustment to a partnership-related item must be taken into account when computing the imputed underpayment. The regulations under section 6225 provide rules and limitations for netting adjustments within each grouping or subgrouping that generally are based on the examples and discussion in the JCT explanation.[12]

For purposes of determining an imputed underpayment, any adjustment that is a decrease in income (or is treated as a decrease in income) is a "**negative adjustment**." An increase in an item of credit is treated as a negative adjustment. Any adjustment that is not a negative adjustment is a "**positive adjustment**." A "**net positive adjustment**" refers to an amount that is greater than zero that results from netting within a grouping or subgrouping. A net positive adjustment includes a positive adjustment that is not netted with any other adjustment. A "**net negative adjustment**" refers to an amount that results from netting within a grouping or subgrouping that is not a net positive adjustment. A net negative adjustment includes a negative adjustment that is not netted with any other adjustment. Under the imputed underpayment determination rules, a net positive adjustment generally has the effect of increasing the amount of an imputed underpayment.

Treas. Reg. § 301.6225-1(b)(4) provides a special rule to prevent double-counting adjustments as inputs in the IU computation (the "**zero-adjustment rule**"). Specifically, Treas. Reg. § 301.6225-1(b)(4) provides that:

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[9] I.R.C. § 6225(b)(1)(A); Treas. Reg. § 301.6225-1(b).

[10] To correct errors on partnership-related items, partnerships under the BBA must file an AAR instead of an "amended return."

[11] 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) ("**JCX-6-18**"), at 39-40 (2018).

[12] Treas. Reg. § 301.6225-1(c)-(e).

If the effect of one partnership adjustment is reflected in one or more other partnership adjustments, the IRS may treat the one adjustment as zero solely for purposes of calculating the imputed underpayment.

Treas. Reg. § 301.6225-1(c)(5)(ii) provides that the residual grouping (used to compute the imputed underpayment) includes any adjustment to a partnership related-item that derives from an item that would not have been required to be allocated by a partnership to a reviewed year partner under section 704(b). Treas. Reg. § 301.6225-1(d)(2)(iii)(B) provides that an adjustment to a partnership-related item that derives from an item that would not have been required to be allocated to a reviewed year partner under section 704(b) and that could result in an increase in income or decrease in loss, deduction, or credit for any person without regard to any person's particular circumstances, is treated as a positive adjustment to income or credit (the "**non-704(b) item rule**").

In lieu of paying an imputed underpayment, a partnership generally may make an election under section 6226 to push out the adjustments associated with the imputed underpayment to its reviewed year partners. A direct or indirect partner that is a pass-through partner[13] (which generally includes partnerships, S corporations, non-grantor trusts, and estates of a decedent) must either push the adjustments out to its partners, shareholders, or beneficiaries for the reviewed year or compute and pay an imputed underpayment based on its share of the adjustments.[14]

The imputed underpayment determination rules under section 6225 apply in the context of both a Service examination and an AAR under section 6227. These rules also might apply in the case of a push out election (in an examination or an AAR) where a reviewed year partner that is a pass-through partner computes and pays an imputed underpayment.[15]

Certain adjustments ("**non-IU adjustments**") do not result in an imputed underpayment. Non-IU adjustments include net negative adjustments. In addition, all adjustments taken into account in determining the imputed underpayment will be treated as non-IU adjustments if the imputed underpayment computation results in an amount that is zero or less than zero. In the case of a BBA examination, non-IU adjustments associated with an imputed underpayment may be pushed out to reviewed year partners, while non-IU adjustments that are not associated with an imputed underpayment must be allocated to partners in the adjustment year in accordance with Treas. Reg. § 301.6225-3. However, Treas. Reg. § 301.6225-1(e)(3)(ii) provides that credits resulting in a net negative adjustment generally must be pushed out unless the Service determines that the net negative adjustment can be taken into account in the computation of an imputed

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[13] *See* Treas. Reg. § 301.6241-1(a)(5).

[14] *See* Treas. Reg. § 301.6226-3(e)(4)(i).

[15] Treas. Reg. §§ 301.6226-3(e)(4), 301.6227-3(c)(1).

underpayment. In the case of an AAR, non-IU adjustments *must* be pushed out to reviewed-year partners.

II. Guidance

On January 2, 2018, the Department of the Treasury ("**Treasury**") and the Service published final regulations on electing out of the BBA regime.[16] They published final regulations on the designation and authority of the partnership representative and the election to apply the BBA early on August 4, 2018.[17] They published final regulations implementing the remainder of the BBA regime on February 27, 2019.[18]

On January 14, 2019, Treasury and the Service released Notice 2019-06[19] to inform taxpayers that future proposed regulations would be implemented with respect to the special enforcement matters under section 6241(11). Specifically, the notice identified two items that the Secretary had determined involved special enforcement matters and were necessary for the effective and efficient enforcement of the Code. The first matter involved certain situations in which an adjustment during an examination of a person other than the partnership requires a change to a partnership-related item. The second matter involved situations where a qualified S corporation subsidiary ("**QSub**") is a partner in a partnership.

On November 24, 2020, Treasury and the Service published the Proposed Regulations to implement the authority under section 6241(11) to prescribe regulations for special enforcement matters. The Proposed Regulations also include revisions to current BBA regulations relating to electing out of the regime, the imputed underpayment, and treatment of partnerships that "cease to exist."

The Section offers these Comments on the Proposed Regulations for your consideration as the Proposed Regulations are being finalized. We would be pleased to discuss these Comments further upon request.

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[16] 83 Fed. Reg. 24 (Jan. 2, 2018).

[17] 83 Fed. Reg. 39,331 (Aug. 9, 2018).

[18] 84 Fed. Reg. 6468 (Feb. 27, 2019). While these regulations incorporated many of the changes made by TTCA, they did not address newly enacted provisions under section 6241(11) (relating to special enforcement) and section 6232(f) (relating to failure to pay the imputed underpayment).

[19] 2019-03 I.R.B. 353.

Comments

I. Special Enforcement Matters

A. Background

1. Section 6241(11)

Section 6241(11) provides that, in the case of partnership-related items that involve special enforcement matters, the Secretary may prescribe regulations pursuant to which (i) subchapter C of chapter 63 of the Code (or a portion thereof) does not apply to such items and (ii) such items are subject to special rules as the "Secretary determines to be necessary for the effective and efficient enforcement of [the Code]." Under section 6241(11)(B), the term "special enforcement matter" includes termination and jeopardy assessments, criminal investigations, indirect methods of proof of income, foreign partners or partnerships, and matters that the Secretary determines by regulation present "special enforcement considerations." The special enforcement matters listed in subsection 6241(11)(B) generally are the same as the TEFRA special enforcement areas described in former section 6231(c).[20] The JCT's explanation of section 6241(11) states that the provision provides "regulatory authority similar to that under the prior-law TEFRA partnership audit rules."[21]

2. Effect of Special Enforcement Rules

Generally, partnership-level proceedings are simpler for the Service than partner-level proceedings, meaning that it is more difficult for the Service to make partnership adjustments under the deficiency procedures, and easier for the Service to make partnership adjustments under the BBA. However, there are certain circumstances where it might be more appropriate for the Service to proceed directly against a single partner, rather than being required to open an examination of the entire partnership. Therefore, iprovisions under both the TEFRA and the BBA regimes permit the Service to "turn off" the partnership-level procedures in certain situations and proceed directly against a partner under the deficiency procedures.[22]

The ability of the Service to "turn off" one set of procedural rules and proceed under a different set of procedural rules can have significant consequences. Section 6241(11) understandably limits this authority by requiring that (i) the rules, including designation of other matters not specifically listed in the statute that present special

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[20] Regulations under section 6231(c) of TEFRA identified the following five areas where special enforcement considerations were present and, therefore, partnership items are treated as non-partnership items: (i) termination and jeopardy assessments (Treas. Reg. § 301.6231(c)-4); (ii) criminal investigations (Treas. Reg. § 301.6231(c)-5); (iii) indirect method of proof of income (Treas. Reg. § 301.6231(c)-6); (iv) bankruptcy and receivership (Treas. Reg. § 301.6231(c)-7); and (v) prompt assessment (Treas. Reg. § 301.6231(c)-8).

[21] JCX-6-18 at 50.

[22] *Id.*

enforcement consideration, be set forth in regulations; and (ii) the Secretary determine that rules for special enforcement matters are "necessary for the effective and efficient enforcement of [the Code]."[23]

3. Notice 2019-06

Notice 2019-06 announced forthcoming regulations under section 6241(11) with respect to two special enforcement matters. The first special enforcement matter concerned "certain situations in which an adjustment during an examination of a person other than the partnership required a change to a partnership-related item." Regarding that matter, the notice stated that regulations would provide that the Service may determine that the BBA does not apply to adjustments to partnership-related items when the following conditions are met:

- The examination being conducted is of a person other than the partnership;
- A partnership-related item must be adjusted, or a determination regarding a partnership-related item must be made, as part of an adjustment to a non-partnership-related item of the person whose return is being examined; and
- The treatment of the partnership-related item on the return of the partnership or in the partnership's books and records was based in whole or in part on information provided by, or under the control of, the person whose return is being examined.

The second special enforcement matter concerned partnerships with a QSub partner. Regarding that matter, the notice stated that regulations would provide that generally a partnership with a QSub as a partner would generally not be eligible to elect out of the BBA regime. However, it stated that the regulations would provide rules similar to the rules applicable to partnerships with S corporations as partners, allowing partnerships with a QSub partner to elect out of BBA if certain requirements are met.

The notice stated that Treasury and the Service intended to make the regulations applicable at the latest to partnership taxable years beginning after December 31, 2017 (the general applicability date of the BBA), and ending after December 20, 2018.

4. Prop. Treas. Reg. § 301.6241-7

The Proposed Regulations would add a new Treas. Reg. § 301.6241-7 to implement the rules under section 6241(11) regarding the treatment of special enforcement matters. Prop. Treas. Reg. § 301.6241-7 identifies six special enforcement matters and describes the treatment of partnership-related items in each case:

- Under Prop. Treas. Reg. § 301.6241-7(b), partnership-related items underlying or related to non-partnership-related items can be adjusted in an examination of the

[23] Section 6231(c) of TEFRA contained a similar provision.

partner without having to make the adjustment in a partnership proceeding under the BBA. This was one of the special enforcement matters addressed by Notice 2019-06.

- Under Prop. Treas. Reg. § 301.6241-7(c), a termination or jeopardy assessment of a partner can include assessment of partnership-related items without having to make the adjustment in a partnership proceeding under the BBA.

- Prop. Treas. Reg. § 301.6241-7(d) allows the Service to adjust a partnership-related item of a partner that is under criminal investigation without having to make an adjustment in a partnership proceeding under the BBA.

- Under Prop. Treas. Reg. § 301.6241-7(e) a partnership-related item can be adjusted as part of a deficiency against a partner without having to make the adjustment in a partnership proceeding under the BBA if the deficiency is determined using indirect methods of proof of income.

- Under Prop. Treas. Reg. § 301.6241-7(f), if the period for making adjustments against the partnership has expired, the Service can make an adjustment to a partnership-related item against a related (under section 267(b) or 707(b)) partner if the period to make assessment against the partner is still open or if the partner agrees to extend the period in writing for this purpose.

- Treas. Reg. § 301.6241-7(g) identifies a partnership's liability for chapter 1 taxes, penalties and interest, and partnership-related items of a partnership as part of determining the amount and applicability of any penalty and interest as a special enforcement matter.

Prop. Treas. Reg. § 301.6241-7 does not include partnerships with a QSub partner as a special enforcement matter even though identified as such in Notice 2019-06. However, partnerships with a QSub partner are addressed in Prop. Treas. Reg. § 301.6221(b)-1, which covers eligibility to elect out of the BBA.

B. Recommendations

1. Withdraw Prop. Treas. Reg. § 301.6241-7(b).

Consistent with Notice 2019-06, Prop. Treas. Reg. § 301.6241-7(b) would identify a partnership-related item adjusted as part of an underlying adjustment to a non-partnership-related item as a special enforcement matter. This category of special enforcement matter would apply if:

> (i) An examination is being conducted of a person other than the partnership;
>
> (ii) A partnership-related item is adjusted, or a determination regarding a partnership-related item is made, as part of, or underlying, an

adjustment to a non-partnership-related item of the person whose return is being examined; and

(iii) The treatment of the partnership-related item on the partnership's return or in the partnership's books and records is based in whole or in part on information provided by the person whose return is being examined.[24]

For the reasons described below, we recommend not finalizing this special enforcement category.

i. Existing BBA provisions address same issues.

Prop. Treas. Reg. § 301.6241-7(b) would address a problem that other provisions of the BBA already address. Specifically, existing BBA provisions under section 6225, such as the modification provisions relating to partners filing amended returns and the alternative provisions under pull in,[25] and the push out mechanism under section 6226, already allow for the tax attributable to an adjustment that affects a single partner, or a limited number of partners, to be assessed and collected from such partner or partners. Because existing BBA rules already address the issues this proposed rule seeks to address, we believe the proposed regulation is not necessary.

In describing the situations that Treasury and the Service intend the Proposed Regulations to address, the preamble to the Proposed Regulations (the "**Preamble**") states that the Service anticipates invoking Prop. Treas. Reg. § 301.6241-7(b) "in cases in which the adjustments are likely only relevant to a single partner or a small group of partners," and the adjustments "are unlikely to involve items that are allocable to all partners generally or that impact the partnership as a whole."[26] Similarly, the Preamble notes that adjusting partnership-related items outside of the BBA regime in situations where "the number of partners potentially impacted by an adjustment is limited" does not implicate the inefficiency and inconsistency concerns the BBA was designed to address. Specifically, the Preamble states that:

Adjusting the partnership-related items in direct examinations of those partners does not raise inefficiency or inconsistency concerns that the centralized partnership audit regime is designed to alleviate. As a result, it may be a more efficient use of both IRS and taxpayer resources to

[24] Prop. Treas. Reg. § 301.6241-7(b)(1).

[25] Treas. Reg. § 301.6225-2(d)(2).

[26] Preamble, 85 Fed. Reg. at 74,947.

examine and adjust that partnership-related item in an examination of the person who provided this information.[27]

In BBA proceedings, unlike TEFRA proceedings, the Service is not limited to determining a single imputed underpayment, but rather may determine multiple imputed underpayments.[28] Treas. Reg. § 301.6225-1(g)(2)(iii) permits the Service to designate a specific imputed underpayment on the basis of certain adjustments where such adjustments are "allocated to one partner or a group of partners that had the same or similar characteristics or that participated in the same or similar transaction" or on such other basis as the Service "determines properly reflects the facts and circumstances."[29] The preamble to the Notice of Proposed Rulemaking on the Centralized Partnership Audit Regime,[30] first announcing the rule under Treas. Reg. § 301.6225-1(g), provided the following example to illustrate the specific imputed underpayment rule:

> For example, if a partnership intends to elect the alternative to payment of an imputed underpayment under section 6226 and the regulations thereunder, and, based on the appropriate allocable shares, a particular adjustment should be allocated to one partner or group of partners, the IRS could separate that adjustment into a separate imputed underpayment, called a specific imputed underpayment. The partnership could then elect to apply the rules under section 6226 to the specific imputed underpayment for which a single partner or group of partners would be responsible and the partnership could pay the general imputed underpayment at the partnership level.[31]

Because there already is a mechanism in Treas. Reg. § 301.6225-1(g) for the Service to make, efficiently, an adjustment that involves a single or limited number of partners, we believe that Prop. Treas. Reg. § 301.6241-7(b) is redundant and, therefore, not necessary.

Separately, we believe that the efficiencies and objectives described in the Preamble to support Prop. Treas. Reg. § 301.6241-7(b) are not necessarily consistent with the foundational principles underlying the centralized nature of the BBA, *i.e.,* that as a default the partnership is liable for any tax due as a result of adjusting partnership-related items. Adjusting partnership-related items and assessing and collecting the tax from those adjustments from the partnership, as represented by the partnership representative,

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[27] *Id.* We believe that this rationale does not meet the standard in section 6241(11) for when a special enforcement matter is appropriate. That standard requires Treasury to determine that special rules are *necessary* for the effective and efficient enforcement of the Code. We believe that requirement is not satisfied merely by determining that they do not "raise inefficiency or inconsistency concerns."

[28] Treas. Reg. § 301.6225-1(g)(1).

[29] Treas. Reg. § 301.6225-1(g)(2)(iii)(A).

[30] 82 Fed. Reg. 27,334 (June 14, 2017).

[31] *Id.* at 27,351-52.

is at the heart of the BBA regime. Where the basic BBA rules would create inefficiency, there are special rules, like specific imputed underpayments modification, and the push out of adjustments, that should sufficiently address concerns of efficiency in most cases. While enabling partners "to more fully control and participate" in the adjustment of partnership-related items could be a desirable objective for partners in certain cases, it is not consistent with the underlying principles of the BBA regime and potentially undermines the authority of the partnership representative.

ii. Prop. Treas. Reg. § 301.6241-7(b) is unnecessarily broad.

Given the broad definition of a partnership-related item under Treas. Reg. § 301.6241-1(a)(6), and the inter-related nature of how such items are reflected on a partnership return, it often can be the case that an adjustment to one item on a partner's return can form part of, lead to, result in, or underlie an adjustment to another item on that return, which could include a partnership-related item.

This is more likely to occur where the partnership's treatment of the partnership-related item on the partnership's return, or in its books and records, is "based on" information provided by the partner. In this way, the requirements in prongs (ii) and (iii) under Prop. Treas. Reg. § 301.6241-7(b)(1) often would overlap – that is, if the partnership's treatment of a partnership-related item is based on information provided by the partner, it stands to reason that an adjustment to that item will often "underlie" an adjustment to the partner's non-partnership-related item. Given that each prong could apply even where the partnership's treatment of the item is only based "in part" on information provided by the partner, the likelihood of both provisions being triggered seems high.[32]

The broad scope of the potential applicability of Prop. Treas. Reg. § 301.6241-7(b) becomes even more apparent when compared with the other provisions in Prop. Treas. Reg. § 301.6241-7. For instance, subsections (c), (d), and (e) of that section concern jeopardy and termination assessments, criminal investigations, and indirect methods of proof of income, respectively. There are specific, established procedures unique to each type of matter contemplated by those subsections, and both the Service and taxpayers have experience in applying and following those procedures. We believe that the breadth of subsection (b) stands in stark contrast to the clear and relatively narrow parameters for the application of those subsections.

iii. Clarify Prop. Treas. Reg. § 301.6241-7(b) if it is not withdrawn.

Our primary recommendation is for Treasury and the Service to withdraw Prop. Treas. Reg. § 301.6241-7(b) for the reasons discussed above. If the proposed regulations

[32] For example, virtually every section 704(c) item is arguably based in part on information provided by the contributing partner.

are not withdrawn, however, we recommend that the issues identified above be clarified, in particular the following:

- When an adjustment or determination of a partnership-related item is "part of" or "underlying" an adjustment to a non-partnership-related item;

- Whether, in Prop. Treas. Reg. § 301.6241-7(b)(1), the person referenced in subsection (i) is the same person referenced in subsections (ii) and (iii) "whose return is being examined";

- Whether the adjustment or determination described in Prop. Treas. Reg. § 301.6241-7(b)(1)(ii) occurs before or after the Service has determined the BBA provisions do not apply to the adjustment or the determination;

- The meaning of the term "non-partnership-related item," which was first introduced in Prop. Treas. Reg. § 301.6241-7(b)(1)(ii); and

- In the example in Prop. Treas. Reg. § 301.6241-7(b)(2), whether the facts provided, such as the fact that the partnership has no liabilities or activity, and the fact that the adjustment to the non-partnership-related item results in the adjustment to the partnership-related item, are determinative of the outcome.

We also recommend that the reference in Prop. Treas. Reg. § 301.6241-7(b)(1)(iii) to section 6031(b), which relates to Schedules K-1, be replaced with what we believe is the intended reference to section 6031(a), which relates to partnership returns.

2. Withdraw Prop. Treas. Reg. § 301.6241-7(f).

Unlike TEFRA, which allows partnership adjustments if either the partnership or partner-level statute of limitations is open,[33] the statute of limitations for partnership adjustments under the BBA is determined exclusively at the partnership level (*i.e.*, the partner's statute of limitations is not taken into account).[34] Section 6235(a) provides the partnership-level limitations period and provides that no partnership adjustment may be made after the later of:

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[33] I.R.C. § 6229 (repealed 2015). Former section 6229(a) provided that the statute of limitations for adjustment of partnership items "shall not expire before" the date that is three 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) is not an exclusive statute of limitations, and an assessment of tax attributable to a partnership item is timely as long as the period of limitations remains open under either sections 6501 or 6229. *See, e.g.*, *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. 533 (2000); *Curr-Spec Partners, L.P. v. Commissioner*, 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. Commissioner*, 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).

[34] I.R.C. § 6235(a).

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

(A) the date the partnership return was filed,

(B) the due date of the return, or

(C) the date on which the partnership filed the administrative adjustment request, or

(2) if the partnership requests a modification of the imputed underpayment, 270 days (plus any agreed to 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 to extension) after the date of the notice of proposed partnership adjustment.[35]

The statute of limitations on adjustments may be extended by agreement.[36] In addition, an adjustment may be made at any time if the partnership files a false or fraudulent return or no return.[37] The limitations period in (1) above is extended from three years to six years if the partnership return contains a substantial omission from gross income.[38]

Prop. Treas. Reg. § 301.6241-7(f) would provide an exception to the statute of limitations set forth in the statute if the *partner's* statute of limitations is open and either (i) the partner has control over the partnership (according to the rules under sections 267(b) and 707(b)); or (ii) the partner has extended its statute of limitations under section 6501(c)(4) and the extension expressly states that the partner is extending the time to make partnership adjustments.

Statutes of limitation are strictly construed.[39] For example, in *United States v. 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."[40] Likewise, section 6235 contains detailed limitations for the time period in which partnership adjustments may be made.

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[35] *See also* I.R.C. § 6232(b) (no assessment may be made before the 90th day after the notice of final partnership adjustment is mailed and – if a petition is filed in the Tax Court – the decision of the court has become final).

[36] I.R.C. § 6235(b).

[37] I.R.C. § 6235(c)(1) and (3).

[38] I.R.C. § 6235(c)(2).

[39] *Badaracco v. Commissioner*, 464 U.S. 386, 391–92 (1984).

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

Unlike TEFRA, there is no language in the statute suggesting that the statute of limitations for partnership adjustments may be determined at the *partner* level.[41] The JCT's explanation of that section provides further evidence that Congress intended the statute of limitations for partnership adjustments to be determined exclusively at the partnership level.[42]

By way of explanation, the Preamble states that Prop. Treas. Reg. § 301.6241-7(f) is necessary because certain "partnership issues might become apparent only at a future date or during an examination of a partner, which can frustrate the Service's ability to allocate resources and examine taxpayers timely, especially in situations where the partnership structure includes many related and controlled entities."[43] In addition, the Preamble states that the application of the partner's statute of limitation is necessary in the case of complex multi-tiered partnership structures.[44]

These arguments do not seem strong to us. The procedural reforms adopted by the BBA, *i.e.* treating partnerships more like corporations for audit purposes, substantially reduced the possibility that upper tier or controlling partners could avoid the repercussions of adjustments made to lower tier partnerships. Instead, the BBA put the onus on partnerships and their partners to figure out how the adjustments will play out if the imputed underpayment is not paid by the partnership entity itself. Thus, we do not believe that deviation from the statutory rule 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 to an adjustment to any such item shall be determined, *at the partnership level* (emphasis added) . . ."[45] is warranted in this context. Unlike the special enforcement areas expressly identified in section 6241(11)(B) that might warrant special rules (*e.g.*, a criminal investigation or foreign partners), Prop. Treas. Reg. § 301.6241-7(f) would allow the Service to avoid the BBA partnership-level statute of limitations rules primarily for the Service's own convenience.

Accordingly, we recommend that Prop. Treas. Reg. § 301.6241-7(f) be withdrawn.

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[41] We believe such a change would require an amendment to the Code. *See 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.").

[42] Staff of the Joint Comm. On Tax'n, General Explanation of the Tax Legislation Enacted in 2015 (JCS-1-16), at 57–63, 75–77 (2016).

[43] 85 Fed. Reg. at 74,948.

[44] Preamble, 85 Fed. Reg. at 74,948.

[45] I.R.C. § 6221(a) (emphasis added).

3. Withdraw Prop. Treas. Reg. § 301.6241-7(g).

Prop. Treas. Reg. § 301.6241-7(g) would allow the Service to adjust "any tax, penalties, additions to tax, or additional amounts imposed on, and which are the liability of, the partnership under chapter 1" outside of the BBA.[46] Language in the Preamble related to Prop. Treas. Reg. §§ 301.6225-1 and 301.6225-2 seems to indicate that this special enforcement authority is intended to apply to a partnership-partner who either paid an imputed underpayment or is subject to liability as a result of a push out election by a partnership in which the partnership-partner is directly or indirectly a partner.[47]

We do not believe such a rule is necessary within the construct of the BBA regime. That is because we do not believe a partnership-partner would owe an imputed underpayment only as a result of the partnership electing under section 6226 to push out adjustments. In such a case, the entity-level liability of the partnership making the section 6226 election no longer exists and the partners are subject to tax (and any penalties and interest associated with the tax) with respect to their allocable share of adjustments. The adjustments that are pushed out are determined by the Service in a BBA proceeding or by the source partnership filing an AAR. The adjustments are not subsequently determined or adjusted at the partner-level under any interpretation of the BBA regime. We believe that Prop. Treas. Reg. § 301.6241-7(g) is unnecessary because there should not be a second proceeding.

We also do not believe that the statute contemplates such adjustments to partnership-related items outside the BBA. Treas. Reg. § 301.6241-1(a)(6)(ii)(C) provides that a partnership-related item includes an imputed underpayment. Treas. Reg. § 301.6241-1(a)(6)(i) provides that a partnership adjustment is an adjustment of a partnership-related item. Section 6211(c) provides that subchapter C of chapter 63 of the Code, the BBA partnership audit regime, is the exclusive means for adjustments to partnership-related items. Section 6211(c) provides that "adjustments to partnership-related items shall be made only as provided in subchapter C."

There might be disputes between the Service and a partner regarding the partner's computation of its tax liability when the partner takes into account its allocable share of adjustments that it received as a result of a push out. However, such a dispute remains part of the BBA regime and relates to how the partnership adjustments are translated into tax liability at the partner level, as opposed to how those adjustments are determined at the partnership level. In fact, section 6232(f) was enacted precisely so that the Service would have a streamlined mechanism to collect the imputed underpayment (including penalties and interest) from partnerships, including partnership-partners and S corporation partners who do not pay the correct imputed underpayment due after taking

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[46] This language is curious because a partnership is not subject to chapter 1 tax pursuant to section 702, and the BBA did not change that fact.

[47] Preamble, 85 Fed. Reg. at 74,943 ("For example, the rules apply to the filing of an administrative adjustment request when the partnership-partner computes and pays the imputed underpayment.").

into account the adjustments.[48] Accordingly, section 6232(f) ensures that it is unnecessary for the Service to begin a new proceeding to collect the imputed underpayment (and penalties and interest) from a partnership-partner.

For the reasons stated above, we recommend that Prop. Treas. Reg. § 301.6241-7(g) be withdrawn.

4. Revise Prop. Treas. Reg. § 301.6241-7(c), (d), and (e).

As discussed earlier, the JCT's explanation of section 6241(11) states that it "provides regulatory authority similar to that under the prior-law TEFRA partnership audit rules."[49] Section 6241(11)(B) lists several examples of special enforcement matters, including four that were also identified as examples of special enforcement matters under section 6231(c) of TEFRA. Subsections (c), (d), and (e) of Prop. Treas. Reg. § 301.6241-7 provide rules for three of these as special enforcement matters for purposes of the BBA: termination and jeopardy assessments, criminal investigations, and indirect methods of proof of income.

The TEFRA regulations at Treas. Reg. §§ 301.6231(c)-4 (regarding termination and jeopardy assessment), 301.6231(c)-5 (regarding criminal investigations), and 301.6231(c)-6 (regarding indirect method of proof of income), provide that if the triggering circumstance exists then the special enforcement rule in the regulation applies – the Service has no discretion. In contrast, subsections (c), (d), and (e) of Prop. Treas. Reg. § 301.6241-7 would provide that if the triggering circumstance exists the Service "may" adjust the partnership-related item outside of the BBA, giving the Service broad discretion. Given the extraordinary consequences of the special enforcement provisions, we believe that clear, certain rules are critical. Therefore, we recommend that those subsections be revised to make the special enforcement procedure mandatory if a triggering circumstance exists.

Similarly, the TEFRA regulations provide that if the Service properly avails itself of certain procedures with respect to a partner, such as termination or jeopardy assessment, notification of a criminal investigation, or use of indirect methods of proof of income, then it may identify the partnership item as one subject to special enforcement and treat it as a non-partnership item.[50] In contrast, it is unclear when the special enforcement procedures would apply to a partnership-related item involved in any of the

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[48] *See* JCX-6-18 at 45-50.

[49] *See* note 21, *supra*.

[50] Treas. Reg. § 301.6231(c)-4 provides that the partnership item is treated as a non-partnership item as of the moment prior to the termination or jeopardy assessment; Treas. Reg. § 301.6231(c)-5 provides that the partnership item is treated as a non-partnership item as of the date the partner is notified by the Service that they are subject to a criminal investigation and that the partnership related items will be treated as non-partnership related items; and Treas. Reg. § 301.6231(c)-6 provides that the partnership item is treated as a non-partnership item as of the date a deficiency notice based on indirect methods of proof of income is mailed to the partner.

special enforcement matters under subsection (c), (d), or (e) of Prop. Treas. Reg. § 301.6241-7. We recommend that these subsections be revised to provide more clarity similar to that in the TEFRA regulations.

Also, subsections (c), (d), and (e) of Prop. Treas. Reg. § 301.6241-7 would not address a situation where a partner and a partnership have different tax years, although the corresponding TEFRA regulations do.[51] We recommend that these subsections be revised by adopting the language in the TEFRA regulations to provide that the special enforcement rules apply to partnership-related items arising in any partnership taxable year ending on or before the last day of the taxable year of the partner.

Finally, subsection (e) of Prop. Treas. Reg. § 301.6241-7 would not define the phrase "indirect methods of proof of income."[52] Given the extraordinary power of the special enforcement rules, we believe the rules should be clear and that taxpayers should understand precisely when they are triggered. Accordingly, we recommend that subsection (e) be revised to define this phrase. To enable stakeholders an opportunity to comment on the definition, we also recommend that the definition be set forth in proposed regulations prior to having effect.

5. Apply Prop. Treas. Reg. § 301.6241-7 to "items" not "adjustments."

Consistent with the TEFRA rule (former section 6231(c)), current section 6241(11) provides the Secretary with authority to prescribe regulations that, in the case of special enforcement matters, allows the Service to "turn off" the BBA rules with respect to partnership-related items. However, each of the provisions in Prop. Treas. Reg. § 301.6241-7 describes special enforcement matter rules that would allow the Service to make "adjustments," outside the BBA regime. We believe this is inconsistent with the Secretary's authority under the statute, which expressly provides that the special rules apply to partnership-related "items."

We believe the Proposed Regulations' focus on adjustments, as opposed to items, leaves unanswered the question of which procedural regime will apply to the remainder of the proceeding (*e.g.*, assessment, collection, and litigation). Section 6221(a) provides the general rule that any adjustment to a partnership-related item must be determined at the partnership level. It also provides that, in general, any tax attributable to an adjustment to a partnership-related item must be assessed and collected at the partnership level, and the applicability of any penalty, addition to tax, or additional amount relating to an adjustment to a partnership-related item must be determined at the partnership level.

Accordingly, we recommend that the Proposed Regulations be revised to state that a partnership-related item (and any related penalties) which the Service determines is

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[51] *Id.*

[52] Treas. Reg. § 301.6231(c)-6 (Indirect method of proof of income) does not, either.

not subject to the BBA rules by application of section 6241(11) is subject to the deficiency procedures of subchapter B of chapter 63 of the Code.

II. Partnership that Ceases to Exist

A. Background

Section 6241(7) provides that "[i]f a partnership ceases to exist before a partnership adjustment under this subchapter takes effect, such adjustment shall be taken into account by the former partners of such partnership under regulations prescribed by the Secretary."

Section 6232(f), which was added by the TTCA, addresses the situation in which a partnership has not fully paid an imputed underpayment within ten days of notice and demand. Among other things, section 6232(f) generally provides that if the partnership has ceased to exist, the Service may assess the former partners "as determined for purposes of section 6241(7)" a tax equal to the partners' proportionate share of the imputed underpayment.[53] Treasury and the Service have not proposed any regulations under section 6232(f).

Treas. Reg. § 301.6241-3 implements the "cease-to-exist" rules under section 6241(7). Treas. Reg. § 301.6241-3(b) provides that a partnership ceases to exist if the Service makes a determination that a partnership ceases to exist because (i) the partnership terminates within the meaning of section 708(b)(1) or (ii) the partnership does not have the ability to pay the imputed underpayment. Treas. Reg. § 301.6241-3(c) provides that partnership adjustments take effect when there is full payment of the tax and other amounts owed as a result of the partnership adjustments. Treas. Reg. § 301.6241-3(d) defines former partners as the partners from the adjustment year of the partnership or, if there were no adjustment year partners, the partners from the partnership taxable year for which a final partnership return is filed.

The Proposed Regulations would make several changes to the "cease-to-exist" regulations in Treas. Reg. § 301.6241-3. Our recommendations regarding these changes are below.

B. Recommendations

1. Provide guidance on section 6232(f) before changing Treas. Reg. § 301.6241-3.

The Preamble explains that the reason for the changes to the "cease-to-exist" regulations in Treas. Reg. § 301.6241-3 is to coordinate the "cease-to-exist" rules under section 6241(7) with the rules for collecting the imputed underpayment when it is not

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[53] I.R.C. § 6232(f)(1)(B). Section 6232(f) also addresses a failure to pay a specified similar amount, and treats S corporations as partnerships and S corporation shareholders as partners for purposes of this section.

paid after notice and demand under section 6232(f). As noted above, Treasury and the Service have not issued regulations or other guidance to implement section 6232(f).

Section 6232(f) and the "cease-to-exist" rules under section 6241(7) address a similar issue, namely the need to provide the Service with tools to ensure collection of an imputed underpayment. Therefore, it will be necessary to coordinate these two provisions. However, without guidance on section 6232(f), it is unclear how Treasury and the Service envision section 6232(f) working.[54] Fully developing section 6232(f) guidance will provide important insights into how (and whether) that section and section 6241(7) should be coordinated. Those insights will, in turn, help inform comments from the public on regulations under both sections. Until section 6232(f) guidance is issued, we believe that it would be premature to adopt any changes to the "cease-to-exist" regulations that are intended to coordinate that section with section 6232(f).

Therefore, we recommend that the changes to the "cease-to-exist" regulations not be finalized.

2. Clarify when doubts about collectability causes a partnership to cease to exist.

Prop. Treas. Reg. § 301.6241-3(b)(1)(ii) proposes to change the standard for determining that a partnership ceases to exist on account of doubts about its ability to pay the imputed underpayment. It provides that the Service may determine that a partnership ceases to exist if:

> The partnership does not have the ability to pay, in full, any amount that may be due under the provisions of subchapter C of chapter 63 for which the partnership is or may be liable. For purposes of this section, a partnership does not have the ability to pay if the IRS determines that the partnership is currently not collectible based on the information the IRS has at the time of such determination.

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[54] There are a number of questions about how section 6232(f) will be implemented. For instance, section 6232(f) introduces a new concept that is not otherwise part of the BBA taxonomy – a "specified similar amount" – that is subject to the general rules of section 6232(f)(1), allowing the Service to assess the amount due and include a higher interest charge. This term is undefined. Additionally, section 6232(f)(5) provides that for purposes of these rules S corporations and their shareholders are treated the same as partnerships and their partners, yet it is unclear how that would work. Section 6232(f)(3) provides that each partner will pay a proportionate share "as the Secretary may determine." There is no guidance regarding how that will work. Finally, section 6232(f)(1)(B) cross-references the "cease-to-exist" rules for definition of former partners. However, the "cease-to-exist" rules are completely different collection tools from the section 6232(f) rule. While pursuant to section 6241(7), the adjustments are allocated to former partners, under section 6232(f), the former partners are liable for their proportionate share of the unpaid imputed underpayment. Accordingly, it is unclear whether the rules for determining who is a former partner for purposes of section 6232(f) will be (or should be) identical to the rule for former partners under section 6241(7).

This change includes the addition of the word "currently" to the existing definition of "cease to exist" under Treas. Reg. § 301.6241-3(b)(1)(ii). "Currently not collectible" is a term of art used by the Service to indicate that collection activity is unlikely to result in the receipt of funds due to the present financial circumstances of the taxpayer, but it does not eliminate the assessment. The Internal Revenue Manual ("**I.R.M.**") sets forth procedures for Service personnel to determine if the assessment is currently not collectible.[55] I.R.M. provisions with respect to "currently not collectible" are not set forth in regulations and are subject to change without notice or an opportunity to comment.

Whether or not Treasury and the Service intend the "currently-not-collectible" standard in the I.R.M. to be used in this context, we recommend that a definition be added to the Proposed Regulations so that partnerships can have clear notice of when the Service would make a "cease-to-exist" determination on this basis.

3. Retain the existing definition of when adjustments take effect.

Prop. Treas. Reg. § 301.6241-3(c) would change the timing of when a partnership adjustment takes effect. Rather than taking effect upon full payment, it would provide that a partnership adjustment takes effect when the adjustment becomes finally determined as described in Treas. Reg. § 301.6226-2(b)(1); the partnership and the Service enter into a settlement agreement regarding the adjustment; or, for adjustments appearing on an AAR, when the AAR is filed. Because all of the events in the proposed rule would occur before any payment would be made, the proposed rules limit the time period during which section 6241(7) applies to earlier stages in the centralized partnership audit regime.

The Preamble explains that the proposal to accelerate the time for treating a partnership adjustment as taking effect was made so that section 6241(7) could be coordinated with section 6232(f):

> If the partnership ceases to exist prior to the amounts due being fully paid, the former partners must take into account the adjustments. This interpretation could potentially preclude the use of section 6232(f) because if there is an amount due from the partnership any determination that a partnership has ceased to exist will trigger the rules under section 6241(7) as it would occur prior to the adjustments taking effect (*i.e.*, full payment)."[56]

The Preamble states that under the Proposed Regulations the rules under section 6241(7) would apply before the adjustments have taken effect, and the rules under section 6232(f) would apply once the adjustments have taken effect.[57] This means that

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[55] *See* I.R.M. 5.16.1, Currently Not Collectible.

[56] Preamble, 85 Fed. Reg. at 74,945.

[57] *Id.*

partnerships would be subject to the discretion of the Service, not only with respect to the determination whether the partnership "ceases to exist," but also with respect to what set of collection rules apply and potentially which partners will be liable for tax on the partnership adjustments.

For example, consider a partnership that terminated for tax purposes before an examination began. Notwithstanding the termination, it appears that the Service would have the discretion to determine when (or if) the partnership ceased to exist for purposes of Treas. Reg. § 301.6241-3(b)(1). The Service could choose to make its "cease-to-exist" determination early in the examination before the adjustments "take effect" triggering section 6241(7), or choose to wait until later in the examination, after the "take effect" event has occurred, therefore allowing it to proceed under section 6232(f).[58] Alternatively, the Service might never make a determination that the partnership ceased to exist.

Further, if the Service did determine that the partnership ceased to exist, it appears that, either under Treas. Reg. § 301.6241-3 or section 6232(f), the former partners would take into account the adjustments.[59] However, the manner in which the former partners take into account the adjustments might differ drastically, depending on the collection mechanism applied by the Service. Under Treas. Reg. § 301.6241-3, former partners take into account *adjustments* under a quasi-push out; under section 6232(f), the Service assesses against each partner the partner's share of the *imputed underpayment*. Given the fact that an imputed underpayment does not necessarily reflect the real tax effect of the adjustments,[60] the distinction between the two collection mechanisms can have profound implications for the former partners.

Therefore, we recommend that the change to the timing of when a partnership adjustment takes effect not be finalized.

4. Do not adopt the proposed change to the definition of former partners, or clarify it.

As stated previously, Treas. Reg. § 301.6241-3(d) defines former partners as the partners from the adjustment year or, if there were no adjustment year partners, the partners from the taxable year for which the last partnership return is filed. The

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[58] Treas. Reg. § 301.6241-3(b)(3) provides that "[i]f a partnership terminates under section 708(b)(1), the partnership ceases to exist on the last day of the partnership's final taxable year." This rule further confuses the operation of the "cease-to-exist" definition. It appears that even if the Service makes its "cease-to-exist" determination after the adjustments take effect (as described in the Proposed Regulations), the "cessation of existence" would occur under Treas. Reg. § 301.6241-3(b)(3) on the last day of the partnership's final tax year, that is, before the adjustments take effect.

[59] However, if the partnership makes a valid push out election, it would be the reviewed year partners of the partnership that take into account the adjustments.

[60] The modification rules of section 6225(c) provide partners with the ability to more closely approximate the correct tax amount. It is unclear if such the modification process would be afforded to partners in a partnership that the Service has determined has "ceased to exist."

adjustment year is the year that the partnership adjustments are finally determined – generally the year of a final court determination (or, if no petition is filed, the year in which the 90-day period to file a petition has lapsed) or the year an AAR is filed.

Prop. Treas. Reg. § 301.6241-3(d) would change the definition of "former partners" to the partners of the partnership during the last taxable year for which a partnership return under section 6031 or an AAR was filed for the partnership or the most recent persons determined to be partners in a final determination (for example, a defaulted notice of final partnership adjustment, final court decision, or settlement agreement) binding upon the partnership.

The Preamble explains that this change is necessitated by the change to the rule defining when the partnership adjustments take effect, which is prior to the adjustment year. The Preamble states that, "[b]ecause the adjustment year does not exist until the adjustments become final, proposed § 301.6241-3 would not apply after that point."[61]

We recommend that the proposed change to the definition of former partners be eliminated. The explanation in the Preamble of the proposed change relies on the change to the definition of when the adjustment takes effect, which we recommend in Section II not be adopted in the final regulations. Further, the need for the change is based on a distinction between when Prop. Treas. Reg. § 301.6241-3 applies (*i.e.*, prior to the adjustments becoming final) and when the adjustment year exists. In our view, that subtle distinction does not support introducing the complexity and potential arbitrariness resulting from the proposed change to the definition of former partners.

Because the effect of section 6241(7) is to determine which partners should be required to take into effect partnership adjustments when the partnership itself is unable to do so, we believe there is no need to determine who those partners are until there is an adjustment to be taken into effect. The explanation in the Preamble nonetheless conveys a concern that the definition of former partners cannot rely on a defined term (*i.e.*, "adjustment year") whose application to the facts is not established during the proposed more limited temporal scope of Prop. Treas. Reg. § 301.6241-3. But neither the statute nor practical considerations place any such limitation on the definition of former partners. That is especially the case under the proposed temporal scope of Prop. Treas. Reg. § 301.6241-3, because the events that trigger the end of its temporal scope (*i.e.*, events that cause the adjustment to "take effect" under Prop. Treas. Reg. § 301.6241-3(c)) also would establish the adjustment year.[62] For example, under the Proposed Regulations a partnership adjustment would take effect when the adjustments become finally

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[61] Preamble, 85 Fed. Reg. at 74,946. This statement does not take into account the fact that the Service could determine the partnership ceases to exist because it is "currently not collectible." That determination normally would not happen until *after* the adjustments are final, an assessment is made, and the Service attempts to collect from the partnership.

[62] *See* Treas. Reg. § 301.6241-1(a)(1) (defining "adjustment year").

determined by way of a final court decision, which would also establish the adjustment year.

Our recommendation to retain the current definition of former partners would have the advantage of maintaining the BBA's fundamental choice, as reflected in section 6225, regarding the relationship between the final determination with respect to an adjustment and the persons who should bear the consequences of that adjustment. In contrast, the proposed changes would provide the Service with the discretion to mandate that a different set of persons bear the economic consequences of an adjustment. In our view, this would add to the complexity of the rules and economic arrangements for partners entering or exiting a partnership.

If our recommendation to remove the proposed definition of former partners is not adopted, we recommend that the definition be clarified. The Proposed Regulations provide three alternative events that could determine who the former partners are. We recommend the rules provide clearer ordering rules to govern the outcome when more than one of the events occurs. For example, assume Partnership P files a return in Year 4 with respect to Year 3. One month later, and also in Year 4, Partnership P files an AAR with respect to Year 2. One month later, Partnership P ceases to exist and a month after that adjustments "take effect" for Year 1. Consequently, a determination must be made regarding the identity of the former partners. Under the Proposed Regulations, the former partners are determined by the "last taxable year" for which a partnership return or AAR is filed. It is unclear whether "last" refers to the latest document to be filed or the latest of the taxable years for which there is a filing. If the former, the AAR filing for Year 2 would be determinative because it was filed after the Year 3 tax return and the Year 2 partners would be the former partners. If the latter, the partnership return would be determinative because it relates to Year 3 rather than Year 2.[63]

As this example indicates, a rule that defines the former partners by an AAR filing introduces an element of randomness, and potential manipulation. For example, the partnership could change the definition of former partners by filing the AAR one week before the tax return. Therefore, we recommend that the proposed rule be clarified by eliminating a filed AAR as a means for determining who the final partners are. We recommend that the final rule provide, instead, that the former partners are determined by the latest tax year for which there is a filing (Year 3 in the example above).

We recommend that Treasury and the Service make similar clarifications regarding the proposal to refer to the partners in a final determination in the definition of former partners.

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[63] If "last" is clarified to refer to the latest taxable year, the inclusion of AARs becomes superfluous because the latest tax year will always be the taxable year of the latest tax return rather than an AAR filing.

5. Confirm that a partnership that ceases to exist retains the ability to take certain actions.

In addition to the other issues highlighted above, the Proposed Regulations create uncertainty as to whether a partnership that "ceases to exist" nevertheless still can avail itself of the opportunities to reduce the imputed underpayment through modification, push out any adjustments to its reviewed year partners, or agree to and pay the imputed underpayment. It appears that the Service could determine that a partnership ceases to exist prior to the time when the partnership would have the opportunity to request modification to reduce the imputed underpayment, make a push out election so the reviewed year partners rather than the former partners would be required to take into account Service adjustments, or agree to and pay the imputed underpayment. In the case of a partnership that is in a position to pay the imputed underpayment, a cease-to-exist determination would delay the Service's collection of tax due.

In the case of the push out provisions, we believe this result would disturb taxpayers' general understanding of the optionality of imputed underpayments versus push out provisions that is built into the BBA (and which has informed countless transactions since the BBA became effective). For example, consider a partnership, operating on a calendar tax year, that terminated on June 30, 2019, and filed its final, short-period return for the tax year January 1, 2019, to June 30, 2019. If the Service opens an examination of the partnership's 2018 tax year, determines the partnership ceased to exist, makes adjustments to the 2018 tax return, and those adjustments "take effect" by way of a defaulted notice of Final Partnership Adjustment (all in that sequential order), it appears under the Proposed Regulations that the "cease-to-exist" determination might mean that the former partners, *i.e.*, the partners reflected on the return filed for the year ended June 30, 2019, would be the former partners required to take into account the adjustments.[64] In our view, the partnership should be able to elect under section 6226 to push the adjustment out to the reviewed year (2018) partners. We believe that such an interpretation would be more consistent with the language of section 6226.

Accordingly, we recommend that Treasury and the Service clarify that a partnership that has ceased to exist before the adjustments take effect (as described in the Proposed Regulations) still can push out those adjustments to its reviewed year partners.

III. Adjustments to an Item That is Not an Item of Income, Gain, Loss, Deduction, or Credit

A. Background

A change to one partnership-related item that is an item of income, gain, loss, deduction, or credit (collectively, "**income items**") might result in cascading changes

[64] It appears, under the proposed regulations, this result could unilaterally be changed by the partnership filing an AAR for 2018, thereby making the 2018 partners the former partners.

throughout the partnership return to items that are not items of income, gain, loss, deduction, or credit (collectively referred to by the Proposed Regulations as "**non-income items**").[65] For example, an adjustment to ordinary business income might result in changes to qualified business income ("**QBI**") for purposes of section 199A and adjusted taxable income ("**ATI**") for purposes of section 163(j). An adjustment to QBI in turn might affect multiple lines on *Statement A – QBI Pass-Through Entity Reporting*, and an adjustment to ATI in turn might affect multiple lines on Form 8990, *Limitation on Business Interest Expense Under Section 163(j)*, *e.g.*, items of, or related to, excess business interest expense ("**EBIE**") and excess taxable income ("**ETI**").

Moreover, the Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.,* includes many non-income items that have no bearing on a partner's ultimate tax liability. Examples include the tax capital reporting requirements (which often will not correspond to outside basis), each partner's aggregate share of forward and reverse section 704(c) amounts, and the amount of a partner's remaining section 743(b) adjustment that has been allocated to each category of partnership property on Schedule L of the Form 1065.

The Proposed Regulations address the treatment of adjustments to non-income items, an issue that had not been previously addressed in guidance.[66] The Preamble states that examples of non-income items include partnership's assets, liabilities, and capital accounts.[67]

Two provisions in the Proposed Regulations would include adjustments to non-income items in the computation of the imputed underpayment or that are based on including non-income items in the imputed underpayment. They are:

- Prop. Treas. Reg. § 301.6225-1(b)(4), which amends the existing zero-adjustment rule to provide that if an adjustment to income items results from or relates to an adjustment to non-income items, the adjustment to a non-income item will be zero unless the Service determines that the adjustment to the non-income item should be included in the imputed underpayment; and

- Prop. Treas. Reg. § 301.6225-3(b)(8), which is a new subsection that provides that a partnership takes into account an adjustment that does not result in an

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[65] A partnership return generally encompasses more than just the Form 1065, *U.S. Return of Partnership Income*. A domestic partnership return generally includes all information required by the Form 1065 and the Instructions for Form 1065. I.R.C. § 6031(a); Treas. Reg. § 301.6031(a)-1(a). As such, a partnership return includes all forms, schedules, and statements that must be attached to the Form 1065.

[66] Preamble, 85 Fed. Reg. at 74,945 ("The final regulations implementing section 6225 do not expressly explain how adjustments to items that are not items of income gain, loss, deduction or credit . . . are taken into account (1) in the calculation of the imputed underpayment; (2) as adjustments that do not result in an imputed underpayment; or (3) if a partnership elects to push out the adjustments to its reviewed year partners.").

[67] *Id.*

imputed underpayment by adjusting the non-income item on its adjustment year return, but only to the extent the item would appear on the adjustment year return without regard to the adjustment.

The Preamble to the Proposed Regulations states that "[a]n adjustment to a non-income item, by definition, is not an adjustment to [an income item], therefore, and [sic] is a positive adjustment."[68]

B. Recommendations

1. Disregard adjustments to non-income items in computing the imputed underpayment.

If adjustments to all non-income items were taken into account as positive adjustments in determining an imputed underpayment, the imputed underpayment would be far greater than the partners' aggregate chapter 1 tax liability, which the imputed underpayment determination process is intended to approximate.

We are concerned that an imputed underpayment that took into account adjustments to non-income items as positive adjustments would fail to reflect accurately the tax impact of the adjustments. In addition, we are concerned that an unrealistically high imputed underpayment resulting from the inclusion of non-income items, or the uncertainty as to whether the Service subsequently may determine that non-income items should have been included in an imputed underpayment, might discourage partnerships from filing AARs. The fact that a partnership may push out adjustments does not mitigate or alleviate these concerns.

Current guidance addressing adjustments to non-income items generally is limited to a few examples involving a single adjustment (*e.g.*, an adjustment to a partnership liability).[69] These examples, however, do not take into account the vast amount of information reported on a typical partnership return. As discussed above, partnership reporting has grown to include many non-income items that have no bearing on a partner's ultimate tax liability. The 2020 Schedule K-1 includes more than 150 different codes, each of which may be used to report multiple partnership-related items. It is not difficult to imagine scenarios where hundreds of non-income items need to be adjusted. We believe that treating each of those adjustments as a positive adjustment for purposes of determining an imputed underpayment would overstate any reasonable approximation of the proper amount of chapter 1 tax attributable to adjustments to partnership-related items.

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[68] *Id.*

[69] *See*, *e.g.*, Treas. Reg. § 301.6225-1(h), Ex. (7); Prop. Treas. Reg. § 301.6225-4(e), Ex. (5), 83 Fed. Reg. 41,954 (Aug. 17, 2018) (generally, IU on net decrease in partner's share of liability); LB&I-04-1019-010 (Oct. 24, 2019) (IU on net earnings from self-employment); Notice 2021-13, 2021-06 I.R.B. 832 (IU on tax capital).

Based on the foregoing, we recommend that the Proposed Regulations be revised to disregard all adjustments to non-income items for purposes of computing the imputed underpayment.

If this recommendation is not adopted, we recommend that the zero-adjustment rule be applied so that the partnership, and not just the Service, can determine that the rule applies. The Preamble states that the Proposed Regulations extend the zero-adjustment rule to persons other than the Service.[70] However, the text of the Proposed Regulations does not appear to be consistent with this statement. Specifically, Prop. Reg. § 301.6225-1(b)(4) would allow only the Service to remedy a situation resulting in double-counting of adjustments. We believe this approach would be unfair to taxpayers and could result in an unreasonably high imputed underpayment. Accordingly, if our primary recommendation is not adopted, we recommend removing the words "unless the IRS determines that the adjustment should be included in the imputed underpayment" from Prop. Treas. Reg. § 301.6225-1(b)(4).

In addition, in the AAR context, the section 6227 regulations cross-reference the section 6225 regulations.[71] In this context, the Service is not making the initial determination of which items may be adjusted and which adjustments may be netted. Rather, it is the partnership that is making these determinations, and it is the partnership who would be applying the nonduplication rule of Treas. Reg. § 301.6225-1(b)(4). Accordingly, if our primary recommendation is not adopted, we recommend that the Proposed Regulations be modified to clarify that the zero-adjustment rule applies in the AAR context by adding a cross reference to the regulations under section 6227 rather than trying to address both examinations and AARs in the section 6225 regulation.

Finally, if both of our recommendations to disregard all non-income items or to allow partnerships to apply the zero-adjustment rule, we recommend that the Proposed Regulations be modified to provide that partnerships that did not take those adjustments into account when computing and paying an imputed underpayment under the AAR rules will not be subject to penalties.

2. Remove the non-IU adjustment rule in Prop. Treas. Reg. § 301.6225-3(b)(8).

The Proposed Regulations would add a new subsection (8) to the rules under Treas. Reg. § 301.6225-3(b) to provide that a partnership takes into account an adjustment of a non-income item that does not result in an imputed underpayment by adjusting the non-income item on its adjustment year return, but only to the extent the item would appear on the adjustment year return without regard to the adjustment.[72] That section of the Proposed Regulations provides, further, that if the non-income item already

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[70] Preamble, 85 Fed. Reg. at 74,945.

[71] Treas. Reg. § 301.6227-2(a)(1).

[72] Prop. Treas. Reg. § 301.6225-3(b)(8).

is reflected on the partnership's adjustment year return or any return between the review year or the adjustment year, the partnership should not create a new item in the amount of the non-income item adjustment on the adjustment year return.

The Proposed Regulations also would add an example illustrating this rule.[73] In the example, the adjustments – a $10 decrease to the adjusted basis of a partnership asset and a $4 increase in credits – result in a non-IU adjustment.

We recommend that the non-IU adjustment rule and the illustrative example in Prop. Treas. Reg. § 301.6225-3(d)(3) be removed. First, the proposed rule appears to preclude reporting of items that otherwise never could be reported, for instance an increase in a partner's share of QBI or unadjusted basis immediately after acquisition ("**UBIA**") under section 199A, where a partnership otherwise did not report such item for that partner for the adjustment year, thus denying that partner the benefit of the UBIA or the QBI. We see no reason to deny the partner the benefit of these items.

Second, in many cases, partnerships with different software, advisors, or levels of sophistication might reasonably differ on how much information is required to be disclosed with respect to items that should or must be included on a return, as well as how that information is presented. As a result, the application of the non-IU adjustment rule likely will vary depending upon the manner in which the return is prepared, and the rule does not provide a clear and administrable standard as to when a non-income item adjustment should be reflected in the adjustment year return.

Finally, the implication in the example is that an incorrect basis of an asset, in itself, can give rise to a taxable adjustment. The example assumes that the only adjustments are the incorrect asset basis and the adjustment to the credit. It is difficult to understand why an incorrect asset basis, in itself, would give rise to a positive adjustment, to be taken into account in the calculation of an imputed underpayment, without a disposition of the asset, or a realization or recognition event upon which gain or loss would be determined. Until there is a realization and recognition event, the adjustment to an item that is not an item of income, gain, loss, deduction or credit should not be taken into account. We are not aware of anything in the statute or legislative history of the BBA that indicates that Congress intended that, in the context of an examination or AAR, the Service could cause a realization or recognition event when such events otherwise have not occurred under the Code. Furthermore, if an adjustment that is an adjustment to income, deduction, gain, loss or credit impacts the basis of an asset, the correlative asset basis adjustment seemingly is better described as an adjustment to a specified tax attribute under the rules of Prop. Treas. Reg. § 301.6225-4 than as a separate, non-income adjustment of its own.[74]

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[73] Prop. Treas. Reg. § 301.6225-3(d), Ex. (3).

[74] *See* Prop. Treas. Reg. § 301.6225-4(a)(1), providing that "[w]hen there is a partnership adjustment (as defined in § 301.6241-1(a)(6)), the partnership and its adjustment year partners (as defined

IV. Recommendation to Remove the Non-704(b) item Rule in Treas. Reg. § 301.6225-1(d)(2)(iii)(B)

The non-704(b) item rule in Treas. Reg. § 301.6225-1(d)(2)(iii)(B), and the zero-adjustment rule as proposed to be amended by Prop. Treas. Reg. § 301.6225-1(b)(4), address the same thing: how adjustments to non-income items are taken into account in determining an imputed underpayment. Consistent with our primary recommendation that non-income items should not be taken into account in determining an imputed underpayment, we recommend that Treas. Reg. § 301.6225-1(d)(2)(iii)(B) be revised to provide that non-704(b) items are not taken into account in computing the imputed underpayment. To the extent that any prior guidance relies on this rule to take non-income items into account in determining an imputed underpayment, we recommend that guidance be revised, too.

V. Recommendations With Respect to Imputed Underpayment Computations in the AAR Context

A. Remove the requirement to include an imputed underpayment computation with an AAR.

The AAR forms and instruction require reporting of the imputed underpayment even if the partnership will be pushing out the adjustments.[75] Where the partnership elects to push out the requested adjustments and/or where the adjustments are all net negative adjustments that must be pushed out in an AAR, we see no purpose for including the imputed underpayment computation on the AAR. An imputed underpayment computation can be a complex and difficult undertaking, and its complexity and difficulty grow with each additional adjustment included in the AAR.

Accordingly, we recommend that there not be a requirement to include an imputed underpayment computation with an AAR unless the partnership is paying the imputed underpayment. Adoption of this recommendation generally will have the effect of reducing unnecessary costs associated with filing an AAR.

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in § 301.6241-1(a)(2)) generally must adjust their specified tax attributes (as defined in paragraph (a)(2) of this section). . . . For a partnership adjustment that results in an imputed underpayment (as defined in § 301.6241-1(a)(3)), specified tax attributes are generally adjusted by making appropriate adjustments to the book value and basis of partnership property under paragraph (b)(2) of this section . . . ." Prop. Treas. Reg. § 301.6225-4(a)(2) defines "specified tax attributes" as "the tax basis and book value of a partnership's property, amounts determined under section 704(c), adjustment year partners' bases in their partnership interests, adjustment year partners' capital accounts determined and maintained in accordance with § 1.704-1(b)(2), and earnings and profits under section 312." *See also* Prop. Treas. Reg. § 301.6226-4, 83 Fed. Reg. 41,954 (Aug. 17, 2018) (adjusting tax attributes in the case of a push out election).

[75] *See*, *e.g.*, Instructions for Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR) (Rev. January 2021), at p. 6.

B. Issue a dedicated form for computing an imputed underpayment.

We recommend that the Service develop and publish a dedicated form, schedule, worksheet, or statement for purposes of computing an imputed underpayment. The imputed underpayment computation process is new and complex. Many partnerships filing an AAR might not be familiar with the imputed underpayment computation process, let alone the need to include an imputed underpayment computation when the partnership is pushing out the requested adjustments. We believe that providing such a form for computing an imputed underpayment – similar to the "IUA Workbook" that we understand will be used by the Service in the exam context – would provide more equity between taxpayers and the Service regarding the computation of an imputed underpayment.[76] We believe this recommendation also would promote equity across taxpayers – specifically between sophisticated partnerships and smaller partnerships.

C. Allow net negative adjustments to the credit grouping to reduce the imputed underpayment.

In the case of an imputed underpayment computed in the context of filing an AAR or a pass-through partner taking into account its allocable share of adjustments received as a result of a push out, Prop. Reg. § 301.6225-1(e)(3)(ii) would provide that a net negative adjustment in the credit group is a non-IU adjustment "unless the IRS determines that such net negative adjustment should be taken into account under [the formula for computing the imputed underpayment]." This would appear to give the Service discretion to determine whether to net the credit. The result would be that the partnership computing the imputed underpayment never would be able to reduce the imputed underpayment by a credit that normally would be available to reduce tax due. The reason net negative adjustments are treated as non-IU adjustments is that they are adjustments that are not appropriate to be netted against the other adjustments. We are not aware of any circumstance where it would be inappropriate to net a credit against the product of multiplying the total netted partnership adjustments by the highest tax rate.

Accordingly, we recommend that Prop. Reg. § 301.6225-1(e)(3)(ii) be revised to provide that a net negative adjustment in the credit grouping reduces the imputed underpayment, except that, in an examination, the Service may require that a net negative adjustment in the credit grouping be treated as a non-IU adjustment if there is a determination by the Service that netting would be inappropriate.

VI. Recommendations to Clarify the Rules Relating to Adjustments to an Imputed Underpayment and Chapter 1 Taxes and Penalties

The Proposed Regulations would make four revisions to the current regulations to provide a mechanism to account for the adjustments to a partnership's chapter 1 taxes, penalties, additions to tax, or similar amounts or any adjustment to a previously

[76] *See* Interim Guidance Memorandum, LB&I-04-1019-010 (Oct. 24, 2019).

determined imputed underpayment (collectively referred to in the Preamble as "chapter 1 liabilities"[77]) described above:

1) Prop. Treas. Reg. § 301.6225-1 would be modified to "provide a mechanism for including the partnership's chapter 1 taxes, penalties, additions to tax, or additional amounts, as well as adjustments to a previously determined imputed underpayment (chapter 1 liabilities) in the calculation of the imputed underpayment."[78]

2) Under Prop. Treas. Reg. § 301.6225-1(c)(3), any adjustment to "chapter 1 liabilities" would be placed in the credit grouping and treated similarly to credits for purposes of calculating the imputed underpayment.

3) Prop. Treas. Reg. § 301.6225-1(f)(1)(ii) and (f)(3) would provide two special rules for the treatment of net negative adjustments to "chapter 1 liabilities" because, as the Preamble states, the normal framework that governs net negative adjustments in the credit grouping "does not operate well" in the case of such liabilities.[79]

4) Prop. Treas. Reg. § 301.6226-2(g)(4) would provide that a partnership making a push out election must pay any "chapter 1 liabilities" when the statements are furnished to the partners. The Preamble states that "[b]ecause these amounts are the partnership's liability, partnerships are not permitted to push out any adjustments to these items when making the push out election."[80]

According to the Preamble, these changes are intended to address partnership-partners:

> If the IRS adjusts a partnership's chapter 1 taxes, penalties, additions to tax, or similar amounts utilizing the centralized partnership audit regime, there must be a mechanism for including these amounts in the imputed underpayment and accounting for these amounts if the partnership elects to push out the adjustments under section 6226. In addition, there must also be a mechanism to account for any adjustments to a previously determined imputed underpayment. Accordingly, these proposed rules apply to the calculation of the imputed underpayment

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[77] We believe this shorthand is imprecise and perhaps misleading. An imputed underpayment, while assessed *as if* it were a tax imposed by subtitle A, is not a tax imposed by chapter 1. And while the partnership is treated as an individual for purposes of determining penalties under the BBA, it does not follow that such penalty amounts are automatically transformed into "chapter 1 liabilities." It is not clear from the Preamble precisely what taxes and penalty amounts the Service is addressing with these proposed rules.

[78] Preamble, 85 Fed. Reg. at 74,943.

[79] *Id.* at 74,944.

[80] Preamble, 85 Fed. Reg. at 74,944-45.

during an IRS examination and to adjustments to the imputed underpayment as calculated by the partnership.[81]

The circumstances intended to be covered by this language appear to involve situations where a partnership makes what the Service determines on examination was an error when it determined its own imputed underpayment or its own penalty. This could occur in the following scenarios:

1) The partnership filed an AAR determining an imputed underpayment and then on examination of the partnership taxable year to which the AAR relates the Service determines that the AAR adjustments were incorrect or the imputed underpayment computation on the AAR was incorrect.

2) The partnership is a pass-through partner that receives adjustments pursuant to a push out election by the lower tier partnership under section 6226 or 6227 and the Service determines on examination of that the pass-through partner incorrectly determined the imputed underpayment and/or penalties.

3) The partnership is a pass-through partner and takes the adjustments into account under the modification rules using an amended return or the alternative to the amended return procedures referred to as "pull in" procedures.

With regard to the first scenario, we recommend that the adjustments on the AAR be treated the same way that adjustments on an amended return are treated in the case of an examination. The Service examines the items as adjusted by the AAR. Those items, as adjusted by the AAR, will then be adjusted under the existing BBA rules. We believe no modification of the regulations is needed to address this scenario. To the extent the Service is adjusting solely the amount of the imputed underpayment computed on the AAR (a requirement we recommend the Service eliminate, as discussed in Section V.A), it is not clear why the adjustment to that imputed underpayment must then result in a second imputed underpayment. Given the rule under Prop. Treas. Reg. § 301.6226-2(g)(4), which appears to limit the partnership's ability to push out at least a portion of that second imputed underpayment, it is not clear why the Service would not merely adjust the incorrect imputed underpayment and assess the difference against the partnership. The end result would be the same: the partnership would be liable. On the other hand, if Treasury and the Service maintain their position that the AAR imputed underpayment adjustment should result in a second imputed underpayment, we recommend that the partnership be allowed to push out that entire second imputed underpayment. We see nothing in the statute or legislative history that implies a limitation on the push out election. In our view, Congress would have indicated its intent

[81] *Id.* at 74,943.

to limit a push out election if it felt it was appropriate for the partnership to pay the tax, instead of pushing out the adjustments.[82]

With regard to the second scenario, while we agree that the Service can examine and adjust the partnership's determination of these amounts, the context of that examination and the adjustments is not a *new* BBA examination of the partnership or pass-through partner and is not part of any BBA examination of the partnership for the reporting year or the partnership's taxable year that corresponds with the reviewed year, but rather the collection phase of the BBA examination of the source partnership for the review year. Unlike non-pass-through partners that determine and pay the additional reporting year tax as an adjustment to their normal chapter 1 tax for the reporting year, a pass-through partner pays the imputed underpayment (and penalties) as a separate tax amount on the Form 8985, *Pass-Through Statement – Transmittal /Partnership Adjustment Tracking Report (Required Under Sections 6226 and 6227)*. If the Service determines that the pass-through partner did not correctly determine the imputed underpayment and/or penalties on Form 8985, we believe the Service should send notice and demand to the pass-through partner and use the tools provided in section 6232(f) to collect the imputed underpayment (including penalties and interest) if not paid within 10 days.

In our view, the result of the third scenario should be similar to the first scenario, meaning that the adjustments taken into account through the modification, amended return or pull in procedures would be the amount of the items should the Service audit the pass-through partner's tax year corresponding to the review year of the source partnership. Moreover, modification is at the discretion of the Service. If the Service disagrees with the imputed underpayment reflected on the amended return, the Service does not need to accept the associated modification.

We recommend that Treasury and the Service provide an example of the type of chapter 1 tax imposed against a partnership that are concerning enough to necessitate the proposed rule, in addition to providing one or more examples along the lines of the three scenarios above that illustrates how they envision the Service making adjustment to a previously determined imputed underpayment.

Finally, we recommend including such adjustments in their own grouping rather than the credit grouping under Prop. Treas. Reg. § 301.6225-1(c)(3). While we agree that the dollar-for-dollar set-off against the tax liability is the same as provided for in the credit grouping, there is a risk of confusion as to the items. The credit grouping relates to adjustments of credits actually claimed on the Form 1065 filed by the examined partnership. There is a risk of confusing these proposed adjustments to "chapter 1 liabilities" with such adjustments to credits, and we believe it would be better to keep these separate. Creating a separate grouping for "chapter 1 liabilities" also would

[82] *See*, *e.g.*, I.R.C. § 6241(9)(B).

simplify the regulations by obviating the need for an exception to the rule governing other net negative adjustments in the credit grouping.

VII. Recommendations with Respect to Applicability Dates

Section 7805(b)(1) of the Code provides that, except as otherwise provided, no final regulation shall apply to any taxable period ending before the earliest of the following dates:

> (A) the date on which the regulation is filed with the Federal Register.
>
> (B) the date on which any proposed or temporary regulation to which the final regulation relates was filed with the Federal Register.
>
> (C) the date on which any notice substantially describing the expected contents of the final regulation was issued to the public.

It is against this backdrop that we provide the following comments.

A. Apply Prop. Treas. Reg. §§ 301.6221(b)-1(f), 301.6225-1(i)(1), 301.6225-2(e)(1), and 301.6226-2(h)(1) prospectively after finalization.

Prop. Treas. Reg. §§ 301.6221(b)-1(f), 301.6225-1(i)(1), 301.6225-2(g)(1), 301.6225-3(e)(1), and 301.6226-2(h)(1) provide that the changes that would be made by those sections are "applicable on November 20, 2020." To be consistent with section 7805(b)(1), we believe that the earliest periods to which those changes may apply are taxable years ending on or after November 20, 2020. However, we recommend that they apply no earlier than taxable years beginning on or after the date final regulations are published in the Federal Register, to provide sufficient time after the final regulations are published for partnerships to adjust their internal tax compliance and reporting procedures. If finalized, these proposed changes will require partnerships to carefully review existing partnership agreements and internal partnership accounting to determine how they are affected by the changes and, if necessary, revise these agreements and update partnership accounts to align with the new rules.

B. Apply Prop. Treas. Reg. § 301.6241-3 prospectively after finalization.

Prop. Treas. Reg. § 301.6241-3(g) provides that the changes to the "cease-to-exist" rules that would be made by that section "appl[y] to any ['cease-to-exist'] determinations made after November 20, 2020." Consistent with section 7805(b)(1), we believe that the earliest periods to which those changes may apply are taxable years ending on or after November 20, 2020. Similar to the comments above, however, we recommend that they apply no earlier than taxable years beginning on or after the date final regulations are published in the Federal Register, to provide sufficient time after the final regulations are published to plan for the change. In addition, as a practical matter, it is not clear how the Service could make a "cease-to-exist" determination utilizing the proposed rules until those rules are finalized.

An example might help illustrate our concern: Suppose the Service audited a partnership's 2018 tax year in 2020. Suppose, further, that it made a determination at the end of the exam, in 2021, that the partnership "ceased-to-exist" during 2018. The effective date would be triggered on the date of the "cease-to-exist" determination, here 2021. However, the tax year to which the "cease-to-exist" determination would relate is 2018. This would appear to be contrary to section 7805, which says that a final regulation may not apply to any tax period (in this example the 2018 calendar year) any earlier than the date a final, proposed, or temporary regulation is published, or the date a notice with the rule is published: In this case the earliest of the three dates would be November 20, 2020; therefore the date the "cease-to-exist" determination would be made – 2021 – while after that date, would relate to a tax period (2018) that was before that date.

C. Apply Prop. Treas. Reg. § 301.6241-7 prospectively after finalization.

Prop. Treas. Reg. § 301.6241-7(j)(1) provides that the special enforcement matters rules in that section (other than paragraph (b)) generally "appl[y] to partnership taxable years ending after November 20, 2020, or any examination or investigation begun after November 20, 2020." Because examinations or investigations that would be subject to these rules could relate to partnership taxable years ending before the Proposed Regulations were filed with the Federal Register, in our view this applicability date would violate section 7805. Accordingly, we recommend removing the language "or any examination or investigation begun after November 20, 2020." In addition, although permissible under section 7805(b)(1)(B), for the reasons stated above we recommend that the general portion of the applicability date be revised to apply to partnership taxable years beginning after final regulations are published in the Federal Register.

Prop. Treas. Reg. § 301.6241-7(j)(1) provides that paragraph (b) of that section, relating to partnership-related items underlying non-partnership-related items, "applies to partnership taxable years beginning after December 20, 2018, or any examination or investigation begun after November 20, 2020." Treasury and the Service appear to rely on section 7805(b)(1)(C) in proposing this applicability date, as December 20, 2018, was the date that Notice 2019-06 was issued to the public. However, as a result this rule could apply to a partnership taxable year beginning even before the general applicability date of the BBA (taxable years beginning after January 1, 2018).[83] Although permissible under section 7805, this does not appear to us to be within the spirit of the provision. By the time that final regulations are published, it will have been over two years since Notice 2019-06 was issued. Exams might have commenced during that period, the rules for which might suddenly change. Accordingly, and for the reasons stated above, we recommend that Prop. Treas. Reg. § 301.6241-7(b) not be applicable before final regulations are published in the Federal Register. If our recommendations above are adopted, we also recommend, for consistency, removing the language "or any

[83] Notice 2019-06 itself said that Treasury and the Service intended to make the regulations applicable at the latest to partnership taxable years *beginning after* December 31, 2017, and ending after December 20, 2018.

examination or investigation begun after November 20, 2020," from the applicability date.