



Section of Taxation

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September 11, 2017

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments on New Partnership Audit Regime

Dear Commissioner Koskinen:

Enclosed please find comments on proposed regulations implementing the partnership audit procedures enacted as part of the Bipartisan Budget Act of 2015 (“Comments”). These comments are submitted on behalf of the American Bar Association Section of Taxation and have not been 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 the Comments with you or your staff if that would be helpful.

Sincerely,

Karen L. Hawkins
Chair, Section of Taxation

Enclosure

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AMERICAN BAR ASSOCIATION SECTION OF TAXATION
COMMENTS ON PROPOSED REGULATIONS IMPLEMENTING THE
PARTNERSHIP AUDIT PROCEDURES ENACTED AS PART OF THE
BIPARTISAN BUDGET ACT OF 2015

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been 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.

Principal responsibility for preparing these Comments was exercised by Jennifer E. Breen and George A. Hani of the Section’s Administrative Practice Committee (the “Committee”). Substantive comments were provided by Jim Gadwood, Thomas D. Greenaway, Kat Gregor, Gabrielle Hirz, Kevin Johnson, Joshua A. Lichtenstein, James Malone, Clint Massengill, Mary McNulty, Lee Meyercord, Yuval Peled, Veronika Polakova, Brad Ridlehoover, Kathryn SeEVERS, Mary Slonina, and Katherine Zhang of the Committee; by Adam Cohen of the Section’s Partnerships & LLCs Committee; by Mitchell Horowitz, Sam Kamyans, and Alexandra Minkovich of the Section’s Court Procedure and Practice Committee; and by Edward Bernert, Jaye A. Calhoun, Bruce Ely, and Peter L. Faber of the Section’s Committee on State and Local Taxes. These Comments were reviewed by Sheri Dillon, the Section’s Council Director for the Committee, Michael J. Desmond, on behalf of the Section’s Committee on Government Submissions, and William H. Caudill, the Section’s Immediate Past Chair.

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

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Date: September 11, 2017

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I. INTRODUCTION

The Bipartisan Budget Act of 2015¹ (the “BBA”) (as modified by the Protecting Americans from Tax Hikes Act of 2015² (the “PATH Act”)) adopted a new centralized regime through which the Internal Revenue Service (the “Service”) will audit partnerships. The BBA repeals the partnership audit provisions of the Tax Equity and Fiscal Responsibility Act of 1982³ (“TEFRA”) and electing large partnership (“ELP”) regimes and replaces them with a new set of rules for partnership audits and judicial review of partnership audit adjustments, which we refer to herein as the “BBA Regime.”

Under the BBA Regime, “[a]ny adjustment to items of income, gain, loss, deduction, or credit of a partnership . . . (and any partner’s distributive share thereof) shall be determined . . . at the partnership level.”⁴ Under TEFRA, the additional tax due as the result of audit adjustments to a partnership’s return was assessed and collected from the partners. The BBA establishes a new default rule under which the Service assesses and collects certain taxes from the partnership.⁵ The BBA also allows a partnership and its partners to take various steps to alter the outcome under the default rule, which can include modifying the amount due from the partnership or utilizing alternative procedures to collect the tax due from the partners.⁶ In this regard, the BBA instructs the Department of the Treasury (“Treasury”) to establish procedures to implement these modifications and alternatives.

The BBA includes several specific provisions that instruct Treasury and the Service to provide further guidance. In Notice 2016-23,⁷ the Service requested comments on many issues, including those identified in the BBA. We previously submitted comments (our “Prior Comments”) on the statutory provisions and items referenced in Notice 2016-23.⁸

On June 14, 2017, Treasury and the Service published in the Federal Register proposed regulations (REG-136118-15) providing detail on the implementation of the BBA Regime (the “Proposed Regulations,” and the accompanying publication in the

¹ Pub. L. No. 114-74, 129 Stat. 584.

² Pub. L. No. 114-113, § 411, 129 Stat. 2242.

³ Pub. L. No. 97-248, 96 Stat. 324.

⁴ I.R.C. § 6221(a). Unless otherwise indicated, all “section” references are to the Internal Revenue Code as amended by the BBA and the PATH Act (the “Code” or “I.R.C.”). Pursuant to § 1101(g)(1), 129 Stat. at 638, of the BBA, the changes generally apply to partnership taxable years beginning after December 31, 2017.

⁵ I.R.C. § 6221(a).

⁶ I.R.C. §§ 6225 and 6226.

⁷ 2016-12 I.R.B. 490 (Mar. 28, 2016).

⁸ Letter from the American Bar Association Section of Taxation to John A. Koskinen, William J. Wilkins, and Mark Mazur, Re: Comments on Bipartisan Budget Act of 2015 Partnership Audit Procedures (June 6, 2016) (*available at* https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/060616comments_authcheckdam.pdf).

Federal Register, the “Notice of Proposed Rulemaking”).⁹ These Comments address the Proposed Regulations and offer recommendations for changes when those Regulations are finalized. Please note that the Section expects to separately submit comments that specifically address the basis and capital account issues raised in the Proposed Regulations.

II. EXECUTIVE SUMMARY

The following is a summary of our comments and recommendations:

A. Scope

- Revise the language from Proposed Regulation section 301.6621(a)-1(b)(1)(i)(H) to refer to “items *of a partnership* related to . . . transactions to which section 707 applies.”

B. Election to Opt Out of the BBA Regime

- Eliminate the rule that disregarded entities described in Regulation section 301.7701-2(c)(2)(i) are ineligible partners.
 - Instead, allow as an eligible partner any partner that is not specifically enumerated in the statute, but that is ultimately wholly owned by a single person (as defined in section 7701(a)(1)) that would be an eligible partner if that single person held the partnership interest directly.
 - In the case of any such partner, require the partnership to include with its tax return detailed information about the ownership structure to be eligible to make the Opt-Out Election.
- In Example 2 of Proposed Regulation section 301.6221(b)-1(b)(2)(iii), revise the example to state simply that Spouse 2 has only a community property interest in the partnership, which eliminates the need for the example to include the two assumptions (*i.e.*, (1) Spouse 1 and Spouse 2 have lived in a community property state at all times since they were married, and (2) Spouse 1 acquired the partnership interest while married to Spouse 2).
- Establish procedures through a private letter ruling program or otherwise to address uncertainties concerning whether a Schedule K-1 is required to be issued.
- Incorporate substantial compliance principles in evaluating the impact of flaws in making an Opt-Out Election.
- Provide a mechanism to allow partnerships to correct minor compliance errors relating to the Opt-Out Election, especially when the partnership

⁹ Notice of Proposed Rulemaking, 82 Fed. Reg. 27334, 27343 (2017).

acted reasonably and there is no prejudice to the Service, as well as when the partnership makes the correction before an audit has begun.

- Allow the Opt-Out Election to be valid when the partnership reasonably relies on the partner for the correct TIN and takes reasonable steps to make corrections, or, in the alternative, where the partnership acts reasonably and the partner's ownership falls below certain thresholds (*e.g.*, ten percent).
- Provide that, prior to the issuance of a notice of partnership proceeding, the Service will notify the partnership of any incorrect TINs and allow the partnership a reasonable period of time to provide the correct TIN.
- Revise Schedules K-1 to include a box for indicating that a partnership has made the Opt-Out Election.
- In the case of foreign partners who are individuals, provide that the partnership can submit a completed Form W-8 in lieu of the foreign partner's TIN.
- Clarify the effects of a constructive or de facto partnership on an otherwise valid Opt-Out Election.

C. Consistent Reporting Requirement

- Include an example to illustrate the outcome of the application of the rule that when a partnership fails to file a return, a partner's treatment of items is deemed to be *per se* inconsistent unless the partner files a notice of inconsistent treatment.
- Where a partner's treatment of an item on the partner's return is consistent with the treatment of that item as reported to the partner by the partnership but the treatment differs from what was reported on the return actually filed by the partnership, provide that the 60-day period during which the partner may elect to be treated as having complied with the requirement to file a notice of inconsistent treatment may be extended with approval by the Service.
- Permit a partner to take an inconsistent position (with the required statement identifying such inconsistent position) with respect to the partnership's treatment of an item reflected on an Administrative Adjustment Request ("AAR").
- Clarify that a partner may file an amended return in order to take a position inconsistent with the partnership's filed return as long as such amended return includes the required statement identifying such inconsistent position.

D. Partnership Representative

- To the extent the Service requires the Partnership Representative to provide updated contact information, it should only require that a Partnership Representative provide updated contact information to the Service if the partnership files an AAR or receives a notice of administrative proceeding.
- Explicitly provide that a disregarded entity can serve as a Partnership Representative.
- For the first prong of the substantial presence test—provide further guidance as to what constitutes “reasonable” with respect to the time and place for the ability to meet.
- For the second prong of the substantial presence test—clarify whether the requirement to be available during “normal business hours” is judged based on the Service’s normal business hours or the business’s normal business hours.
- Provide standards or limits for the “catch-all” circumstance under which the Service may determine that a person no longer has capacity to serve as a Partnership Representative.
- Include two additional categories of lack of capacity, where:
 - The Partnership Representative is known to be under criminal investigation for a violation of the Code. In the same category of incapacity, provide that an individual who has been convicted of a felony or of a crime that involves dishonesty or breach of trust lacks capacity to act.
 - The Partnership Representative is in bankruptcy or receivership proceedings.
- Provide that a Partnership Representative’s resignation is immediately effective if the resignation occurs because of one of the following circumstances:
 - The representative is the subject of a court order determining that the representative is incompetent.
 - The representative is the subject of a court order enjoining the representative from serving as a Partnership Representative.
 - The representative has been incarcerated.
 - The representative has become the subject of a criminal tax investigation.
 - The representative has been convicted of a felony or of a crime that involves dishonesty or breach of trust.

- The representative has become the subject of bankruptcy or receivership proceedings.
- If the mandatory requirement in Proposed Regulation section 301.6223-1(d)(2) (a Partnership Representative who resigns in connection with filing an AAR “must” designate a successor) controls, then provide that a Partnership Representative’s written notice of resignation may designate a successor Partnership Representative subject to the provisions of Regulation section 301.6223-1(d)(2).
- Use consistent language between Regulation section 301.6223-1(d)(1) and -1(d)(3), or if it is intentional that a Designated Individual’s written notice of resignation “may, but is not required to” appoint a successor while a Partnership Representative’s written notice of determination “may” designate a successor, clarify the consequences of the difference.
- In Regulation section 301.6223-1(d)(3), refer to the “restrictions described in paragraph (d)(2)” rather than to the “time of resignation restrictions in paragraph (d)(2).” If this proposed change is adopted, also replace the statement that a Designated Individual’s notice of resignation “may, but is not required to” appoint a successor with a statement that a Designated Individual’s notice of resignation does not have to appoint a successor except as provided in paragraph (d)(2).
- In lieu of determining that no Partnership Representative designation is in effect where a Designated Individual resigns without designating a successor, provide the partnership with an opportunity to appoint a new Designated Individual and/or a new Partnership Representative.
- Explicitly provide that a partnership can revoke a Partnership Representative designation for any reason.
- Require partnerships to revoke a designation in any circumstance where the partnership is aware that the Partnership Representative lacks capacity.
- Allow immediate revocations in the following situations:
 - The representative is the subject of a court order determining that the representative is incompetent.
 - The representative is the subject of a court order enjoining the representative from serving as a Partnership Representative.
 - The representative has been incarcerated.
 - The representative has become the subject of a criminal tax investigation.
 - The representative has been convicted of a felony or of a crime that involves dishonesty or breach of trust.
 - The representative has become the subject of bankruptcy or receivership proceedings.

- Provide that any resignation or revocation is effective immediately upon receipt of written notification by the Service.
- Provide a mechanism for the partnership to designate a new Designated Individual without revoking the Partnership Representative designation.
- In the context of an entity Partnership Representative with a Designated Individual—require the partnership also to send the revocation notice to the Designated Individual, and the Service to notify the Designated Individual for any Partnership Representative whose designation is being revoked.
- Delete “as shown on the partnership return for that taxable year” from Proposed Regulation section 301.6223-1(e)(3)(i), to make clear that a partnership is not limited to revoking only the initial Partnership Representative identified on the partnership’s tax return for a particular taxable year.
- Include, among the circumstances in which a partner other than the general partner may sign a revocation, the situation where each general partner eligible to sign the revocation no longer has capacity to act due to “any similar situation where the IRS reasonably determines the person may no longer have the capacity to act.”
- In the definition of “LLC”, exclude the specification that the organization “is classified as a partnership for Federal tax purposes.”
- Permit a partnership to revoke a designation of Partnership Representative made by the Service in either of the following instances:
 - The partnership seeks to revoke the designation to substitute a qualified representative who is ready to act on the partnership’s behalf.
 - There is a *bona fide* dispute over the capacity of the Partnership Representative designated by the Service.
- For a partnership that responds to a notice that a partnership designation is not in effect due to a technically faulty designation, provide such partnership with an opportunity to cure. Also clarify, perhaps through an example, that as long as the partnership responds within the 30-day period specified in the Regulations with a new Partnership Representative designation, the designation is valid and effective unless and until notified by the Service, at which time a new 30-day period would commence for the partnership to cure with a new designation.
- In situations involving multiple revocations, limit the partnership’s loss of the right to designate a Partnership Representative to cases where the Service determines that multiple revocations are part of a plan to delay or obstruct the audit.

- Limit the discretion that the Service has to appoint a particular Partnership Representative, *e.g.*, by barring the Service from designating any federal employee or contractor as a Partnership Representative as well as any former federal employee or contractor that participated in any prior audit of the partnership or would be precluded from representing the partnership under existing conflicts and ethics rules.
- Provide that the Service will appoint a non-partner as a Partnership Representative only in situations in which no partner is qualified to act and willing to serve.
- Specify the duties, including fiduciary duties, owed by the Partnership Representative to the partnership, particularly in the context of the Service appointing a non-partner as the Partnership Representative.
- With respect to the factors considered when the Partnership Representative is designated by the Service, focus the presumption on the largest profits interest in the reviewed year, rather than the status of the partner or member.
- Account for the possibility that a partnership may not have a Partnership Representative for the partnership taxable year, by clarifying that if the Service determines that a Partnership Representative designation is not in effect, the Service will notify the partnership and the most recent Partnership Representative if there was one. Additionally, if there is a prior entity Partnership Representative for the partnership tax year, require that the Service also notify the Designated Individual for the prior entity Partnership Representative.
- If the Service intends to reserve the flexibility to designate an entity Partnership Representative, then require the Service to designate a Designated Individual any time the Service designates an entity Partnership Representative and to provide the Designated Individual's contact information to the partnership.
- Revise Proposed Regulation section 301.6223-2(a) to state that "a notice of final partnership adjustment with respect to the partnership that is not contested by the partnership representative on behalf of the partnership" is binding.
- Implement section 6223 in a manner that contemplates that the Partnership Representative will act in a manner consistent with the authority granted to her by the partnership. Revise the language in Proposed Regulations section 301.6223-2(c)(1) and (2) as recommended, and revise examples in Proposed Regulation section 301.6223-2(d) accordingly.

- Require the Partnership Representative to take reasonable steps to provide notice to the partners upon commencement of the administrative proceeding, 30 days prior to finalizing any settlement, and upon the conclusion of the administrative proceeding, with similar requirements for judicial proceedings. Additionally, direct any pass-through partner to forward notices on to indirect partners.

E. Imputed Underpayment and Modifications

- Allow an ordinary income grouping to be reduced by a capital loss grouping to the extent of \$3,000 per direct or indirect individual partner.
- Apply the applicable rate for net negative adjustments to the relevant subgrouping and allow this amount to reduce the Imputed Underpayment amount.
- Provide for grouping and ordering credits in accordance with Form 3800.
- For items that may be treated as a credit when taken into account by a partner and are not otherwise limited (for instance, by their non-creditable status against the alternative minimum tax), specify that those items are credited against the Imputed Underpayment amount. For other items which may be subject to limitations at the individual level, provide rules similar to those under Proposed Regulation section 301.6225-1(b), as any adjustment to a credit would not result in an Imputed Underpayment.
- For foreign partners who may be subject to gross basis taxation or a modified rate under the Code or an income tax treaty, allow verification of requested modifications based on taxpayer status to be provided on expanded versions of the existing Forms W-8 and W-9. This would include verification of modifications or exemptions based on a tax exemption based on foreign status (including, without limitation, certification, if applicable, of the application of the portfolio interest exception for certain partners and the modification of the Imputed Underpayment on U.S.-source dividends from 39.6% to 30% even in the absence of reduced treaty rates), a tax exemption based on section 892, and reduction in taxes based on eligibility for reduced rates of withholding under a tax treaty).
- Expand the modification based on closing agreements to allow modifications based on closing agreements by and amongst the partnership and the relevant partners entered into in the course of a proceeding with the competent authority office.
 - Provide that partnerships can file protective claims for refund directly, on behalf of all partners, with the competent authority office in advance of filing an AAR.

- Permit multiple closing agreements and/or provide procedures for cooperation between the competent authority and partnership examination teams.
- With respect to the amended return modification process, provide that the required affidavit contain the partner’s TIN and contact information.
- With respect to other types of modification, include a basis for reducing an Imputed Underpayment where only the partner experiencing additional income (or less deduction, loss, or credit) as a result of a reallocation adjustment files an amended return and the partner experiencing a decrease to income (or more deduction, loss, or credit) as a result of a reallocation adjustment does not file an amended return.
- Do not adopt rules that require the submission of a request to file an amended return with a prohibition on filing the amended return until permission is granted. Instead, consider revising the amended return forms (1) to include a check-box asking if taxpayer filed a prior amended return for that same tax year that was the basis for a modification under section 6225, and (2) to require any taxpayer who answers in the affirmative to attach to the amended return an explanatory statement and certain related documents, such as the prior amended return.
- Regarding fiduciary responsibility rules under the Employee Retirement Income Security Act (“ERISA”): (1) provide that the Partnership Representative may solicit a vote of the partners in the partnership in determining whether to request a modification, and that the Service agrees to grant automatically a request for an extension of the 270-day period for requesting a modification if such a vote of the partners has been solicited, and (2) coordinate with the Department of Labor (“DOL”) so that the DOL clarifies that a Partnership Representative will not be treated as a fiduciary with respect to any ERISA plan partner if the Partnership Representative requests (or fails to request) a modification based on the results of a vote of the partners.
- Incorporate notification of reduction in suspended passive loss carryovers under section 6223 into the Schedule K-1 distributed to such partners at the end of the year.
- Provide that the allowance of a deficiency dividend be agreed to in advance of a notice of proposed partnership adjustment (“NOPPA”), but in the event of a challenge to the underlying substantive adjustment to Appeals or in court, does not become effective until final resolution of the underlying challenge.
- In the case of prior credits that should be recaptured as a result of a partnership adjustment, adopt a rule that incorporates any credit recapture into the calculation of any Imputed Underpayments to the extent that the originating credits were generated from partnership activities.

- In the case of a partnership adjustment that results in a credit that is incorporated into the calculation of Imputed Underpayments but should be recaptured at a later date, require the partnership to notify partners that they received the benefit of such credits, and that partners will be obligated to recapture those credits at a later date. This notice could be provided as notes to a current year Schedule K-1.
- For Service-initiated adjustments to foreign tax credit calculations, adopt an additional modification type that would allow the partnership to demonstrate the impact of these adjustments on one or more of its partners as not being as beneficial as assumed (for example, if the audit adjustment may result in no change to the foreign tax credits that could be claimed by one or more partners).
- Permit partners to submit requests for installment agreements or offers in compromise within the 270-day period as part of a closing agreement or an “other” appropriate adjustment.
- Where a partnership has had partners transfer their interests in the partnership, permit the partnership to demonstrate that such partner’s share of an adjustment was partially or fully reversed, and the calculation of the Imputed Underpayment should be reduced to give credit for taxes paid in a later year.
- Permit a publicly-traded partnership with certain passive losses to request a modification of the Imputed Underpayment within 74 days of the end of the adjustment year.
- Allow a publicly-traded partnership to reduce the Imputed Underpayment based on a net decrease in the passive activity loss allocable to a specified partner in the reviewed year to the extent the partnership takes such loss into account in the taxable year immediately preceding the year in which the NOPPA is issued.
- Clarify what issues a partnership may protest to Appeals and the process for doing so.
 - Allow the partnership to protest unagreed issues presented in a NOPPA to Appeals before providing information to the Service to modify the Imputed Underpayment.
 - Extend the 270-day period to allow a partnership at least 270 days following the completion of the Appeals process to provide information to the Service to modify the Imputed Underpayment.
 - Provide that the partnership may protest disagreements regarding modifications to the Imputed Underpayment to Appeals.
- Provide that any denied modification requests be reflected in the notice of final partnership adjustment (“FPA”). This will ensure that any Tax Court proceeding will also address the dispute regarding the requested modification.

- F. Alternative to Payment of the Imputed Underpayment Amount
- Authorize Push-Out Election by upper-tier flow-through entities of the audited partnership to the ultimate taxable owners.
 - Process the amended statements to indirect owners of upper-tier flow-through entities issuing partnership statements in a similar manner as the Service treats other information returns.
 - Provide an overall time limit for upper-tier flow-through entities in the chain of ownership to make the Push-Out Elections and issue the statements (for example, require that all upper-tier partnerships make any Push-Out Elections and issue any required statements no later than 270 days after the audited partnership makes its Push-Out Election).
- G. Administrative Adjustment Requests and Taxpayer Favorable Adjustments
- Specify that a partnership is deemed to have satisfied section 905(c) by filing an AAR that includes the required information outlined in Temporary Regulation section 1.905-4T(c)(2).
 - For a re-determination that results in a reduction of foreign income taxes paid or deemed paid, require the partnership to determine if the adjustment requested in the AAR results in an Imputed Underpayment in the reviewed year.
 - Where the adjustment requested in the AAR results in an Imputed Underpayment, permit the partnership to follow the procedures outlined in Proposed Regulation section 301.6227-2 and decide whether to pay any deficiency at the partnership level or push out the adjustment to the reviewed-year partners.
 - If the re-determination results in an increase of foreign income taxes paid or deemed paid, require the partnership to submit an AAR for the reviewed year and treat such AAR as a notice of re-determination for purposes of section 905(c).
 - Provide for an exception to the rule requiring reviewed-year partners to take into account adjustments requested in AARs that do not result in an Imputed Underpayment in the reporting year, *i.e.*, the year that the AAR is filed and statement furnished.
 - Require the partnership to calculate the safe harbor amount and include such amount in the statement to be furnished to reviewed-year partners.

H. Statute of Limitations

- Clarify that the NOPPA must be issued within the three-year period specified in section 6235(a)(1).
- Provide that, to the extent that the issuance of a NOPPA extends the statute of limitations beyond the date that would be applicable under section 6235(a)(1), such extension is effective only with respect to issues raised in the NOPPA.
- Include an explanation and example of how a request to modify an Imputed Underpayment under section 6225(c) impacts the computation of the period of limitations in sections 6235(a)(2) and 6235(a)(3).
- Prescribe a form that must be used to consent to an extension of the 270-day period under section 6225(c)(7) to avoid confusion and disputes over when the period of limitations expires.
- Clarify that when an amended return is filed taking into account adjustments that increase the partner's income, the partner should be allowed to offset such adjustments by previously unclaimed deductions.

I. Notices

- Specify that the 270-day period referenced in the first sentence of the flush language in section 6231(a) includes the number of days of any extension consented to by the Secretary under section 6225(c)(7).

J. State and Local Implications

- State that the Imputed Underpayment is a payment by the partnership of its partners' tax liabilities rather than a tax on the partnership entity.

III. **DISCUSSION**

We respectfully submit the following comments. In each section below, we briefly summarize particular statutory provisions and the pertinent provisions of the Proposed Regulations and then provide our comments.

A. Scope

1. The Statute – Section 6221

The BBA Regime applies to any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year and any partner's

distributive share thereof.¹⁰ “[U]nlike prior law, distinctions between partnership items and affected items are no longer made.”¹¹

2. The Proposed Regulations

Proposed Regulation section 301.6221(a)-1(b)(1) defines the phrase “income, gain, loss, deduction, or credit” to include: the character, timing, source, and amount of items; the character, timing, and source of the partnership’s activities; contributions to and distributions from the partnership; the partnership’s basis in its assets and the value of those assets; the amount and character of partnership liabilities; the separate category (for purposes of the foreign tax credit limitation), timing, and amount of the partnership’s creditable foreign tax expenditures; elections made by the partnership; items related to transactions between a partnership and any partner (including disguised sales and guaranteed payments); and any items related to terminations of a partnership; and partners’ capital accounts.

Proposed Regulation section 301.6221(a)-1(b)(2) defines “a partner’s distributive share” to include any partner’s share of any item determined at the partnership level; the nature and amount of the partner’s interest in the partnership; whether any special allocations apply to any partner; the character and timing of any item or activity required to be taken into account by the partner which is related to any item adjusted at the partnership level under subchapter C of chapter 63; and any amount required to be taken into account by the partner if the partnership makes an election under section 6226.

3. Comments

“[T]he proposed regulations take an expansive view of the scope of the centralized partnership audit regime”¹² and, accordingly, “broadly” interpret the phrase “items of income, gain, loss, deduction, or credit.”¹³ In particular, the Proposed Regulations identify eleven categories that are included within the definition of that phrase. Those categories generally include things that could affect “items of income, gain, loss, deduction, or credit of a partnership” in some relevant manner. In that sense, the identified categories seem generally consistent with the BBA itself.

However, we believe that Proposed Regulation section 301.6621(a)-1(b)(1)(i)(H) could be interpreted as going beyond the statutory authority provided by section 6621(a). That Proposed Regulation includes “items related to . . . transactions to which section 707 applies” within the definition of “items of income, gain, loss, deduction, or credit.” While such transactions may involve an “item of income, gain, loss, deduction, or credit of a partnership,” they may also involve items of income, gain, loss, deduction, or credit of the partners themselves. For example, the ordinary income a partner may realize from

¹⁰ I.R.C. § 6221(a).

¹¹ Staff of J. Comm. Tax’n, *General Explanation of Tax Legislation Enacted in 2015* at 57 (J. Comm. Print Mar. 2016).

¹² 82 Fed. Reg. 27334, 27337 (2017).

¹³ *Id.* at 27342.

a disguised fee under section 707(a)(2)(A) and the gain or loss a partner may realize from a disguised sale under section 707(a)(2)(B) are not “items of income, gain, loss, deduction, or credit *of a partnership*.”¹⁴ Consequently, bringing such ordinary income, gain, or loss within the scope of the BBA Regime would seem to go beyond the bounds of the authority that section 6221(a) confers. To remedy this issue, we recommend that the final Regulations revise the language from Proposed Regulation section 301.6621(a)-1(b)(1)(i)(H) to refer to “items *of a partnership* related to . . . transactions to which section 707 applies.”

B. Election to Opt Out of the BBA Regime

1. The Statute – Section 6221

The BBA permits certain partnerships with certain types of partners and a limited number of partners to make an annual election out of the BBA Regime for a tax year (the “Opt-Out Election”).¹⁵ The Opt-Out Election must be made on the timely filed return for such taxable year and must include, in a manner prescribed by the Secretary of the Treasury (the “Secretary”), a disclosure of the name and taxpayer identification number (“TIN”) of each partner of such partnership.¹⁶ The Secretary is authorized to allow “alternative identification of any foreign partners.”¹⁷

First, to be eligible for this election, each partner in the partnership must be “an individual, a C corporation, any foreign entity that would be treated as a C corporation were it domestic, an S corporation, or an estate of a deceased partner” (collectively, “eligible partners”).¹⁸ In addition, the Secretary may prescribe rules that provide for additional types of eligible partners.¹⁹ Second, to be eligible for this election, the partnership cannot have more than 100 partners, with the number of partners determined based on the number of statements the partnership is required to issue under section 6031(b) (*i.e.*, the Schedules K-1) for such taxable year.²⁰ If the partnership has an S corporation as a partner, the Schedules K-1 issued by the S corporation plus the S corporation itself count for purposes of meeting the 100-or-fewer-partners requirement. The partnership must also notify each of its partners, in a manner prescribed by the Secretary, when it makes an Opt-Out Election.²¹

¹⁴ I.R.C. § 6221(a) (emphasis added).

¹⁵ I.R.C. § 6221(b).

¹⁶ I.R.C. § 6221(b)(1)(D).

¹⁷ I.R.C. § 6221(b)(2)(B).

¹⁸ I.R.C. § 6221(b)(1)(C).

¹⁹ I.R.C. § 6221(b)(2)(C).

²⁰ I.R.C. § 6221(b)(1)(B).

²¹ I.R.C. § 6221(b)(1)(E).

2. The Proposed Regulations

Proposed Regulation section 301.6221(b)-1 provides guidance for this Opt-Out Election.

a. **Eligible Partnerships**

The Proposed Regulations reiterate that for a partnership to be eligible to make the Opt-Out Election, it must have 100 or fewer eligible partners, with that ceiling measured based on the number of statements (*i.e.*, Schedules K-1) that the partnership is required to issue under section 6031(b).²² For an S corporation, which can be an eligible partner, the statements required to be issued by the S corporation under section 6037(b) also count toward this ceiling, as does the statement issued to the S corporation itself.²³ In the Notice of Proposed Rulemaking, Treasury and the Service emphasize that compliance with the ceiling takes into account only statements *required* to be issued, so statements issued mistakenly by a partnership or S corporation do not count toward the limit.²⁴ The Proposed Regulations also treat statements issued to each of a husband and wife as two statements (and thus two partners counted toward the ceiling) if the issuance to each of the husband and wife was required under section 6031(b) or 6037(b).²⁵

The Proposed Regulations define an “eligible partner” as any partner that is an individual, a C corporation, an eligible foreign entity, an S corporation, or an estate of a deceased partner.²⁶ The Proposed Regulations specify that a C corporation is as defined by section 1361(a)(2) (which defines a C corporation as any corporation other than an S corporation) and that an S corporation will be an eligible partner regardless of whether one or more of its shareholders is not an eligible partner.²⁷ In the Notice of Proposed Rulemaking, Treasury and the Service note that the definition of C corporation encompasses a regulated investment company (a “RIC”) under section 851 and a real estate investment trust (a “REIT”) under section 856.²⁸ Additionally, Treasury and the Service “intend to continue to treat an organization that is determined to be, or claims to be, exempt from tax under section 501(a) and is classified as a corporation under section 7701(a)(3) as a C corporation” for purposes of this rule.²⁹ However, if the entity exempt from tax under section 501(a) is not organized as a corporation (and instead is, for example, a charitable trust), then it will not be treated as a C corporation for purposes of this rule.³⁰

²² Prop. Reg. § 301.6211(b)-1(b).

²³ Prop. Reg. § 301.6211(b)-1(b)(2)(ii) and (iii) Ex. (4).

²⁴ 82 Fed. Reg. 27334, 27343 (2017).

²⁵ Prop. Reg. § 301.6221(b)-1(b)(2)(iii), Ex. (1) and Ex. (2).

²⁶ Prop. Reg. § 301.6221(b)-1(b)(3)(i).

²⁷ *Id.*

²⁸ 82 Fed. Reg. 27334, 27343 (2017).

²⁹ *Id.*

³⁰ *Id.*

The Proposed Regulations define an “eligible foreign entity” by reference to the Regulations under section 7701, so that the foreign entity will be an eligible partner if it is a *per se* corporation, is classified as a corporation under the default rules, or properly elects to be treated as a corporation.³¹

The Proposed Regulations also exclude a number of entities from the definition of eligible partner. Those excluded entities are partnerships, trusts, foreign entities that are not eligible foreign entities, disregarded entities, nominees (or other similar persons that hold an interest on behalf of another person), and estates that are not estates of a deceased partner.³²

b. Making the Opt-Out Election

The Proposed Regulations also provide guidance for how to make the Opt-Out Election. A partnership may make the Opt-Out Election only on a timely filed partnership return (*i.e.*, Form 1065) (including extensions) for the partnership taxable year to which the election relates.³³ Thus, this election cannot be made on a return filed after the due date (including extensions). Further, the Proposed Regulations require that the partnership making the Opt-Out Election must disclose the names, correct TINs, and federal tax classifications of all partners (and shareholders of any S corporation partners) and any other information regarding those partners (and shareholders) as required by the Service in forms and instructions.³⁴ The Proposed Regulations also require that a partnership that makes the Opt-Out Election must notify each of its partners that the election has been made within 30 days of making the election.³⁵ In the Notice of Proposed Rulemaking, Treasury and the Service note that the Proposed Regulations do not mandate the form of the notice that the partnership must provide to its partners.³⁶ Accordingly, the notice may be in writing, electronic, or any other form chosen by the partnership.

The Proposed Regulations provide that an Opt-Out Election made by one partnership has no impact on any other partnership.³⁷ Thus, if a partnership that makes the Opt-Out Election is itself a partner in a partnership (which would make that lower-tier partnership ineligible to make the Opt-Out Election), then the BBA Regime continues to apply to the lower-tier partnership and any audit adjustment that might result from the audit of that lower-tier partnership.³⁸

The Proposed Regulations provide that if a partnership makes the Opt-Out Election, the Service will rely on that election unless and until it determines that the

³¹ Prop. Reg. § 301.6221(b)-1(b)(3)(iii).

³² Prop. Reg. § 301.6221(b)-1(b)(3)(ii).

³³ Prop. Reg. § 301.6221(b)-1(c)(1).

³⁴ Prop. Reg. § 301.6221(b)-1(c)(2).

³⁵ Prop. Reg. § 301.6221(b)-1(c)(3).

³⁶ 82 Fed. Reg. 27334, 27344 (2017).

³⁷ Prop. Reg. § 301.6221(b)-1(d).

³⁸ See Prop. Reg. § 301.6221(b)-1(d)(2), Ex. (1) and Ex. (2).

election was invalid.³⁹ If the Service determines that the election is invalid for a taxable year, then the Proposed Regulations provide that the Service will notify the partnership that the BBA Regime applies to that partnership for that taxable year.⁴⁰

The Notice of Proposed Rulemaking includes an admonition that the Service intends to scrutinize the Opt-Out Elections “to ensure that the election out rules are not used solely to frustrate IRS compliance efforts.”⁴¹ This scrutiny will include using “existing judicial doctrines and general federal tax principles” to determine if two or more partnerships should be recast “as having formed one or more constructive or de facto partnerships” with the result being that the constructive or de facto partnerships are subject to the BBA Regime and would be ineligible to make an Opt-Out Election.⁴²

3. Comments

a. **Additional Eligible Partners**

In our Prior Comments, we recommended that Treasury and the Service expand the types of “eligible partners.” The Proposed Regulations declined to add any types of “eligible partners” beyond the minimum required by the statutory provisions. We will not repeat all of our recommendations, but with respect to taxpayers who own their interests in a partnership through disregarded entities, single owner trusts, or nominees, we recommend the Treasury reconsider its decision not to treat them as eligible partners.

In the Notice of Proposed Rulemaking, the Treasury and the Service explain the decision not to expand the scope of “eligible partners” by summarizing the difficulties posed by various historical approaches to partnership audits, noting that the BBA Regime was intended to enhance the ability of the Service to audit partnerships, and concluding that the types of eligible partners should not be expanded because it will increase the administrative burden on the Service.⁴³

Treasury’s and the Service’s reluctance to expand the types of eligible partners is understandable. The administrative burden of assessing and collecting tax from each partner can be significantly greater than under the BBA Regime. But the reduced administrative burden for the Service is not without potentially significant consequences to taxpayers. The BBA Regime shifts from the Service to partnerships certain administrative functions performed by the Service under TEFRA. In addition, partners potentially affected by the BBA Regime must address (preferably in their partnership agreements) potential indemnification issues and conflicts of interest that do not exist under TEFRA or outside of the BBA Regime.

³⁹ Prop. Reg. § 301.6221(b)-1(e).

⁴⁰ Prop. Reg. § 301.6221(b)-1(e)(2).

⁴¹ 82 Fed. Reg. 27334, 27344 (2017).

⁴² *Id.*

⁴³ *Id.* at 27343.

Under the BBA, Congress determined that a partnership with up to 100 eligible partners could exercise the Opt-Out Election and, by doing so, place on the Service the administrative burden of examining and assessing tax on 100 different “eligible partners.” In contrast, under TEFRA, a partnership could not avoid the TEFRA centralized audit regime if it had more than 10 partners.⁴⁴ And unlike the BBA, a partnership could not avoid TEFRA if it had an S corporation as a partner.⁴⁵ These differences between TEFRA and the BBA Regime suggest that Congress intended to broaden the ability to elect out of a centralized audit, even if that meant the Service would face some administrative burdens. As long as the partners were of a certain type, Congress intended partnerships with up to 100 partners to be eligible to make the Opt-Out Election. Given that the statutory language provides express authority for the Secretary to expand the list of eligible partners, we believe it was Congress’ expectation that the list of eligible partners would be expanded through Regulations.

In declining to add additional types of eligible partners, the Proposed Regulations weigh too heavily in favor of avoiding administrative burden on the Service. In doing so, the Proposed Regulations do not appropriately reflect Congress’ policy choice to limit the burdens and complexities of the BBA Regime to partnerships of a certain size and complexity.

In the Notice of Proposed Rulemaking, Treasury and the Service state that comments on any potential expansion of the election out rules are particularly helpful if they address the additional burdens any such expansion would impose on the Service and not just the decreased burden on taxpayers resulting from the suggested change.⁴⁶ When a taxpayer owns a beneficial interest in a partnership through a disregarded entity, a single owner grantor trust, or a nominee (referred to herein as “simple disregarded structures”), the administrative burden on the Service of assessing and collecting tax from that taxpayer is nearly identical to a situation in which the taxpayer owns the interest directly. For example, if an individual owns a disregarded entity that owns a partnership interest, the administrative burden on the Service is not meaningfully different from what it would have been had that individual held the partnership interest directly, because the owner’s TIN is disclosed on the Schedule K-1.

Yet, when simple disregarded structures preclude the ability to make the Opt-Out Election, two partnerships that impose nearly identical administrative burdens on the Service will have dramatically different levels of complexity with respect to addressing Service examinations. Consequently, denying the Opt-Out Election simply because a partner owns the interest through a simple disregarded structure is not consistent with the broader policy objectives reflected in the BBA.

Furthermore, some partnerships with disregarded entities as partners are ultimately 100% owned by members of the same affiliated group. If these partnerships

⁴⁴ I.R.C. § 6231(a)(1)(B) (prior to amendment by the BBA).

⁴⁵ I.R.C. § 6231(a)(1)(B) (prior to amendment by the BBA).

⁴⁶ 82 Fed. Reg. 27334, 27343 (2017).

are not allowed to opt out of the BBA Regime, then any audit of the partnership will be conducted separately from any audit of the consolidated return. There is no benefit to two separate audits when it would be administratively easier for both taxpayers and the Service to audit the partnership in the same proceeding along with the consolidated group.

Notably, the BBA provides that a C corporation is an eligible partner for purposes of determining whether a partnership is eligible to elect out of the BBA Regime. A C corporation includes a qualified subchapter S subsidiary (“QSub”) and a qualified real estate investment trust subsidiary (“QRS”). Therefore, although QSubs and QRSs are disregarded for U.S. federal income tax purposes, neither one is an ineligible partner for purposes of determining whether a partnership can elect out of the BBA Regime. This, in turn, shows that under section 6221, not all partnerships with a disregarded entity as a partner are *per se* ineligible to elect out of the BBA Regime.

Accordingly, we recommend that the final Regulations eliminate the rule that disregarded entities described in Regulation section 301.7701-2(c)(2)(i) are ineligible partners. We recognize that such a definition of disregarded entity does not include QSubs and QRSs and so, in that sense, does not directly conflict with the underlying statute. However, there remains a potential inconsistency between the underlying statute, which treats some disregarded entities as eligible partners, and the Proposed Regulations, which treat other disregarded entities as ineligible partners.

We recommend that the final Regulations allow as an eligible partner any partner that is not specifically enumerated in the statute, but that is ultimately wholly owned by a single person (as defined in section 7701(a)(1)) that would be an eligible partner if that single person held the partnership interest directly. We also recommend that in the case of any such partner, the final Regulations require the partnership to include with its tax return detailed information about the ownership structure to be eligible to make the Opt-Out Election.

b. Community Property Example

Proposed Regulation section 301.6221(b)-1(b)(2)(iii) provides examples illustrating the rules for determining whether a partnership is eligible to elect out of the BBA Regime. Example 2 considers a situation where Spouse 1 owns a partnership interest and lives in a community property state with Spouse 2. The example provides that Spouse 2’s community property interest in Spouse 1’s partnership interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b). However, before reaching that conclusion, the example makes two assumptions: (1) Spouse 1 and Spouse 2 have lived in a community property state at all times since they were married, and (2) Spouse 1 acquired the partnership interest while married to Spouse 2. We do not believe that either of those assumed facts is relevant in reaching the ultimate conclusion that Spouse 2’s community property interest in Spouse 1’s partnership interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b). Consequently, we recommend that the final Regulations revise the

example to state simply that Spouse 2 has only a community property interest in the partnership, which eliminates the need for the example to also include the two assumptions noted above.

c. Importance of Proper Schedule K-1 Reporting

We note that the BBA Regime puts added pressure on the determination of whether to issue a Schedule K-1. As with any set of rules, there will be uncertainty in particular circumstances as to whether a Schedule K-1 is required to be issued. A common practice has been, when in doubt, to issue a Schedule K-1 because there was little to no downside to issuing an unnecessary Schedule K-1. Such a circumstance can now impact the ability to opt out of the BBA Regime. We recommend that the Service establish procedures (perhaps through the private letter ruling program) to address quickly uncertainties as they are identified.

d. Making the Election

In our Prior Comments, we recommended that the final Regulations provide a mechanism for correcting minor compliance errors (which are inevitable) so that Opt-Out Elections would not be treated as invalid because of a compliance error. We renew that request for a global mechanism to correct compliance errors. For example, the final Regulations could treat such errors as correctable as long as the partnership acted reasonably and the Service was not prejudiced by the error. Another option would be to allow corrections as long as the partnership makes them before an audit has begun.

While we continue to recommend a general mechanism for corrections, we are especially concerned by certain compliance requirements that seem especially prone to creating confusion, unfairness, or both. The Proposed Regulations provide that a partnership making the Opt-Out Election must disclose to the Service information about each partner, including the partner's "correct U.S. taxpayer information number (TIN)." The use of "correct" (which is not in the statutory language) raises a question whether the Service would view an Opt-Out Election as valid if the partnership inadvertently provided the Service with the wrong number after relying on the TIN the partner provided to the partnership. This result would be especially troublesome if the partner has a small interest in the partnership. For example, it would be unnecessarily harsh for an Opt-Out Election to be treated as invalid where a one-percent partner inadvertently reverses digits in the TIN information given to the partnership and the partnership relies on that number. Accordingly, we recommend that the final Regulations incorporate substantial compliance principles in evaluating the impact of flaws in making an Opt-Out Election.

We also recommend the final Regulations include a mechanism for allowing the partnership to make corrections. For example, the final Regulations could provide that where the partnership reasonably relies on the partner for the correct TIN and takes reasonable steps to correct the error, the Opt-Out Election will be valid. While we believe that should be sufficient, the final Regulations could also provide that where the partnership acts reasonably and the partner's ownership falls below certain thresholds

(e.g., ten percent), the Opt-Out Election is valid. In addition, we recommend that the final Regulations provide that if the Service identifies an incorrect TIN, it will provide notice of such incorrect TIN to the partnership prior to the issuance of a notice of partnership proceeding and allow the partnership a reasonable period of time to provide the correct TIN.

Another potential compliance error involves the requirement to provide notice of the Opt-Out Election within 30 days of making the election. We reiterate our recommendation that the Service revise Schedules K-1 to include a box for indicating that a partnership has made the Opt-Out Election.

Treasury and the Service requested comments describing situations in which a foreign partner in a partnership subject to the BBA Regime may not otherwise be required to have a TIN except for purposes of making an election out under section 6221(b), as well as recommendations for alternative identification procedures that could be used in such cases. With respect to identifying foreign partners, we do not believe that a foreign partner should be required to obtain a TIN in each instance. If a foreign partner invests in a U.S. partnership that does not have (i) a U.S. trade or business or (ii) U.S. source income for which there has not been withholding at the source, that foreign partner is not required to obtain a TIN. We recommend that in the case of foreign partners who are individuals, the final Regulations provide that the partnership can submit a completed Form W-8 in lieu of the foreign partner's TIN.

e. **Constructive and De Facto Partnerships**

We recommend that the final Regulations clarify the effects of a constructive or de facto partnership on an otherwise valid Opt-Out Election. For example, assume Partnership A and Partnership B each have 90 individual partners and each made an Opt-Out Election. In addition, assume the Service determines that Partnership A and Partnership B should instead be treated as a single partnership, thereby eliminating their eligibility to make the Opt-Out Election. We recommend that the final Regulations clarify the consequences in those circumstances for the two partnerships that filed and made Opt-Out Elections. In addition to avoiding wasteful litigation over procedural matters, including the clarification in the final Regulations (rather than only in the Notice of Proposed Rulemaking or the preamble to final Regulations) would have the advantage of putting taxpayers and their advisors on notice and allows taxpayers to rely on the clarification.

C. Consistent Reporting Requirement

1. The Statute – Section 6222

Section 6222 provides that a partner's return must be filed consistently with the partnership return, including the manner in which the partnership treats each item of income, gain, loss, deduction, or credit.⁴⁷ However, a partner may take a position on the

⁴⁷ I.R.C. § 6222(a).

partner's return that is (or may be) inconsistent with the position taken on the partnership's return if the partner files a statement identifying the inconsistency.⁴⁸ When a partner fails to report items consistently (and fails to file the appropriate statement), the Service will assess and collect any underpayment as a math error with no right to petition the Tax Court and contest the tax liability in a prepayment forum.⁴⁹ For partners that fail to comply with the consistency requirements in section 6222, an accuracy-related penalty under section 6662 is imposed.⁵⁰

2. The Proposed Regulations

Proposed Regulation section 301.6222-1 provides guidance regarding a partner's requirement to report items consistently with the partnership's return.

a. **Partner's Consistent Treatment of Partnership Items**

The Proposed Regulations provide guidance on what is required to satisfy the requirement of "consistent treatment" as set forth in the BBA. Specifically, the Proposed Regulations require that the treatment must be consistent "in all respects, including the amount, timing, and characterization" of such items.⁵¹ Further, a partner is not considered to have filed consistently, despite having treated the item consistently with schedules or other information furnished to the partner, if the treatment is ultimately inconsistent with the treatment on the partnership return that was actually filed.⁵² Finally, a partner's treatment of items attributable to a partnership that does not file a return is considered *per se* inconsistent.⁵³

Pursuant to the Proposed Regulations, the treatment of an item on a partnership return includes the treatment of an item on the partnership's return filed with the Service under section 6031 and any amendment thereto, including an administrative adjustment request ("AAR") filed pursuant to section 6227.⁵⁴ It also includes the treatment of any item on any statement, schedule or list, and any amendment or supplement thereto filed with the Service by the partnership.⁵⁵ This would include any statements filed pursuant to section 6226.⁵⁶

b. **Effect of Inconsistent Treatment**

The Proposed Regulations provide that in the event that a partner does not treat partnership items consistently with the manner in which they were reported on the

⁴⁸ I.R.C. § 6222(c).

⁴⁹ I.R.C. § 6222(b).

⁵⁰ I.R.C. § 6222(e).

⁵¹ Prop. Reg. § 301.6222-1(a)(1).

⁵² *Id.*

⁵³ Prop. Reg. § 301.6222-1(a)(3).

⁵⁴ Prop. Reg. § 301.6222-1(a)(4)(i).

⁵⁵ Prop. Reg. § 301.6222-1(a)(4)(ii).

⁵⁶ *Id.*

partnership return and does not provide notice of this inconsistent treatment as discussed below, the Service may adjust the inconsistently reported item on the partner's return to make it consistent.⁵⁷ Based upon this adjustment, the Service can determine the underpayment of tax that results and assess and collect such underpayment as if it were a mathematical or clerical error.⁵⁸ The partner would have no right to seek abatement under section 6213(b)(2).⁵⁹

c. Partner's Notification of Inconsistent Treatment

The Proposed Regulations provide that the rules regarding consistent treatment of items and the effect of inconsistent treatment do not apply to items identified by the partner as inconsistent.⁶⁰ This statement must be made by the partner in a manner prescribed by the Service in its forms, instructions or other guidance and must be attached to the partner's return on which the item is treated inconsistently.⁶¹ Further, the partner is only protected with respect to those items identified in the statement.⁶²

In the instance where the partner is bound under section 6223 by the actions of the partnership, such as with respect to the treatment of an item reflected on an AAR under section 6227 or a statement under section 6226 filed by the partnership, the notification provisions of Proposed Regulation section 301.6222-1(c)(1) applicable to partners would not apply.⁶³

d. Adjustment after Notification

The Proposed Regulations provide that if the partner properly notifies the Service of the inconsistent treatment of an item, and the Service disagrees with the partner's treatment, the Service may institute a proceeding with respect to the partner to examine the identified inconsistently reported item.⁶⁴ The Service is not precluded from also conducting a proceeding with respect to the partnership.⁶⁵

During this proceeding, the Service may adjust the identified, inconsistent item to make it consistent with the partnership, or determine that the correct treatment is altogether different.⁶⁶ The Service may also adjust any other items on the partner's return, including those not attributable to the partnership.⁶⁷ Any final decision with

⁵⁷ Prop. Reg. § 301.6222-1(b)(1).

⁵⁸ Prop. Reg. § 301.6222-1(b)(2).

⁵⁹ *Id.*

⁶⁰ Prop. Reg. § 301.6222-1(c)(1).

⁶¹ *Id.*

⁶² Prop. Reg. § 301.6222-1(c)(3).

⁶³ Prop. Reg. § 301.6222-1(c)(2).

⁶⁴ Prop. Reg. § 301.6222-1(c)(4)(i).

⁶⁵ *Id.*

⁶⁶ Prop. Reg. § 301.6222-1(c)(4)(ii).

⁶⁷ *Id.*

respect to an inconsistent position in a proceeding to which the partnership is not party is not binding on the partnership.⁶⁸

e. **Partner Receiving Incorrect Information**

In the event that the partner files consistently with the treatment of the item as reported to the partner by the partnership but that treatment differs from what was reported on the return that was actually filed by the partnership, the Proposed Regulations provide the partner with a remedy. A partner will be treated as having complied with the notification requirement if the partner demonstrates that the treatment on the partner's return is consistent with the treatment of that item as reported to the partner by the partnership and the partner makes an election for such an exception to apply.⁶⁹ The Proposed Regulations outline the time, manner, and contents for such election, which must be made no later than 60 days after the partner receives notice from the Service of the inconsistent treatment.⁷⁰

f. **Partner that is a Partnership**

The Proposed Regulations provide that the rules requiring consistency in reporting apply to a partnership-partner regardless of whether the partnership-partner has made an election under section 6221(b) to elect out of the BBA Regime.⁷¹ A partnership-partner must treat items attributable to a partnership in which it is a partner consistently with the treatment of such items on the return filed by the partnership in which it is a partner, unless the partnership-partner provides the required notification of inconsistent treatment.⁷² Any adjustment on account of such partnership-partner's failure to satisfy the consistent reporting requirements will be treated as a math error adjustment with no right to seek abatement of such assessment.⁷³

3. Comments

As a threshold matter, we believe the Proposed Regulations provide straightforward guidance with respect to the rules implementing section 6222. We make only a few recommendations with respect to the Proposed Regulations in this area.

a. **Partner's Consistent Treatment of Partnership Items**

As noted above, the Proposed Regulations explicitly provide that when a partnership fails to file a return, the partner's treatment is deemed to be *per se* inconsistent unless the partner files a notice of inconsistent treatment.⁷⁴ It is unclear,

⁶⁸ *Id.*

⁶⁹ Prop. Reg. § 301.6222-1(d)(1).

⁷⁰ Prop. Reg. § 301.6222-1(d)(2).

⁷¹ Prop. Reg. § 301.6222-1(a)(1).

⁷² *Id.*

⁷³ Prop. Reg. § 301.6222-1(b)(3).

⁷⁴ Prop. Reg. § 301.6222-1(a)(3).

however, what the ultimate outcome to the partner and possible effect of the “inconsistent treatment” would be. It does not appear that the Proposed Regulations would permit the Service to determine an underpayment and make a math error-type assessment utilizing the provisions in section 6222. Without a return filed by the partnership, there would not be a return with which to make the partner’s return consistent. The Proposed Regulations provide several examples that serve to illustrate the rules of Proposed Regulation section 301.6222-1(a). We recommend that the final Regulations include an example to illustrate the outcome of the application of the rules in Proposed Regulation section 301.6222-1(a)(3).

b. Partner Receiving Incorrect Information

The Proposed Regulations provide for a 60-day filing period for an election made pursuant to Proposed Regulation section 301.6222-1(d)(2). We recommend that the final Regulations provide that this period may be extended with approval by the Service. While many situations may be easily addressed by the partner seeking to make such election and compliance with the requirements within a 60-day period would not present an issue, under certain circumstances, a need may arise where the partner may require additional time to file such election, especially in the instance where the partner would also be required to provide an additional explanation of how the treatment of the item on the partnership’s return is consistent with the statement or other information provided to the partner by the partnership.

c. Due Process Concerns

As expressed in our Prior Comments we have a significant concern with respect to the lack of due process afforded to partners. Partnership returns may be prepared and filed incorrectly, and partners have little or no notice of these errors, especially before the filing of the partner’s original return. Under the Proposed Regulations, if an item on the partnership return is reported incorrectly and the partner does not identify it and file a notice of inconsistent treatment, the partner is bound by that error unless and until an AAR is filed or the Service examines the partnership and makes an adjustment.

Further, the Proposed Regulations provide that the notification procedures set forth in Proposed Regulation section 301.6222-1(c)(1) do not apply with respect to a partner’s treatment of an item reflected on an AAR under section 6227. This exclusion binds a partner to the amended return of a partnership as there is no ability to file a notice of inconsistent treatment by the partner as the Proposed Regulation prohibits it.

While they would not fully address or ameliorate the concerns expressed with respect to due process on which we elaborated in our Prior Comments, we make the following two recommendations. First, we recommend that the final Regulations be revised to permit the paragraph (c)(1) notification provisions to apply with respect to the partner’s treatment of an item reflected on an AAR. Second, we recommend that the final Regulations make clear that a partner may file an amended return in order to take a position inconsistent with the partnership’s filed return as long as such amended return includes the required statement identifying such inconsistent position.

D. Partnership Representative

1. The Statute – Section 6223

As part of the BBA, Congress created a replacement for the TEFRA “tax matters partner” called the “Partnership Representative.” Each partnership must designate, in the manner prescribed by the Secretary, a partner or other person with a substantial presence in the United States as the Partnership Representative.⁷⁵ The Partnership Representative has the sole authority to act on behalf of the partnership for purposes of the BBA Regime. Where no designation is in effect, the Secretary may select any person as the Partnership Representative.

The partnership and all of its partners are bound by actions taken by the Partnership Representative on behalf of the partnership and by any final decision in a proceeding brought under the BBA Regime with respect to the partnership.⁷⁶

The BBA significantly changes the tax matters partner rules of TEFRA. First, the partnership can identify a non-partner to serve as the Partnership Representative. Second, if the Service appoints a Partnership Representative, the statute does not require that the Service appoint someone who is (or was) a partner; instead, the Service may appoint “any person.”⁷⁷ Third and most significant, the Partnership Representative has greater power to bind the other partners, as it is vested with “sole authority” to act on the partnership’s behalf, and all partners are bound by actions taken by the partnership.⁷⁸

2. The Proposed Regulations

Proposed Regulations sections 301.6223-1 and 301.6223-2 provide guidance regarding the role and responsibilities of the Partnership Representative.

a. **Eligibility to Serve as the Partnership Representative**

The only limitations provided in the BBA for who can be the Partnership Representative are that the representative must be a “person” and such person must have a “substantial presence” in the United States.⁷⁹ The Proposed Regulations impose the additional requirement that the Partnership Representative also have “capacity.”⁸⁰

⁷⁵ I.R.C. § 6223(a).

⁷⁶ I.R.C. § 6223(b).

⁷⁷ I.R.C. § 6223(a).

⁷⁸ I.R.C. § 6223(b).

⁷⁹ I.R.C. § 6223(a).

⁸⁰ Prop. Reg. § 301.6223-1(b)(4).

i. **Person**

The Proposed Regulations adopt the section 7701(a)(1) definition of person.⁸¹ Section 7701(a)(1) provides: “The term ‘person’ shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.”⁸² However, if an entity is designated as the Partnership Representative, the Proposed Regulations require the partnership to appoint a “Designated Individual” to act “as the sole individual through whom the partnership representative will act for all purposes” related to the BBA Regime.⁸³ The Designated Individual must also meet the substantial presence and capacity requirements.⁸⁴ If the partnership does not appoint a Designated Individual, the Service may determine the Partnership Representative designation is not in effect, which would then trigger the procedures, discussed below, that allow the partnership 30 days to designate a new Partnership Representative (after which the Service can designate the Partnership Representative).⁸⁵

ii. **Substantial Presence**

While the term “substantial presence” is not defined in the BBA, it is defined in the Proposed Regulations. In the Notice of Proposed Rulemaking, the Treasury, and the Service specifically note that the Proposed Regulations do not adopt the substantial presence test from section 7701(b)(3) because the purpose of that test is to determine whether an alien individual should be treated as a resident for U.S. tax purposes.⁸⁶ Consistent with the explanation provided by the Staff of the Joint Committee on Taxation, Treasury and the Service note that the purpose of requiring a Partnership Representative to have a substantial presence “is to ensure ease of communication so the audit process can proceed smoothly.”⁸⁷

Accordingly, the Proposed Regulations adopt a three-part test to have a substantial presence in the United States for this purpose:

- i. The person is available to meet in person with the Service in the United States at a reasonable time and place, as is necessary and appropriate, as determined by the Service;

⁸¹ Prop. Reg. § 301.6223-1(b).

⁸² I.R.C. § 7701(a)(1).

⁸³ Prop. Reg. § 301.6223-1(b)(3)(i).

⁸⁴ *Id.*

⁸⁵ Prop. Reg. § 301.6223-1(b)(3)(ii).

⁸⁶ 82 Fed. Reg. 27334, 27347 (2017).

⁸⁷ *Id.*; see also Staff of J. Comm. Tax’n, *General Explanation of Tax Legislation Enacted in 2015* at 62 (J. Comm. Print Mar. 2016) (“A substantial presence in the United States enables the partnership representative to meet with the Secretary in the United States as is necessary or appropriate, and facilitates communication during the audit process and during any other proceedings in which the partnership is involved.”).

- ii. The person has a street address that is in the United States and a telephone number with a United States area code where the person can be reached during normal business hours; and
- iii. The person has a United States taxpayer identification number.⁸⁸

iii. Capacity

As noted above, the Proposed Regulations add the requirement that the Partnership Representative have “capacity.”⁸⁹ Rather than defining “capacity,” the Proposed Regulations identify five specific circumstances in which a person does not have capacity to act, plus a catch-all circumstance for “any similar situation where the IRS reasonably determines the person may no longer have the capacity to act.”⁹⁰ The five specific circumstances are:

- i. death;
- ii. a court order adjudicating that the person does not have the capacity to manage his or her person or estate;
- iii. a court order enjoining the person from acting on behalf of the partnership or the entity partnership representative;
- iv. incarceration; and
- v. liquidation or dissolution under state law in the case of an entity partnership representative.⁹¹

b. Mechanics for Designating the Partnership Representative

The BBA delegates to the Secretary the authority to determine the “manner” in which the partnership will designate its Partnership Representative.⁹² The Proposed Regulations provide that a partnership must designate the Partnership Representative (and appoint the Designated Individual, if applicable) on the partnership’s return for each partnership taxable year and must include the information required by forms, instructions, and other guidance to be released later.⁹³ Thus, a partnership can have different Partnership Representatives for different tax years, and the designation of a Partnership Representative for a later tax year does not invalidate a different Partnership Representative designation for an earlier tax year. Once designated by the partnership,

⁸⁸ Prop. Reg. § 301.6223-1(b)(2).

⁸⁹ Prop. Reg. § 301.6223-1(b)(4).

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² I.R.C. § 6223(a).

⁹³ Prop. Reg. § 301.6223-1(c).

the Partnership Representative (or the Designated Individual, if applicable) is deemed to satisfy the substantial presence requirements and have capacity to act unless and until the Service determines otherwise.⁹⁴ A designation of a Partnership Representative for a partnership taxable year remains in effect until the Partnership Representative resigns, the partnership revokes the designation, or the Service determines that the designation is not in effect, each of which is discussed below. An individual's status as a Designated Individual automatically terminates on the date the Partnership Representative designation is no longer in effect.⁹⁵

c. Changing the Partnership Representative

TEFRA allowed the tax matters partner to resign or the partnership to designate a new tax matters partner quite easily, allowing a new form to be submitted to the Service at any time to effectuate a resignation or replacement. As noted in the Notice of Proposed Rulemaking, the Service viewed these filings to resign or replace as creating unnecessary work for the Service until it had reason to interact with the tax matters partner. Accordingly, the Proposed Regulations restrict the timing for any resignation or revocation so that the Partnership Representative (or Designated Individual, if applicable) may not be changed until the Service issues a notice commencing an audit of the partnership or the partnership files a valid AAR other than for the sole purpose of effecting the resignation or revocation.⁹⁶

i. Partnership Representative Resignation

Subject to the timing rules described immediately above, the Proposed Regulations allow a Partnership Representative to resign simply by notifying the partnership and the Service in writing.⁹⁷ The Partnership Representative may resign regardless of whether the Partnership Representative was designated by the partnership or the Service. The resigning Partnership Representative may, but is not required to, designate a successor Partnership Representative.⁹⁸ A resignation is effective 30 days after the date the Service receives the written notification.⁹⁹ If the resigning Partnership Representative does not designate a successor and the partnership fails to designate a new Partnership Representative by the time the resignation is effective, the Service can trigger the rules for an ineffective designation, discussed below, that allow the partnership 30 days to designate a new Partnership Representative (after which the Service can designate the Partnership Representative).¹⁰⁰ Similar rules apply to the Designated Individual, allowing the Designated Individual to resign and appoint a successor.¹⁰¹

⁹⁴ Prop. Reg. § 301.6223-1(a).

⁹⁵ Prop. Reg. § 301.6223-1(b)(3)(i).

⁹⁶ Prop. Reg. § 301.6223-1(d)(2), -1(e)(2).

⁹⁷ Prop. Reg. § 301.6223-1(d)(1).

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ Prop. Reg. § 301.6223-1(d)(3).

ii. Partnership Revocation

Subject to the timing rules discussed above, the Proposed Regulations allow the partnership to revoke the Partnership Representative designation and designate a successor.¹⁰² To effectuate a revocation, the partnership must notify the Service in writing and must also notify the Partnership Representative whose designation is being revoked.¹⁰³ In addition, any revocation must identify a successor Partnership Representative and include a statement signed under penalties of perjury that the partner signing the revocation is authorized by the partnership to revoke the designation and has provided a copy of the revocation to the partnership and the Partnership Representative.¹⁰⁴ A revocation is effective 30 days after the Service receives the written notification. Upon the receipt of a valid revocation, the Service will notify the partnership and any Partnership Representative whose designation is being revoked of the acceptance of the revocation.¹⁰⁵ Should the Service designate the Partnership Representative (pursuant to rules discussed below), the partnership needs the Service's permission to revoke that Partnership Representative designation.¹⁰⁶

Failure to satisfy all the requirements of the revocation (including identification of a successor Partnership Representative) results in the prior Partnership Representative designation remaining in effect until the Service determines otherwise (or a proper resignation or revocation is submitted).¹⁰⁷

This revocation provision is an exception to the general rule that the Partnership Representative has the sole authority to act on behalf of the partnership. Accordingly, the Proposed Regulations set forth the mechanics for someone other than the Partnership Representative to effectuate the revocation.¹⁰⁸ Under the Proposed Regulations, a general partner as shown on the partnership return at the close of the taxable year for which the Partnership Representative was designated must sign the revocation.¹⁰⁹ If each general partner eligible to sign the revocation is no longer a partner or no longer has capacity to act on behalf of the partnership, any reviewed-year partner in the partnership may sign the revocation.¹¹⁰ The Proposed Regulations contain special definitions with respect to limited liability companies ("LLCs") and certain rules for which members of an LLC may sign a revocation.¹¹¹ For purposes of which members may sign a revocation, member-managers are treated as general partners, and other members are

¹⁰² Prop. Reg. § 301.6223-1(e).

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ Prop. Reg. § 301.6223-1(e)(4).

¹⁰⁷ Prop. Reg. § 301.6223-1(e)(1).

¹⁰⁸ Prop. Reg. § 301.6223-1(e)(3).

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

treated as a partner other than a general partner.¹¹² If there is no member-manager, each member is treated as a member-manager for purposes of effectuating a Partnership Representative revocation.¹¹³

iii. **Ineffective Designations**

As noted above, there are various circumstances in which the designation of a Partnership Representative or appointment of a Designated Individual is not properly made or the properly designated Partnership Representative or appointed Designated Individual fails to satisfy either the substantial presence or capacity requirements. As provided in the Proposed Regulations, when the Service determines a designation is not in effect, the Service will notify the partnership and the last Partnership Representative, if there was one, of the Service's determination.¹¹⁴ The Service's determination is effective on the date the Service mails the notification.¹¹⁵ Except as described below, the partnership will have 30 days to designate a successor Partnership Representative before the Service will designate a new Partnership Representative.¹¹⁶

The Proposed Regulations include special rules in the event multiple revocations are received within a 90-day period.¹¹⁷ The Notice of Proposed Rulemaking states that when this happens, "the IRS may not be able to readily determine the identity of the proper partnership representative."¹¹⁸ Accordingly, the Proposed Regulations provide that if the Service receives multiple revocations from different partners and determines that it is unable to ascertain which Partnership Representative the partnership wants to designate, the Service will notify the partnership that the designation is not in effect and designate a new Partnership Representative without providing the partnership with an opportunity to designate a Partnership Representative.¹¹⁹ The Treasury and the Service justify this result by saying this "rule avoids creating further confusion between the partnership and the IRS, which would delay the designation and the administrative proceeding."¹²⁰ As noted above, if the Service designates the Partnership Representative, the partnership cannot revoke that designation without permission from the Service. The Partnership Representative designated by the Service, though, could still resign.

d. **Authority of the Partnership Representative**

Section 6223(a) provides that the Partnership Representative has "sole authority to act on behalf of the partnership" with respect to an audit of the partnership. Further, section 6223(b) provides that the partnership and its partners are "bound" by any actions

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ Prop. Reg. § 301.6223-1(f).

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Prop. Reg. § 301.6223-1(e)(5).

¹¹⁸ 82 Fed. Reg. 27334, 27348 (2017).

¹¹⁹ *Id.*

¹²⁰ *Id.*

taken by the partnership in the course of the audit and by any final decision in a judicial proceeding brought under the BBA Regime with respect to the partnership.¹²¹ The Proposed Regulations extend that authority to a Designated Individual.¹²² Accordingly, the Partnership Representative (and Designated Individual, if applicable) is responsible for making all decisions with respect to the conduct of an audit, including formulating and delivering responses to requests for information from the Service, agreeing to extend the statute of limitations, agreeing to a proposed resolution with the Service, and contesting proposed adjustments either administratively or in court.

The Staff of the Joint Committee on Taxation describes the role of the Partnership Representative as meaning that “partners may not participate in or contest the results of an examination of a partnership by the Secretary.”¹²³ The Treasury and the Service expand somewhat in the Notice of Proposed Rulemaking by saying that the BBA Regime “does not include a statutory right to notice of, or to participate in, the partnership-level proceeding for any person other than the partnership and the [Partnership Representative].”¹²⁴ Thus, the statute does not provide the partners with any rights to participate in or contest any proposed audit adjustments. The Proposed Regulations provide that a partner must have permission from the Service in order to participate in the examination or any proceeding involving the partnership under the BBA Regime.¹²⁵

The Proposed Regulations specifically provide that “[n]o state law, partnership agreement, or other document or agreement may limit the authority of the partnership representative or the designated individual as described in section 6223 and this section.”¹²⁶ In addition, the Proposed Regulations include an example in which the partnership agreement requires the Partnership Representative to consult with an identified group of partners before extending the statute of limitations, but the Partnership Representative signs a statute extension without consulting that group.¹²⁷ The example states that the statute extension is valid.¹²⁸

Similarly, the ability of the Partnership Representative (or Designated Individual) to bind the partnership under state law is irrelevant. The Proposed Regulations include another example of a non-partner serving as the validly designated Partnership Representative, and the election by the Partnership Representative to “push out” audit adjustments under section 6226 was valid even though the Partnership Representative had no authority to act on behalf of the partnership under state law.¹²⁹

¹²¹ See also Prop. Reg. § 301.6223-2(a) (binding actions) and (c) (sole authority).

¹²² Prop. Reg. § 301.6223-1(b)(3).

¹²³ Staff of J. Comm. Tax’n, *General Explanation of Tax Legislation Enacted in 2015* at 61–62 (J. Comm. Print Mar. 2016).

¹²⁴ 82 Fed. Reg. 27334, 27339 (2017).

¹²⁵ Prop. Reg. § 301.6223-2(c)(1).

¹²⁶ Prop. Reg. § 301.6223-2(c).

¹²⁷ Prop. Reg. § 301.6223-2(d), Ex. (1).

¹²⁸ *Id.*

¹²⁹ Prop. Reg. § 301.6223-2(d), Ex. (2).

e. **Selection of the Partnership Representative by the Service**

As noted above, there can be circumstances in which the Service can designate a Partnership Representative. The differences between TEFRA and the BBA Regime with respect to the ability to appoint the party acting on behalf of the partnership (tax matter partner under TEFRA and Partnership Representative under the BBA) raise several issues. Under TEFRA, the Service could designate a tax matters partner when a partnership failed to designate one, but the person designated by the Service had to be a partner in the partnership. Under the BBA, the pool of potential Partnership Representatives is not limited to partners in the partnership. The BBA and the Proposed Regulations provide that when the Service designates the Partnership Representative, it may designate any person.¹³⁰ The Proposed Regulations do not explicitly require that the person selected by the Service must meet the substantial presence and capacity requirements.

Rather, the Proposed Regulations identify factors that the Service will consider in designating a person as the Partnership Representative, including whether the person is a partner in the partnership, either in the reviewed year or at the time the designation is made.¹³¹ The Proposed Regulations do not specify a preference for current or former partners (as many commentators had suggested) and do not require consideration of current or former partners before moving to other factors.¹³²

The other factors identified for consideration are:

- i. the views of the partners having a majority interest in the partnership regarding the designation;
- ii. the general knowledge of the person in tax matters and the administrative operation of the partnership;
- iii. the person's access to the books and records of the partnership; and
- iv. whether the person is a United States person (as defined in section 7701(a)(30)).¹³³

The Service will notify the partnership of its designation and provide the name, address, and telephone number of the new Partnership Representative.¹³⁴ The designation by the Service of a new Partnership Representative is effective on the day the Service mails the notification to the partnership.¹³⁵ Once the Service has designated a Partnership Representative, the partnership may not revoke that designation without the

¹³⁰ I.R.C. § 6223(a); Prop. Reg. § 301.6223-1(f)(5).

¹³¹ *Id.*

¹³² *Id.*

¹³³ Prop. Reg. § 301.6223-1(f)(5)(ii).

¹³⁴ Prop. Reg. § 301.6223-1(f)(5)(i).

¹³⁵ *Id.*

consent of the Service.¹³⁶ The Service is also required to send a notice of its designation to the new Partnership Representative.¹³⁷ While the Service is not required to seek the consent of the new Partnership Representative to act in such a capacity, the new Partnership Representative can resign as described above.

3. Comments

Our comments regarding the Partnership Representative provisions in the Proposed Regulations are grouped in the following three sections. First, we address the mechanics for designating the Partnership Representative in Proposed Regulation section 301.6223-1. Second, we address proposed provisions regarding the authority of the Partnership Representative in Proposed Regulation section 301.6223-2. Third, we provide some general comments that are focused on the issue of notice.

a. **Designation of the Partnership Representative**

i. **Overview**

There are a number of aspects of the Proposed Regulations that we believe will work well. In particular, the flexibility given to partnerships to designate a Partnership Representative is laudable, as it sweeps away artificial distinctions among partners and members that were present under TEFRA. In addition, we believe that having Partnership Representatives serve on a tax-year basis is a positive approach that may serve to limit some conflicts of interest where more than one year is under examination and the partnership has had changes in its composition from one tax year to the next. Further, the approach of requiring that the designation be made on the partnership return is sensible.

Proposed Regulation section 301.6223-1(a) provides that if a Partnership Representative's contact information changes, then the Partnership Representative must update its contact information "as required by forms, instructions, or other guidance" prescribed by the Service. Form 8822 or Form 8822-B could be modified to include notification of a change in a Partnership Representative's contact information. A Partnership Representative may want to provide such updated contact information to ensure timely receipt of any notices or communication from the Service. However, to the extent updating contact information is mandated, we recommend that the Service track the timing restrictions that apply to terminations of Partnership Representative designations via resignation or revocation. More specifically, we recommend that the final Regulations impose the requirement to provide updated contact information to the Service only if the partnership files an AAR or receives a notice of administrative proceeding.

The Treasury and the Service explain in the Notice of Proposed Rulemaking that processing resignations, revocations, and subsequent designations regardless of whether a

¹³⁶ Prop. Reg. § 301.6223-1(e)(4).

¹³⁷ Prop. Reg. § 301.6223-1(f)(5).

partnership is examined creates unnecessary work for the Service because the Partnership Representative may never be required to take any action on behalf of the partnership. To avoid that “resource drain,” the Proposed Regulations allow a change in Partnership Representative (either by resignation or revocation) only in connection with a valid AAR or after the Service issues a notice of administrative proceeding to the partnership.

The same rationale applies in the context of updated contact information for the Partnership Representative. We recognize that the Service is required to mail a notice of administrative proceeding to both the partnership and the Partnership Representative.¹³⁸ That the partnership will receive directly the notice of an administrative proceeding lessens the need for updated contact information from the Partnership Representative and use of the Partnership Representative’s last known address should be sufficient. After receiving a notice of administrative proceeding, a partnership should be incentivized to ensure that the Service has the Partnership Representative’s current contact information and so could provide such updated contact information at that time. As noted above, a Partnership Representative can choose to update its contact information but should not be required to unless and until the partnership files an AAR or receives a notice of administrative proceeding.

We also recommend that the final Regulations explicitly provide that a disregarded entity can serve as a Partnership Representative, as we note that the status of disregarded entities continues to cause a degree of confusion under TEFRA.¹³⁹ We see no reason why a disregarded entity (such as single-member limited liability company) should be ineligible to be a Partnership Representative as long as a Designated Individual is also appointed. For this reason, we recommend that the Regulations, when finalized, provide in Regulation section 301.6223-1(b)(1) that: “Any person (as defined in section 7701(a)(1)) *including any single member limited liability company treated as a disregarded entity (as described in § 301.7701-2(c)(2)(i))* that meets the requirements of paragraphs (b)(2) and (3) of this section, as applicable, is eligible to serve as a partnership representative.”

ii. **Substantial Presence Test**

The substantial presence test in Proposed Regulation section 301.6223-1(b)(2) appears workable for the most part and provides significant flexibility to partnerships in designating a Partnership Representative. That same flexible approach is bolstered by Proposed Regulation section 301.6223-1(b)(3), which authorizes the selection of an entity as the Partnership Representative.

While the third prong of the test for substantial presence is objective and the satisfaction of which should be easy to determine, the first two prongs are somewhat vague (“available to meet . . . at a reasonable time and place” and “normal business

¹³⁸ I.R.C. § 6231(a)(1).

¹³⁹ See *Seaview Trading, LLC v. Comm’r*, No. 15-71330, 2017 U.S. App. LEXIS 10109 (9th Cir. June 7, 2017) (holding that a partner’s ownership of a partnership interest through a disregarded entity makes the small partnership exception inapplicable and that the disregarded entity can serve as a tax matters partner).

hours”). Each of these seems to invest in the Service the discretion to determine if the prong is satisfied. The ability to be certain that all three prongs have been satisfied is critical to partnerships due to the rules that essentially leave it to the Service’s discretion to reject the designation of a Partnership Representative (or the appointment of a Designated Individual) and can trigger the procedures for an ineffective designation, which could lead to the Service designating the Partnership Representative. We recommend that the final Regulations include further guidance as to what the Service considers reasonable with respect to the time and place for the ability to meet.

With respect to “normal business hours,” we note that some businesses have “business hours” only at night or on a periodic or seasonal basis. We recommend that the final Regulations clarify whether the requirement to be available during “normal business hours” is judged based on the Service’s normal business hours or the business’s normal business hours.

iii. Capacity

In general, we believe that it is a positive development that the Proposed Regulations add capacity as a requirement for a Partnership Representative.¹⁴⁰ We believe the five specific circumstances of incapacity are sufficiently clear, but the vagueness of the catch-all and the discretion seemingly invested in the Service raises the prospect for the Service to reject the designation of a Partnership Representative (or appointment of a Designated Individual) and potentially trigger the procedures for an ineffective designation, which can lead to the Service designating the Partnership Representative. We recommend that the catch-all include standards or limits, as discussed above with the substantial presence test.

While the capacity requirements will apply to a Partnership Representative whether designated by the partnership or by the Service, there does not appear to be a mechanism in place that would permit the partnership to raise concerns about the capacity of a Partnership Representative designated by the Service. This is particularly important because a partnership can only revoke a designation by the Service with the consent of the Service.¹⁴¹

We thus also recommend that the final Regulations include two additional categories of incapacity.

The first additional category of incapacity to include is where the Partnership Representative is known to be under criminal investigation for a violation of the Code. The existing Regulations under TEFRA provide a mechanism to convert a partner’s partnership items into non-partnership items when the tax matters partner is notified that she is the subject of a criminal investigation, thereby precluding her from serving as a tax matters partner.¹⁴² Furthermore, courts applying TEFRA have concluded that a tax

¹⁴⁰ Prop. Reg. § 301.6223-1(b)(3); -1(b)(4).

¹⁴¹ See Prop. Reg. § 301.6223-1(e)(4).

¹⁴² See Reg. § 301.6231(c)-5.

matters partner who is under criminal investigation for a tax crime has a conflict of interest that may be disabling, at least where she is aware of the investigation.¹⁴³ For similar reasons, we believe that when a Partnership Representative is advised that she is the subject of a criminal investigation involving a violation of an internal revenue law, she should lack capacity to act on behalf of the partnership. Accordingly, we recommend that the final Regulations provide that such a person lacks capacity to serve as Partnership Representative. In the same category of incapacity, we also recommend that the final Regulations provide that an individual who has been convicted of a felony or of a crime that involves dishonesty or breach of trust lacks capacity to act, as such a conviction raises serious questions about the fitness of an individual to represent others, a concern that is reflected in Circular 230.¹⁴⁴

The second additional category of incapacity to include is where the Partnership Representative is in bankruptcy or receivership proceedings. Under TEFRA, where a partner filed for bankruptcy or was the subject of a receivership, partnership items became non-partnership items, thereby terminating that partner's ability to serve as tax matters partner.¹⁴⁵ We believe that a similar rule should be applied to the Partnership Representative. Having a person or entity who is involved in a bankruptcy or receivership act as the Partnership Representative creates the prospect that she may face conflicting duties. Moreover, a bankruptcy may also limit the incentive that the debtor has to achieve a favorable outcome on the tax liability associated with a partnership, undercutting such person's ability to represent others adequately. In addition, the bankruptcy of a non-partner Partnership Representative can adversely impact the person's ability to adequately represent the partnership. Therefore, we recommend that the final Regulations provide that a person who is in bankruptcy or receivership proceedings lacks the capacity to serve as Partnership Representative.

iv. **Resignation of the Partnership Representative**

We understand that the Service has concerns with the administrative burden associated with tracking changes in the Partnership Representative for partnerships that may never become the subject of examination. From the perspective of administrative convenience, making resignations effective as of the commencement of an administrative proceeding or the filing of an AAR is sensible. However, Treasury and the Service requested comments regarding other circumstances that warrant allowing a partnership or Partnership Representative to change the Partnership Representative designation. In response to that request, we believe that there should be some additional situations in which the Partnership Representative may resign. This is because the Partnership Representative is cloaked with authority to act on the partnership's behalf, and there will be situations in which a representative is resigning for a reason that would make it inappropriate to defer the effective date of his or her resignation. We recommend that the

¹⁴³ See *Transpac Drilling Venture 1982-12 v. Comm'r*, 147 F.3d 221, 227–28 (2d Cir. 1998); see also *Madison Recycling Assocs. v. Comm'r*, 295 F.3d 280, 288–89 (2d Cir. 2002).

¹⁴⁴ See 31 C.F.R. §§ 10.51(a)(2), (3).

¹⁴⁵ See Reg. § 301.6231(c)-7.

final Regulations specify that a resignation is immediately effective if it is because of one of the following circumstances:

- The representative is the subject of a court order determining that the representative is incompetent.
- The representative is the subject of a court order enjoining the representative from serving as a Partnership Representative.
- The representative has been incarcerated.
- The representative has become the subject of a criminal tax investigation.
- The representative has been convicted of a felony or of a crime that involves dishonesty or breach of trust.
- The representative has become the subject of bankruptcy or receivership proceedings.

In these limited categories, we believe that leaving a Partnership Representative in place would create adverse appearances for the relevant partnership and possibly, the Service. Further, to the extent that a representative's resignation is premised on the existence of an order enjoining the existing Partnership Representative from serving in that capacity, having the resignation be effective immediately would reflect appropriate respect for an order of a court of competent jurisdiction.

Proposed Regulation section 301.6223-1(d)(1) provides that a Partnership Representative may resign by notifying the partnership and the Service in writing. The Proposed Regulations provide that such written notification "may" designate a successor Partnership Representative. In contrast, Proposed Regulation section 301.6223-1(d)(2), which identifies the permissible times when a Partnership Representative may resign, provides that if a Partnership Representative resigns in connection with filing a valid AAR, then the Partnership Representative "must" designate a successor Partnership Representative. If the mandatory requirement in Proposed Regulation section 301.6223-1(d)(2) controls, then we recommend that the final Regulations provide that a written notification of resignation may designate a successor Partnership Representative subject to the provisions in Regulation section 301.6223-1(d)(2).

We also question why Proposed Regulation section 301.6223-1(d)(2) requires a written notification of resignation to designate a successor Partnership Representative when a Partnership Representative resigns in connection with a valid AAR but not when a Partnership Representative resigns after receiving a notice of administrative proceeding. It would seem that the Service has as much interest in having a successor Partnership Representative identified in the latter situation as in the former.

Proposed Regulation section 301.6223-1(d)(3) provides rules for when a Designated Individual resigns. As is the case when a Partnership Representative resigns, a Designated Individual may resign by notifying the partnership, the Partnership

Representative, and the Service in writing. The Proposed Regulations provide that the written notification “may, but is not required to” appoint a successor Designated Individual. We contrast that quoted language with Proposed Regulation section 301.6223-1(d)(1), which says only that a written notice of a Partnership Representative’s resignation “may” designate a successor Partnership Representative. We question whether the difference in language is meaningful. If we have identified a distinction without a difference, then we recommend that the final Regulations use consistent language in Regulation section 301.6223-1(d)(1) and (3). In contrast, if the different language is intentional, then we recommend that the final Regulations clarify the consequences of the difference.

Proposed Regulation section 301.6223-1(d)(3) also provides that the ability of a Designated Individual to resign is “subject to the time of resignation restrictions described in paragraph (d)(2).” We believe the Service intends the reference to paragraph (d)(2) to mean that a Designated Individual may resign only in connection with a valid AAR or after the partnership receives a notice of administrative proceeding. However, because the Service refers to the “time of resignation restrictions” in paragraph (d)(2) rather than to paragraph (d)(2) in its entirety, it is unclear whether the Service also meant to require that a Designated Individual appoint a successor if the Designated Individual resigns in connection with a valid AAR. If importing that requirement into Proposed Regulation section 301.6223-1(d)(3) was unintended, then we recommend that the final Regulations refer to the “restrictions described in paragraph (d)(2)” rather than to the “time of resignation restrictions in paragraph (d)(2).” Moreover, if this proposed change is adopted, then we also recommend that the final Regulations replace the statement that a Designated Individual’s notice of resignation “may, but is not required to,” appoint a successor with a statement that a Designated Individual’s notice of resignation does not have to appoint a successor except as provided in paragraph (d)(2).

Proposed Regulation section 301.6223-1(d)(3) also provides that if a resigning Designated Individual does not appoint a successor, then the Service will determine that there is no Partnership Representative designation in effect and will allow the partnership an opportunity to designate a new Partnership Representative. We question why a Designated Individual’s resignation and failure to appoint a successor automatically terminates the Partnership Representative designation and suggest that a more useful rule would be to provide the partnership with an opportunity to appoint a new Designated Individual and/or a new Partnership Representative. We therefore recommend that the final Regulations provide the partnership with this opportunity.

v. **Revocation of Designation**

We recommend that the final Regulations explicitly provide that a partnership can revoke a Partnership Representative designation for any reason. In addition, since the BBA Regime seems aimed at least in part to mitigate the delays due to the need to identify the tax matters partner that occurred under TEFRA, we recommend that the final Regulations require partnerships to revoke a designation in any circumstance where the partnership is aware that the Partnership Representative lacks capacity under Proposed

Regulation section 301.6223-1(b)(4). Specifically, we recommend that the Regulations, when finalized, read as follows in Regulation section 301.6223-1(e)(1):

The partnership may revoke the designation of the partnership representative for a partnership taxable year *for any reason*. *Revocation must be made* by notifying the partnership representative and the IRS in writing. *The partnership shall revoke the designation if it knows that the partnership representative lacks capacity to act as a partnership representative under § 301.6223-1(b)(4).*

In addition, for the reasons outlined above, we believe there should be some limited exception to the rule that revocations will only be effective as of the commencement of an administrative proceeding or the filing of an AAR. We recommend that the final Regulations allow immediate revocations in the following situations:

- The representative is the subject of a court order determining that the representative is incompetent;
- The representative is the subject of a court order enjoining the representative from serving as a Partnership Representative;
- The representative has been incarcerated;
- The representative has become the subject of a criminal tax investigation;
- The representative has been convicted of a felony or of a crime that involves dishonesty or breach of trust; or
- The representative has become the subject of bankruptcy or receivership proceedings.

We also question why Proposed Regulation section 301.6223-1(e) allows a partnership to revoke a Partnership Representative designation but does not allow a partnership to revoke a Designated Individual designation. There may very well be situations in which a partnership does not desire to change an entity Partnership Representative but rather seeks only to change the Designated Individual for that entity Partnership Representative. We recognize that such a change could be accomplished by revoking the Partnership Representative designation and then re-designating the same Partnership Representative with a new Designated Individual. But that approach seems unnecessarily burdensome, particularly given how commonly we expect this situation to arise. Therefore, we recommend that the final Regulations provide a mechanism for the partnership to designate a new Designated Individual without revoking the Partnership Representative designation.

Proposed Regulation section 301.6223-1(e)(1) provides that a partnership may revoke a Partnership Representative designation by providing written notice to the Partnership Representative and the Service. The Proposed Regulations also provide that the Service will notify the partnership and any Partnership Representative whose

designation is being revoked when the Service receives a valid revocation. We recommend that, in the context of an entity Partnership Representative with a Designated Individual, the final Regulations require the partnership also to send the revocation notice to the Designated Individual, and the Service to notify the Designated Individual for any Partnership Representative whose designation is being revoked.

Proposed Regulation section 301.6223-1(e)(3) provides rules for which partners may sign a Partnership Representative revocation. As a general matter, we question whether the restrictions limiting who can execute a revocation are necessary under the circumstances.¹⁴⁶ The fact that any revocation must include a certification that the revocation is duly authorized by the partnership should suffice.

More specifically, Proposed Regulation section 301.6223-1(e)(3)(i) provides that a revocation must be signed by a person who was a general partner at the close of the taxable year for which the Partnership Representative designation is in effect “as shown on the partnership return for that taxable year.” We recommend deleting the quoted language from the final Regulations to make clear that a partnership is not limited to revoking only the initial Partnership Representative identified on the partnership’s tax return for a particular taxable year. For example, we can envision a common situation where a partnership’s general partner revokes the Partnership Representative designation shown on the partnership’s tax return, appoints a successor Partnership Representative, and then subsequently seeks to revoke the successor Partnership Representative designation.¹⁴⁷ The successor Partnership Representative is not “shown on the partnership return for the taxable year” but that should not prevent the general partner from revoking that successor Partnership Representative designation.

Proposed Regulation section 301.6223-1(e)(3)(i) also provides that a partner other than the general partner may sign the revocation only if, at the time the revocation is signed, each general partner eligible to sign the revocation is no longer a partner or no longer has capacity to act as described in paragraphs (b)(4)(i) through (v). We recommend that Regulation section 301.6223-1(e)(3)(i), when finalized, also cite to paragraph (b)(4)(vi), which provides that a person does not have capacity to act in “any similar situation where the IRS reasonably determines the person may no longer have the capacity to act.” We believe that a partnership should have an opportunity to ask the Service to determine that, given the particular facts and circumstances, it is reasonable to determine that a general partner no longer has capacity to act. Such a determination would remain subject to the Service’s sole discretion.

Proposed Regulation section 301.6223-1(e)(3)(ii) provides special rules for when an LLC seeks to revoke a Partnership Representative designation. For purposes of those rules, the Proposed Regulations define “LLC” as an organization that, among other things, “is classified as a partnership for Federal tax purposes.” We recommend that the final Regulations not include the quoted language. The quoted language is confusing

¹⁴⁶ See Prop. Reg. §§ 301.6223-1(e)(3)(i), (ii).

¹⁴⁷ We note that our hypothetical situation does not implicate the multiple-revocation rule in Proposed Regulation section 301.6223-1(e)(5) because the two revocations are not “signed by different persons.”

because it could be read to mean that an LLC must be a partnership at the time it seeks to revoke a Partnership Representative designation for an earlier tax year. Such a reading is overbroad. An LLC that elects to be treated as a corporation for U.S. federal income tax purposes should be able to revoke a Partnership Representative designation for a tax year that precedes the election when the LLC was instead treated as a partnership for U.S. federal income tax purposes. Similarly, the LLC could become disregarded as separate from its owner for U.S. federal income tax purposes.

As to the provisions in Proposed Regulation section 301.6233-1(e)(5) regarding multiple revocations, while we understand the Service's concern that multiple revocations may create confusion about the identity of the appropriate Partnership Representative, we also believe that multiple revocations may have benign explanations. For example, through oversight, two different partners might sign identical revocations designating the same new Partnership Representative. Alternatively, a partnership might revoke a designation and designate a new Partnership Representative only to learn that the newly designated representative suffers some disabling conflict of interest or lacks capacity to act under the Proposed Regulations. We believe the discretion of the Service to treat multiple revocations as an indication that no designation is in place should be limited to cases where the Service determines that the multiple revocations represent an effort to delay or obstruct the examination. This is particularly important given the fact that the Regulation also provides that the partnership will not be given the opportunity to designate a representative before the Service does so (discussed below).¹⁴⁸

We note that Proposed Regulation section 301.6223-1(e)(4) provides that the Service must consent to any revocation of a Partnership Representative that the Service designated. While we understand the rationale for this provision, we are concerned that it offers no standards to guide the discretion of the Service. We understand that there are legitimate concerns that a partnership could seek to revoke a designation made by the Service as a delay or obstruction tactic, but if a partnership seeks to revoke a designation to substitute a qualified representative who is ready to act on its behalf, it should be permitted to revoke the prior Service designation. We also believe that the partnership should be able to revoke a designation by the Service if there is a *bona fide* dispute over the capacity of the Partnership Representative designated by the Service. We therefore recommend that the final Regulations permit a partnership to revoke a designation by the Service in these instances.

vi. **Effective Date for Resignation or Revocation of Partnership Representative Designation**

As noted above, the Proposed Regulations provide that the resignation or revocation of a Partnership Representative is effective 30 days from the date the Service receives written notification of such resignation or revocation.¹⁴⁹ The resignation or revocation of a Partnership Representative may well be precipitated by a dispute between the partnership and its Partnership Representative. To allow a Partnership

¹⁴⁸ See Prop. Reg. § 301.6223-1(f)(4).

¹⁴⁹ Prop. Reg. § 301.6223-1(d)(1) and (e)(1).

Representative, who has a potentially adversarial relationship with the partnership, to continue to have the sole authority to bind the partnership for another 30 days seems inappropriate. Accordingly, we recommend that the final Regulations provide that any resignation or revocation is effective immediately upon receipt of written notification by the Service.

vii. **Designation of the Partnership Representative by the Service**

While the basic mechanics outlined in this portion of the Proposed Regulations appear workable, several aspects of it raise concerns.

First, we believe that a partnership that responds to a notice issued under Proposed Regulation section 301.6223-1(f)(1) with a technically faulty designation should be given an opportunity to cure. We recommend that the final Regulations make clear, perhaps through an example, that as long as the partnership responds within the 30-day period specified in the Regulations with a new Partnership Representative designation, that designation is valid and effective unless and until notified by the Service, at which time a new 30-day period would commence for the partnership to cure with a new designation. A foot fault in the designation should not result in the loss of the right of a partnership to be represented by the person or entity of its choice.

Second, as discussed above in connection with Proposed Regulation section 301.6233-1(e)(5), the fact that a partnership can lose its opportunity to designate whenever there are multiple revocations in a 90-day period appears draconian, as there may be situations in which the multiple revocations have a rational explanation. We believe confidence in the fairness of the audit system is best served by endeavoring to have each partnership determine who will represent it. Accordingly, we recommend that the final Regulations limit the loss of a partnership's right to designate to situations in which the Service determines that multiple revocations are part of a plan to delay or obstruct the audit.

Third, we recommend that the final Regulations impose limits on the discretion that the Service has to appoint a particular representative. While the BBA provides that the Service can appoint "any person," we do not believe Congress intended that language to lead to absurd results (such as permitting a revenue agent conducting an audit to appoint herself as the Partnership Representative). This problem could be resolved by barring the Service from designating any federal employee or contractor as a Partnership Representative as well as any former federal employee or contractor that participated in any prior audit of the partnership or would be precluded from representing the partnership under existing conflicts and ethics rules.

Fourth, we recommend that the final Regulations provide that the Service will appoint a non-partner only in situations in which no partner is qualified to act and willing to serve. It is one thing for a partnership to elect to be represented by a non-partner voluntarily, but it is quite another for a partnership to have a non-partner representative appointed for it. Particularly in the context of the Service appointing a non-partner as the

Partnership Representative, we recommend that the final Regulations specify the duties, including fiduciary duties, owed by the Partnership Representative to the partnership. We believe that this is critical to ensure that the Partnership Representative, particularly one designated by the Service, is properly incentivized to act in the best interest of the partnership.

Fifth, while the factors identified in Proposed Regulation section 301.6223-1(f)(5)(ii) are relevant, we note that the profits interest that the potential appointee holds in the partnership is not listed as a relevant consideration. In contrast, profits interests are a relevant consideration under TEFRA.¹⁵⁰ As a general matter, we believe that a presumption that the Service should designate the partner (limited or general) or the member (managing or non-managing) with the largest profits interest in the reviewed year would generally function well, although the Service would have discretion to select another partner in appropriate circumstances.

TEFRA had a similar approach. In the absence of a designated tax matters partner, the general partner with the largest profits interest as of the end of the tax year was the tax matters partner.¹⁵¹ The problem with the TEFRA approach was that it was tied to general partner status, which ignored the economic reality that in some partnerships limited partners or non-managing members may have a much larger investment at stake than a general partner or managing member, who might have only a nominal investment. Consequently, we recommend that the presumption in the final Regulations be focused on the largest profits interest in the reviewed year and not focus on the status of the partner or member.

Sixth, Proposed Regulation section 301.6223-1(f)(1) provides that if the Service determines that a Partnership Representative designation is not in effect, the Service will notify the partnership and “the most recent partnership representative for the partnership taxable year.” We observe that it is not necessarily the case that there will ever have been a Partnership Representative for the partnership taxable year. For example, the Service may determine that a Partnership Representative designation is not in effect because the original Partnership Representative designated on a partnership’s tax return lacks a substantial U.S. presence. In that case, there would be no “most recent partnership representative for the partnership taxable year.” The Treasury and the Service recognize this point and explain in the Notice of Proposed Rulemaking that if the Service determines that a Partnership Representative designation is not in effect, the Service will notify the partnership and the most recent partnership representative “if there was one.” We recommend including the quoted language in the final Regulations. Additionally, if there is a prior entity Partnership Representative for the partnership tax year, we recommend that the final Regulations also require the Service to notify the Designated Individual for that prior entity Partnership Representative.

Seventh, we also observe that several aspects of the Proposed Regulations seem to suggest that if the Service is required to appoint a Partnership Representative, the Service

¹⁵⁰ Reg. § 301.6231(a)(7)-1(q)(2)(iii).

¹⁵¹ I.R.C. § 6231(a)(7)(B) (prior to amendment by the BBA).

does not intend to appoint an entity Partnership Representative. For example, Proposed Regulation section 301.6223-1(f)(5) provides that if the Service designates a Partnership Representative, then the Service must provide the Partnership Representative’s contact information to the partnership. The Proposed Regulations do not, however, require the Service to provide a Designated Individual’s contact information to the partnership. If the Service intends to reserve for itself the flexibility to designate an entity Partnership Representative, then we recommend that the final Regulations require the Service to provide the Designated Individual’s contact information to the partnership. Similarly, Proposed Regulation section 301.6223-1(b)(3)(ii) provides that if an entity Partnership Representative is designated in the context of either a resignation or a revocation, then a Designated Individual must be appointed at that time. However, Proposed Regulation section 301.6223-1(b)(3)(ii) does not apply the same rule to a situation where the Service appoints a Partnership Representative. Again, if the Service intends to reserve for itself the flexibility to designate an entity Partnership Representative, then we recommend that the final Regulations require the Service to appoint a Designated Individual any time the Service designates an entity Partnership Representative.

b. Binding Effect of Actions of the Partnership and the Partnership Representative

Section 6223(a) requires that each partnership designate a Partnership Representative, “who shall have the sole authority to act on behalf of the partnership under this subchapter.”¹⁵² This is a major change from TEFRA, which gave all partners a potential voice in the audit process.¹⁵³

Section 6223(a) is reinforced by section 6223(b), which provides as follows: “Binding Effect—A partnership and all partners of such partnership shall be bound (1) by actions taken under this subchapter by the partnership, and (2) by any final decision in a proceeding brought under this subchapter with respect to the partnership.”¹⁵⁴ Proposed Regulation section 301.6223-2 is designed to implement section 6223(b).

Proposed Regulation section 301.6223-2(a) provides that “a notice of final partnership adjustment with respect to the partnership that is not contested by the partnership or the partnership representative” is binding. The partnership cannot contest a notice of final partnership adjustment unilaterally. Only the Partnership Representative, acting on the partnership’s behalf, can do so. For that reason, we recommend revising the quoted language such that the Regulations, when finalized, instead state that “a notice of final partnership adjustment with respect to the partnership that is not contested by the

¹⁵² I.R.C. § 6223(a).

¹⁵³ I.R.C. § 6224(a) (prior to amendment by the BBA) (providing that “[a]ny partner has the right to participate in any administrative proceeding relating to the determination of partnership items at the partnership level”). Concededly, not all partners were created equal under TEFRA; some partners were not entitled to direct notice. *See* I.R.C. § 6223(b)(1) (prior to amendment by the BBA) (limiting notice to one percent or greater holders in partnerships comprised of over 100 members); *see also* I.R.C. § 6223(c)(3) (prior to amendment by the BBA) (providing for direct notice to indirect partners if they were identified to the Service).

¹⁵⁴ I.R.C. § 6223(b).

partnership representative *on behalf of the partnership*” is binding. That formulation has the additional benefit of tracking the language in the preceding clause, which refers to “a settlement agreement entered into by the partnership representative on behalf of the partnership.”

Proposed Regulation section 301.6223-2(c) presents significant issues. This portion of the Proposed Regulations provides that “[n]o state law, partnership agreement, or other document or agreement may limit the authority of the partnership representative or the designated individual as described in section 6223 and this section.”¹⁵⁵ Proposed Regulation section 301.6223-2(c)(2) further provides that “[a] partnership representative, by virtue of being designated under section 6223 and Proposed Regulation section 301.6223-1, has the authority to bind the partnership for all purposes under subchapter C of chapter 63.”¹⁵⁶ The Proposed Regulations also include several examples in which the Partnership Representative took action that will be viewed by the Service as a binding and effective event though that action was contrary to or inconsistent with provisions of the partnership agreement.¹⁵⁷

We understand that a goal behind the BBA is to audit more effectively partnerships and that providing the Service with a single point of contact for the audit is important to achieving that goal. As such, it makes sense to centralize responsibility for interacting with the Service in the audit. That centralized responsibility, though, should not be so sweeping so as to allow that person to act unilaterally or without any need to consult with the partnership or its partners. Section 6223 bestows “sole authority” to the Partnership Representative, but that sole authority is still only to “act on behalf of the partnership under this subtitle.”¹⁵⁸ State law and partnership agreements can limit the scope of an agent’s authority, such as requiring consultation or prohibiting an agent from acting inconsistently with instructions from the partnership. A Partnership Representative can act consistently with those limitations and still be the sole authority to act on behalf of the partnership during the audit.

As more fully described below, the final Regulations should clarify (perhaps through additional examples) that the Partnership Representative will be operating as the agent on behalf of the partnership subject to the same control by the partnership as any principal would have over an agent. The Partnership Representative can fulfill the role of having the centralized responsibility for conducting the audit without disregarding limitations that may be imposed by either state law or the partnership agreement. In order to ensure efficient operation of the audit, the final Regulations could also provide that any limitations on the Partnership Representative be made known to the Service shortly after commencement of any examination. Specific recommendations are made below.

¹⁵⁵ Prop. Reg. § 301.6223-2(c)(1).

¹⁵⁶ Prop. Reg. § 301.6223-2(c)(2).

¹⁵⁷ Prop. Reg. § 301.6223-2(d), Ex. (1).

¹⁵⁸ I.R.C. § 6223(a)

i. **The Partnership Representative is an Agent of the Partnership**

That Congress intended the Partnership Representative to be an agent of the partnership is clear from the language of the statute. As noted above, section 6223(a) refers to the Partnership Representative as having “sole authority to act on behalf of the partnership. Further, section 6223(b) provides as follows: “Binding Effect—A partnership and all partners of such partnership shall be bound (1) *by actions taken under this subchapter by the partnership*, and (2) by any final decision in a proceeding brought under this subchapter with respect to the partnership.”¹⁵⁹ Notably, section 6223(b) does not refer to the partners being bound by the actions of the Partnership Representative. When section 6223(a) and (b) are read together, it is apparent that Congress expected the Partnership Representative to act as an agent on behalf of *and at the direction* of the relevant partnership.

Congress’ decision to use the word “representative” is also instructive. The term “representative” has a long history in the context of Service examination proceedings, which is relevant to its meaning in the BBA.¹⁶⁰ It has been used in the statute that authorizes the Secretary to determine who can appear in matters before Treasury since 1884.¹⁶¹ Initially, the statute authorized the Secretary to impose regulations “governing the recognition of agents, attorneys, or other persons representing claimants before his Department,” and it also provided that the Secretary could “require [that] such persons, agents and attorneys, before being recognized as *representatives* of claimants” demonstrate relevant qualifications and good character.¹⁶² Thus, the term “representative” was historically equated with “agents” and with “attorneys,” who are a specialized type of agent.¹⁶³

In its current form, the same statute gives the Secretary the authority to “regulate the practice of representatives of persons before the Department of the Treasury,” and to require that each “representative” demonstrate qualifications, competency, good character, and reputation.¹⁶⁴ The Secretary has exercised this authority to designate

¹⁵⁹ I.R.C. § 6223(b) (emphasis added).

¹⁶⁰ See *Molzof v. United States*, 502 U.S. 301, 307 (1992) (“Where Congress borrows a term of art. . . it presumably knows and adopts the cluster of ideas that were attached to each borrowed word in the body of learning from which it was taken and the meaning its use will convey to the judicial mind. . . .”) (quoting *Morissette v. United States*, 342 U.S. 246, 263 (1952)); see also *Perrin v. United States*, 444 U.S. 37, 42 (1979) (“unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning”). And in discerning the “common meaning” of statutory language, the historical use of a term is relevant. *Id.* at 42–45 (tracing meaning of the term “bribery” from common law to date of relevant legislation).

¹⁶¹ See *Loving v. IRS*, 742 F.3d 1013, 1019 (D.C. Cir. 2014) (quoting Act of July 7, 1884, ch. 334, sec 3, 23 Stat. 258).

¹⁶² *Id.* (emphasis added).

¹⁶³ See *Comm’r v. Banks*, 543 U.S. 426, 436 (2005) (discussed *infra*). The regulations refer to “representatives” as “attorneys-in-fact,” while making “attorneys” one category of persons who will be recognized as an “attorney-in-fact.” Reg. §§ 601-502(a), (b)(1).

¹⁶⁴ 31 U.S.C. §§ 330(a)(1), (2).

attorneys as one of the categories of persons authorized to serve as representatives in adversarial proceedings before the Service, such as audits.¹⁶⁵ Enrolled *agents* are also authorized to serve as representatives.¹⁶⁶

Therefore, the decision of Congress to use the word “representative” was significant because the word is freighted with meaning: “The term ‘representative’ is traditionally and commonly defined as an agent with authority to bind others.”¹⁶⁷ Moreover, the ability of the principal to control and direct its agent is central to the agency relationship:

Agency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and *subject to the principal’s control*, and the agent manifests assent or otherwise consents so to act.¹⁶⁸

The principal’s ability to control the agent is “an essential element” of the agency relationship.¹⁶⁹ The Supreme Court has emphasized this in the context of adversarial proceedings, describing the relationship between attorney and client as follows:

The relationship between attorney and client . . . is a quintessential principal-agent relationship. The client may rely on the attorney’s expertise and special skills to achieve a result the client could not achieve alone. That, however, is true of most principal-agent relationships and *it does not alter the fact that the client retains ultimate dominion and control over the underlying claim*. The control is evident when it is noted that, although the attorney can make tactical decisions without consulting the client, the plaintiff still must determine whether to settle or proceed to judgment and make, as well, other critical decisions.¹⁷⁰

In drafting the BBA, Congress created a Partnership *Representative* to act on behalf of the partnership. Congress’s decision to use a word with an accepted meaning in the context of audit proceedings indicates that Congress intended that the Partnership Representative would be subject to the same control by the partnership that would normally apply to any agent representing a client in an audit.¹⁷¹ That Congress drafted section 6223(b) to provide that partners would be bound “by actions taken under this

¹⁶⁵ 31 C.F.R. § 10.3(a).

¹⁶⁶ 31 C.F.R. § 10.3(c) (providing that “[a]ny individual enrolled *as an agent* pursuant to this part who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service”) (emphasis added).

¹⁶⁷ *Loving v. IRS*, 742 F.3d 1013, 1016 (D.C. Cir. 2014).

¹⁶⁸ RESTATEMENT (THIRD) OF AGENCY, § 1.01 (2006) (emphasis added).

¹⁶⁹ *Hollingsworth v. Perry*, 133 S. Ct. 2652, 2666 (2013) (quoting RESTATEMENT (THIRD) OF AGENCY, § 1.10 comment f (2006)); *see also Taylor v. Sturgell*, 553 U.S. 880, 906 (2008) (discussed *infra*).

¹⁷⁰ *Comm’r v. Banks*, 543 U.S. 426, 436 (2005) (citations omitted) (emphasis added).

¹⁷¹ *See Perrin v. United States*, 444 U.S. 37, 42–43 (1979) (“unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning”); *see also Sturgeon v. Frost*, 136 S. Ct. 1061, 1070 (2016) (“It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.”) (quoting *Roberts v. Sea-Land Servs., Inc.* 566 U.S. 93, 101 (2012)).

subchapter by the partnership” reinforces this inference because actions are only undertaken by the partnership *through* the Partnership Representative.

ii. Supreme Court Precedent Allows Control Over Agents

Existing Supreme Court precedent indicates that a representative such as an agent or a fiduciary can bind others because those who would be bound have the authority to control its actions. Specifically, the Court has recognized that certain relationships will permit one party participating in a judicial proceeding¹⁷² to bind others:

[T]here is an exception when it can be said that there is “privity” between a party to the second case and a party who is bound by an earlier judgment. For example, a judgment that is binding on a guardian or trustee may also bind the ward or the beneficiaries of a trust.¹⁷³

While recognizing that someone can be bound by the outcome of litigation handled by another based on their legal relationship, the Court nonetheless observed that “there are clearly constitutional limits on the ‘privity’ exception.”¹⁷⁴ In *Taylor v. Sturgell*,¹⁷⁵ the Supreme Court explained that an agency or fiduciary relationship permits a court to bind non-parties because of the control the relationship gives the non-party over the actions of the agent: “[P]rivity is appropriate only if the putative agent’s conduct of the suit is subject to the control of the party who is bound by the prior adjudication.”¹⁷⁶ Consistent with Supreme Court precedent, section 6223 should be implemented to contemplate that each partnership would be able to reasonably control its representative’s actions.

iii. State Law Agency Principles

Because the Code generally interacts with state law, rather than displacing it, courts have been reluctant to find that state law is preempted in the absence of a direct

¹⁷² While the relevant case law concerning the ability of an agent to bind her principal has arisen specifically in the context of judicial proceedings, it is equally applicable to administrative proceedings, which can have the same preclusive effect as judicial proceedings. See *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966); see also *B&B Hardware, Inc. v. Hargis Indus., Inc.*, 135 S. Ct. 1293, 1303 (2015); *University of Tenn. v. Elliott*, 478 U.S. 788, 797–98 (1986); see generally RESTATEMENT (SECOND) OF JUDGMENTS § 83(1) (generally, “a valid and final adjudicative determination by an administrative tribunal has the same effects under the rules of res judicata, subject to the same exceptions and qualifications as a judgment of a court”).

¹⁷³ *Richards v. Jefferson Cty.*, 517 U.S. 793, 798 (1996).

¹⁷⁴ *Id.*

¹⁷⁵ 553 U.S. 880 (2008).

¹⁷⁶ *Id.* at 906 (citing RESTATEMENT (SECOND) OF AGENCY, § 14 at 60 (1957)); see also RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (“the agent shall act on the principal’s behalf *and subject to the principal’s control*”) (emphasis added).

conflict between a provision of the Code and a state law rule.¹⁷⁷ For example, the Third Circuit has held that section 7502 (the timely mailing provision) did not preempt the common law mailbox rule.¹⁷⁸ And in the specific area of partnership law, the Fifth Circuit rejected the argument that the trust fund recovery penalty provisions of the Code preempted Texas state partnership law, which made partners in a general partnership jointly and severally liable.¹⁷⁹

Moreover, regulation of the internal affairs of business entities is normally a matter for state law,¹⁸⁰ a factor that makes it unlikely that Congress would lightly displace relevant state law governing a partnership's authority to control its representative.¹⁸¹ For example, in *Mikulski v. Centerior Energy Corporation*,¹⁸² the Sixth Circuit rejected the argument that section 7422(a) precluded shareholders from suing under state law for damages based on an allegation that they paid additional taxes due to the corporation's improper application of section 312.¹⁸³ The Sixth Circuit contrasted the shareholders' case with situations where the defendant is acting as a collection agent for the Service, a context in which courts have concluded that section 7422(a) requires that the sole remedy for an error in withholding be through a refund claim.¹⁸⁴ State law is displaced in those cases because there is a direct conflict with federal law.¹⁸⁵

The Proposed Regulations include an example indicating that a provision in a partnership agreement that requires a Partnership Representative to confer with one or more partners before acting would not constrain her ability to act or alter the validity of her actions.¹⁸⁶ As the language of section 6223 itself does not indicate that Congress intended to preempt state law governing partnerships or the relations between an agent

¹⁷⁷ This approach indicates that field preemption does not apply under the Code. Field preemption is applied in cases where state law "regulates conduct in a field that Congress intended the Federal Government to occupy exclusively." *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990).

¹⁷⁸ See *Phila. Marine Trade Ass'n Int'l Longshoremen's Ass'n Pension Fund v. Comm'r*, 523 F.3d 140, 148–52 (3d Cir. 2008).

¹⁷⁹ *Remington v. United States*, 210 F.3d 281, 283–84 (5th Cir. 2000).

¹⁸⁰ See *Cort v. Ash*, 422 U.S. 66, 84 (1975) ("Corporations are creature of state law . . . except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."); see also *Kamen v. Kemper Fin. Servs. Inc.*, 500 U.S. 90, 98 (1991) ("The presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered into legal relationships with the expectation that their rights and obligations would be governed by state-law standards.").

¹⁸¹ Congressional intent to displace applicable state law must be "clear and manifest" in areas that are traditionally controlled by state law. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

¹⁸² 501 F.3d 555 (6th Cir. 2007) (en banc).

¹⁸³ *Id.* at 564–65.

¹⁸⁴ *Id.*; see also *Umland v. Planco Fin. Servs., Inc.*, 542 F.3d 59, 68 n.10 (3d Cir. 2008).

¹⁸⁵ See *Sigmond v. Southwest Airlines, Inc.*, 110 F.3d 1200, 1204 (5th Cir. 1997).

¹⁸⁶ See Prop. Reg. § 301.6223(d), Ex. (1).

and a principal, Proposed Regulation section 301.6223-1(c) can only be justified on the basis that state law partnership and agency principles conflict with federal law.¹⁸⁷

We submit that there is no conflict that would support the displacement of applicable state law constraints on the actions of a Partnership Representative. State law is preempted on the basis of conflict with federal law “where it is impossible for a private party to comply with both state and federal requirements,”¹⁸⁸ and in situations where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹⁸⁹ Neither circumstance is presented here.

A requirement under applicable state law that a representative confer with one or more partners before taking action in connection with an audit is not incompatible with the language of section 6223 indicating that the decisions of the Partnership Representative will bind the partners and the partnership, because it does not impose inconsistent federal and state obligations on the Partnership Representative. Attorneys, for example, are required to confer with clients.¹⁹⁰ Yet attorneys can routinely bind their clients when they act within the scope of their authority, and they have done so in the context of audits since the time the Service was created. Consequently, a provision of state law or of an agreement that imposes some limitations on the ability of the Partnership Representative to act without consultation can easily be reconciled with the requirement that her decisions be binding.

Nor would a requirement that the Partnership Representative act only after conferring with one or more partners create “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹⁹¹ After all, Proposed Regulation section 301.6223-1 relies upon state law indicia of authority in determining who may revoke the designation of a Partnership Representative.¹⁹² In fact, Proposed Regulation section 301.6223-1(b)(4) provides that a Partnership Representative lacks capacity to act if she is the subject of “[a] court order enjoining the person from acting on

¹⁸⁷ Congress can expressly provide for preemption when it passes a statute. *See English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990). Nothing in the language of section 6223 provides expressly for preemption. Preemption can also occur when state law “regulates conduct in a field that Congress intended the Federal Government to occupy exclusively.” *Id.* Because of the Code’s general respect for state law, courts have been hesitant to read it as preempting state law, as discussed above. As a consequence, applicable state law that would otherwise apply to the Partnership Representative will only be preempted if it conflicts with federal law. *Id.*

¹⁸⁸ *English*, 496 U.S. at 79 (citing *Florida Lime & Avocado Growers Inc. v. Paul*, 373 U.S. 132, 142–43 (1963)).

¹⁸⁹ *Id.* (quoting *Hines v Davidowitz*, 312 U.S. 52, 67 (1941)).

¹⁹⁰ *See* MODEL RULE OF PROF. CONDUCT 1.2(a) (providing, subject to certain limited exceptions, that “a lawyer shall abide by a client’s decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued”). Where a lawyer violates this rule, courts generally refuse to enforce a proposed settlement. *See Makins v. District of Columbia*, 277 F.3d 544, 550–51 (D.C. Cir. 2002); *see also Koval v. Simon Telelect, Inc.*, 693 N.E.2d 1299, 1302–04 (Ind. 1998).

¹⁹¹ *English*, 496 U.S. at 79 (quoting *Hines v Davidowitz*, 312 U.S. 52, 67 (1941)).

¹⁹² *See* Prop. Reg. § 301.6223-1(d)(3).

behalf of the partnership or the entity partnership representative.”¹⁹³ These state law considerations are consistent with (and further support) implementing section 6223 in a manner that recognizes reasonable controls by the principal (the partnership) over its agent (the Partnership Representative).

iv. **Recommendation**

Accordingly, we recommend that the final Regulations implement section 6223 in a manner that contemplates that the Partnership Representative will act in a manner consistent with the authority granted to her by the partnership. We recommend that this result be accomplished in the Regulations, when finalized, by striking the final sentence from Proposed Regulation section 301.6223-2(c)(1), and by revising Proposed Regulation section 301.6223-2(c)(2) as follows:

Designation provides authority to bind the partnership—(i) Partnership representative. A partnership representative, by virtue of being designated under section 6223 and §301.6223-1, has the authority to bind the partnership *as its agent, subject to the partnership’s control*, for all purposes under subchapter C of chapter 63.

(ii) Designated individual. A designated individual described under §301.6223-1(b)(3)(i) by virtue of being appointed as part of the designation of the partnership representative under §301.6223-1, has the sole authority to bind the partnership representative and the partnership *as its agent, subject to the partnership’s control*, for all purposes under subchapter C of chapter 63.

We further recommend that the examples in Proposed Regulation section 301.6223-2(d) be revised accordingly.

Under our recommendation, the Partnership Representative should operate in a manner consistent with applicable requirements of state law that permit a partnership to exercise control over its representative. To the extent the Service has concerns that the scope of any limitations on the authority of the Partnership Representative would be unclear, other measures to address that concern could be adopted without disenfranchising partners. For example, the final Regulations could require the partnership to provide a description of any constraints on the Partnership Representative’s authority to act unilaterally either when it designates a representative or within 30 days of receipt of a notice of the beginning of an administrative proceeding.

c. **General Comments: Notice Should Be Required.**

Under TEFRA, the tax matters partner was required to keep partners informed and to forward notices to them.¹⁹⁴ We understand that the Proposed Regulations reflect a

¹⁹³ Prop. Reg. § 301.6223-1(b)(4)(iii).

¹⁹⁴ See I.R.C. § 6223(g) (prior to amendment by BBA) (requirement that tax matters partner keep other partners informed); see also Reg. § 301.6223(g)-1(a) (tax matters partner required to forward notice of commencement of proceeding and of final administrative adjustment).

conscious decision not to require notice.¹⁹⁵ We believe some limited notices should be provided, for two reasons.

First, we believe that notice should be required in the interest of transparency and as a matter of fairness to partners. While some partnerships would likely provide notice voluntarily, others would simply carry out the specific requirements of the Code and the Regulations. As a consequence, the partners affected by the proceeding would then learn about it by receiving a notice of a push-out election, a demand from the partnership under a contractual tax indemnification clause, or some other notification that the partnership has paid the imputed underpayment. This could lead partners to question the fairness of the audit process.

Second, we believe that mandatory notice would be a prudent measure in view of due process considerations. TEFRA provisions that limited notice to small partners and indirect partners survived a due-process challenge in large measure due to requirements that tax matters partners and pass-through partners forward notices.¹⁹⁶

Accordingly, we recommend that the final Regulations include additional provisions requiring that the Partnership Representative take reasonable steps to provide notice to the partners upon commencement of the administrative proceeding, 30 days prior to finalizing any settlement, and upon the conclusion of the administrative proceeding, with similar requirements for judicial proceedings. We also recommend that the final Regulations direct any pass-through partner to forward notices on to indirect partners. The final Regulations can also make clear that any failure to notify all partners after reasonable steps will have no impact on the partnership proceeding.

E. Imputed Underpayment and Requests for Modifications

1. The Statute – Section 6225

In the event of “any adjustment by the Secretary in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any partner’s distributive share,” the partnership must pay, subject to certain other rules described below, the “imputed underpayment.”¹⁹⁷ The “imputed underpayment” under section 6225(b) (the “Imputed Underpayment”) is determined by first multiplying the net increase in income or gain (or decrease in loss or deduction) by the highest tax rate applicable in the reviewed year under section 1 or section 11 and then increasing or decreasing that amount by any adjustments to the credits claimed by the partnership. With respect to changes to any partners’ distributive shares, section 6225(b)(2) requires the Imputed

¹⁹⁵ In discussing this decision, the Notice of Proposed Rulemaking states: “The centralized partnership audit statutory regime does not include any notice requirements, which relieves both the IRS and the TMP of the cumbersome TEFRA notice requirements.” 82 Fed. Reg. 27334, 27350 (2017). The quoted sentence refers to the tax matters partner (TMP), but it appears it should have referred to the Partnership Representative.

¹⁹⁶ See *Walthall v. United States*, 131 F.3d 1289, 1295 (9th Cir. 1997) (indirect partners); see also *Kaplan v. United States*, 133 F.3d 469, 475 (7th Cir. 1998) (small partners).

¹⁹⁷ I.R.C. § 6225(a)(1).

Underpayment to take into account only the increases to items of income or gain and the decreases to items of deduction, loss, or credit.

The partnership is required to pay the Imputed Underpayment with its return for the adjustment year.¹⁹⁸ The partnership must also pay the amount of interest that would be due under chapter 67 rules from the day after the due date of the reviewed-year return to the due date of the adjustment year return (or if earlier, the date of payment of the Imputed Underpayment).¹⁹⁹ A “proper adjustment” to the computation of the interest due “shall be made for adjustments required for partnership taxable years after the reviewed year and before the adjustment year by reason of such partnership adjustment.”²⁰⁰ Interest on the Imputed Underpayment (determined under section 6233) is nondeductible.²⁰¹

The BBA directs the Secretary to establish procedures under which the Imputed Underpayment can be modified, such that once an amount is calculated pursuant to the rules described above, the amount can be adjusted, pursuant to the rules described under section 6225(c), to take into account certain attributes or affirmative actions of a partner or partners.

One type of adjustment to the Imputed Underpayment would take into account the circumstance in which one or more partners file amended returns that reflect the partnership’s audit adjustments.²⁰² The partner(s) must file the amended return for the taxable year of the partner(s) that includes the end of the reviewed year of the partnership. The amended return must take into account all adjustments properly allocable to such partner(s), and the partner(s) is (are) required to include a payment for any tax due with the amended return.²⁰³ In such case, the partnership’s Imputed Underpayment is modified to exclude the amount of the adjustments taken into account on those amended return(s).²⁰⁴ A partner can file an amended return seeking a refund even if the applicable statute of limitations under section 6511 has expired, but may not file an amended return showing additional tax due if the applicable statute of limitations under section 6501 has expired.²⁰⁵ Due to the lack of symmetry in the applicable statutes of limitations for deficiencies and refunds, the amended return option is limited as a practical matter if the income adjustment results in the reallocation of items among partners (*i.e.*, a shift from one partner to another but no overall increase of income at the partnership level), because in such case, all partners impacted by the reallocation are

¹⁹⁸ I.R.C. § 6225(a)(1).

¹⁹⁹ I.R.C. § 6225(a)(1).

²⁰⁰ I.R.C. § 6233(a)(2).

²⁰¹ I.R.C. § 6241(4).

²⁰² I.R.C. § 6225(c)(2).

²⁰³ I.R.C. § 6225(c)(2)(A).

²⁰⁴ I.R.C. § 6225(c)(2)(A)(iii).

²⁰⁵ I.R.C. § 6225(c)(2)(A)(i).

required by the statute to file amended returns for the partnership's Imputed Underpayment to be reduced.²⁰⁶

In addition, the BBA instructs the Secretary to provide procedures for modifying the Imputed Underpayment in certain circumstances when the tax due from the partners would be less than the partners' share of the Imputed Underpayment as calculated pursuant to the default rules described above. For partnerships with tax-exempt partners, the BBA Regime provides that the Imputed Underpayment amount is calculated without regard to the portion that the partnership demonstrates is allocable to a partner that would not otherwise owe tax as a result of its status as a tax-exempt entity (as defined in section 168(h)(2)).²⁰⁷ Under these rules, the partnership may take into account a lower rate of tax on any portion of the Imputed Underpayment that it demonstrates is allocable to a partner that is a corporation or is allocable as capital gain or qualified dividends to a partner that is an individual.²⁰⁸ In the case of publicly traded partnerships, the BBA Regime provides that the Imputed Underpayment is computed without regard to any portion that the partnership demonstrates is attributable to a net decrease in a specified passive activity loss allocable to a specified partner, and the partnership must take such a net decrease into account as an adjustment in the adjustment year with respect to the partners to which it relates.²⁰⁹ Finally, the Secretary is permitted to issue regulations or guidance to provide "additional procedures to modify the imputed underpayment on the basis of such other factors as the Secretary determines are necessary or appropriate."²¹⁰

Procedurally, a partnership must submit the information necessary to modify the Imputed Underpayment no later than 270 days from the date when the notice of proposed partnership adjustment ("NOPPA") is mailed pursuant to section 6231, unless such period is extended with the consent of the Secretary.²¹¹ In addition, modification to the Imputed Underpayment amount can be made "only upon approval of such modification by the Secretary."²¹²

²⁰⁶ I.R.C. § 6225(c)(2)(B).

²⁰⁷ I.R.C. § 6225(c)(3).

²⁰⁸ I.R.C. § 6225(c)(4). Prior to the modifications set forth in the PATH Act, section 6225(c)(4)(A)(i) permitted reduced rates in respect of corporate partners only "in the case of ordinary income." The PATH Act removed the phrase "in the case of ordinary income" from section 6225(c)(4)(A)(i) so that such modification can take into account all income allocated to a corporate partner. PATH Act, Pub. L. No. 114-13, § 411(a)(1).

²⁰⁹ I.R.C. § 6225(c)(5), which has added by the PATH Act. "Specified partner" means any person that is (i) a partner of the relevant publicly traded partnership; (ii) described in section 469(a)(2) (*i.e.*, any individual, estate, or trust; closely-held C corporation; and personal service corporation); and (iii) has a specified passive activity loss with respect to such publicly traded partnership, with respect to each taxable year of such person which is during the period beginning with the taxable year of such person in which or with which the reviewed year of such publicly traded partnership ends and ending with the taxable year of such person in which or with which the adjustment year of such publicly traded partnership ends. I.R.C. § 6225(c)(5)(C).

²¹⁰ I.R.C. § 6225(c)(6).

²¹¹ I.R.C. § 6225(c)(7).

²¹² I.R.C. § 6225(c)(8).

2. The Proposed Regulations

The Proposed Regulations provide guidance on the initial/default determination of the Imputed Underpayment in Proposed Regulation section 301.6225-1 and guidance on requests for modification of that amount in Proposed Regulation section 301.6225-2.

a. **Default Determination of the Imputed Underpayment**

The determination of the Imputed Underpayment requires several steps. First, partnership adjustments will be grouped into one of the four categories: (1) a “reallocation grouping” for adjustments that reallocate the distributive share of an item among partners; (2) a “credit grouping” for adjustments to a partnership’s credits; (3) a “creditable expenditure grouping” for adjustments to creditable expenditures; and (4) a “residual grouping” for all other types of adjustments.²¹³

Next, within these four groupings, partnership adjustments will be divided “into subgroupings based on preferences, limitations, restrictions, and conventions, such as source, character, holding period, or restrictions under the Internal Revenue Code (Code) applicable to such items.”²¹⁴ In that process, each reallocation of an item between partners will be considered two different adjustments—one for the increase in the item allocated by the Service to the other partner(s) and one for the corresponding decrease in the item allocated by the partnership to the original partner(s).²¹⁵ If a partner or group of partners has multiple reallocation items, they may be included in the same subgroup where appropriate.²¹⁶ Similarly, within the residual grouping, an adjustment that re-characterizes the character of an item is treated as two separate adjustments—one adjustment decreasing the amount of the item as reported by the partnership and a second adjustment increasing the amount of the item as re-characterized by the Service.²¹⁷ The division into groups and subgroups is done for each tax year so that adjustments from one tax year are not netted against adjustments from other tax years even if they relate to the same transaction or item.

Third, after grouping and subgrouping the adjustment items, the Service will net items, including reallocation items, for the same taxable year within the same grouping or subgrouping to determine if there is a net positive adjustment regarding that grouping or subgrouping.²¹⁸ For instance, all ordinary adjustments (assuming no other restrictions under the Code) will be netted against each other, regardless of whether such adjustments were part of related transactions or whether they were increases or decreases to income, but ordinary adjustments will not be netted against the capital adjustments.²¹⁹ The Proposed Regulations provide that the netting process will take into account “all

²¹³ Prop. Reg. § 301.6225-1(d)(2)(i).

²¹⁴ Prop. Reg. § 301.6225-1(d)(1).

²¹⁵ Prop. Reg. § 301.6225-1(d)(2)(ii).

²¹⁶ Prop. Reg. § 301.6225-1(d)(2)(ii).

²¹⁷ Prop. Reg. § 301.6225-1(d)(2)(v); Prop. Reg. § 301.6226-3(g), Ex. (3).

²¹⁸ Prop. Reg. §§ 301.6225-1(c)(4), (d)(2)(ii), (3)(i).

²¹⁹ Prop. Reg. § 301.6225-1(d)(3)(i).

applicable preferences, restrictions, limitations, and conventions” to disallow netting of adjustments or disallow or limit adjustments that could reduce loss, deductions or credits or decrease income or gain, based on the assumption that each adjusted item was originally reported “in the manner most beneficial to the partnership or partners.”²²⁰

After netting items within the appropriate groupings and subgroupings, the Service will compute the “total netted partnership adjustment” by summing all net positive adjustments in the “reallocation grouping” and the “residual grouping,”²²¹ and ignoring all groupings and subgroupings whose net adjustment is negative or neutral.²²²

Finally, the Service will apply the highest federal rate for the “reviewed year,” the taxable year at issue, to the total netted partnership adjustment and increase or decrease the result by the net adjustments to the “credit grouping” and “creditable expenditure grouping” to arrive at the Imputed Underpayment.²²³

The Proposed Regulations allow for multiple Imputed Underpayments in the Service’s discretion. A “general imputed underpayment” is the result of the calculation described above that takes into account all partnership adjustments (and which disregards, as discussed above, the net amount from a group or subgroup that is zero or negative).²²⁴ A “specific imputed underpayment” is determined on the basis of certain adjustments allocated to one partner or a group of partners based on the items or adjustments having the same or similar characteristics, based on the group of partners sharing similar characteristics, or based on the partners having participated in the same or similar transactions.²²⁵ As Treasury and the Service note in the Notice of Proposed Rulemaking, there “may be multiple specific imputed underpayments depending on the adjustments.”²²⁶ Treasury and the Service note further that the “option to create multiple imputed underpayments provides flexibility for the partnership, the partners, and the IRS to address fact-specific issues that may arise as part of the administrative proceeding at the partnership level.”²²⁷ As discussed below, the partnership can request a modification to change the number or composition of Imputed Underpayments reflected in the NOPPA.²²⁸

Any Imputed Underpayments must be paid by the partnership in the same manner as if it were a tax imposed in the year in which the adjustment becomes final (the “adjustment year”).²²⁹

²²⁰ Prop. Reg. § 301.6225-1(a)(2).

²²¹ Prop. Reg. § 301.6225-1(c)(3).

²²² Prop. Reg. § 301.6225-1(d)(3)(ii)(A).

²²³ Prop. Reg. § 301.6225-1(c)(1)(ii).

²²⁴ Prop. Reg. § 301.6225-1(e)(2)(ii).

²²⁵ Prop. Reg. § 301.6225-1(e)(2)(iii).

²²⁶ 82 Fed. Reg. 27334, 27351 (2017).

²²⁷ *Id.* at 27352.

²²⁸ Prop. Reg. § 301.6225-2(d)(6).

²²⁹ Prop. Reg. § 301.6225-1(a)(1); *see* I.R.C. § 6225(d)(2).

b. Requests for Modifications of the Imputed Underpayment

i. In General

Guidance regarding requests for a modification of the Imputed Underpayment is provided in Proposed Regulation section 301.6225-2. If a partnership receives a NOPPA that sets forth an Imputed Underpayment, the Partnership Representative may request modification of that amount within 270 days.²³⁰ The partnership is permitted to request an extension of this 270-day period.²³¹ To receive a modification, the partnership must provide information substantiating its request to the satisfaction of the Service.²³² The partnership may request one or more types of modifications.²³³

The Proposed Regulations clarify that any modification of the Imputed Underpayment changes only the calculation of the Imputed Underpayment and has no impact on the underlying adjustments themselves.²³⁴ The Proposed Regulations also clarify that any review of information submitted to substantiate the modification request does not constitute an examination, inspection, or administrative proceeding with respect to any person other than the partnership for purposes of section 7605(b).²³⁵

ii. Types of Modifications

The Proposed Regulations describe seven types of modifications. The first four are modifications specifically referenced in the BBA. The remaining three are based on the authority delegated in the BBA to the Service to provide additional types of modifications.

(a) Amended Returns

The first type of modification is based on a reviewed-year partner (or indirect partner) filing one or more amended returns that take into account the appropriate adjustments (or portion thereof) and also address the effects of such adjustments on any tax attributes.²³⁶ Once this amended return is made, the partnership cannot request a different type of modification with respect to the partnership adjustment allocated to that partner.²³⁷ The partner filing the amended return must also pay all tax, interest, and penalties for the modification to be approved.²³⁸ The Partnership Representative must submit affidavits from each partner for which modification is sought that the partner did

²³⁰ Prop. Reg. §§ 301.6225-2(a), (c)(3).

²³¹ Prop. Reg. § 301.6225-2(c)(3)(ii).

²³² Prop. Reg. § 301.6225-2(c)(2).

²³³ Prop. Reg. § 301.6225-2(d)(1).

²³⁴ Prop. Reg. § 301.6225-2(b)(2)-(3).

²³⁵ Prop. Reg. § 301.6225-2(c)(i).

²³⁶ Prop. Reg. § 301.6225-2(d)(2)(i).

²³⁷ *Id.*

²³⁸ Prop. Reg. § 301.6225-2(d)(2)(ii).

in fact file amended returns and make appropriate payments.²³⁹ For the partnership to receive modification as a result of a partner's amended returns, the partner must file amended returns for all years with respect to which any tax attribute is affected by reason of the partnership adjustment(s) taken into account and include any payment due.²⁴⁰ Any amended return for which a modification request is made must have been filed within the period of limitations for assessment under section 6501.²⁴¹ A partner may file an amended return requesting a refund after the expiration of the period of limitations in section 6511, but only to the extent the refund relates to items attributable to partnership adjustments.²⁴² In the case of a reallocation adjustment, the Service generally will approve the modification only if all partners affected by the reallocation adjustment file amended returns related to the reallocation adjustment.²⁴³

A special rule allows a pass-through partner, for modification purposes only, to file an amended return and take into account its allocable share of the adjustments, but that pass-through partner must also make a payment with that return.²⁴⁴ That payment is calculated in the same manner (except with a different tax rate)²⁴⁵ as the safe harbor amount is calculated under Proposed Regulation section 301.6226-2(g) (discussed below) for the partner's share of the partnership adjustment.²⁴⁶

The Proposed Regulations provide that if modification is granted based on an amended return, the partner cannot file further amended returns for the modification years with respect to items related to the partnership adjustments and the Imputed Underpayment, unless the partner receives permission from the Service to do so.²⁴⁷

(b) Tax-Exempt Partners

A second type of modification is based on one or more reviewed-year partners being tax-exempt, for example, by virtue of being a tax-exempt entity under the Code or a foreign person.²⁴⁸ However, a partnership may request a modification based on an adjustment allocable to a tax-exempt partner only to the extent the partnership demonstrates to the satisfaction of the Service that the tax-exempt partner would not have

²³⁹ Prop. Reg. § 301.6225-2(d)(2)(iii).

²⁴⁰ Prop. Reg. § 301.6225-2(d)(2)(iv).

²⁴¹ Prop. Reg. § 301.6225-2(d)(2)(v)(A).

²⁴² Prop. Reg. § 301.6225-2(d)(2)(v)(B).

²⁴³ Prop. Reg. § 301.6225-2(d)(2)(vi).

²⁴⁴ Prop. Reg. § 301.6225-2(d)(2)(vii).

²⁴⁵ For purposes of calculating the payment amount, the tax rate to be used by a pass-through partner is the rate determined by substituting the total net income of the pass-through partner for the taxable year (as adjusted) for taxable income in section 1(c) (determined without regard to section 1(h)). Prop. Reg. § 301.6225-2(d)(2)(vii)(B).

²⁴⁶ *Id.*

²⁴⁷ Prop. Reg. § 301.6225-2(d)(2)(vii)(B).

²⁴⁸ Prop. Reg. § 301.6225-2(d)(3).

been subject to tax with respect to the adjustment allocable to the partner for the reviewed year.²⁴⁹

(c) Rate Modification

A third type of modification is based on changing the applicable tax rate used to compute the Imputed Underpayment on the portion of the total netted partnership adjustment allocable to a C corporation or an individual with respect to capital gains and qualified dividends.²⁵⁰ The lower tax rate still will be the highest rate in effect with respect to the type of income and partner for whom modification is requested.²⁵¹

(d) Certain Passive Losses of Publicly Traded Partnerships

The fourth type of modification applies to publicly traded partnerships and allows the Imputed Underpayment to be determined without regard to the portion attributable to a net decrease in a specified passive activity loss for a specified partner, including an individual, estate, trust, closely-held C corporation, or personal service corporation.²⁵² The partnership requesting modification must report to all specified partners that the partnership has adjusted the amount of their suspended passive loss carryovers at the end of the adjustment year by the amount of any passive losses applied in connection with such modifications.²⁵³

(e) Number and Composition of Imputed Underpayments

The fifth type of modification is based on a modification of the number and composition of Imputed Underpayments.²⁵⁴ Treasury and the Service note in the Notice of Proposed Rulemaking that the Service “is not obligated to implement this modification if it determines it is appropriate to reflect the partnership adjustments in imputed underpayments in a manner different than requested by the partnership.”²⁵⁵

(f) Partners that are Qualified Investment Entities

The Proposed Regulations also add as a sixth type of modification, a special modification for partners that are qualified investment entities described in section 860, which includes both regulated investment companies (“RICs”) and real estate investment

²⁴⁹ Prop. Reg. § 301.6225-2(d)(3)(iii).

²⁵⁰ Prop. Reg. § 301.6225-2(d)(4).

²⁵¹ *Id.*

²⁵² Prop. Reg. § 301.6225-2(d)(5).

²⁵³ Prop. Reg. § 301.6225-2(d)(5)(iv).

²⁵⁴ Prop. Reg. § 301.6225-2(d)(6).

²⁵⁵ 82 Fed. Reg. 27334, 27355 (2017).

trusts (“REITs”).²⁵⁶ These entities may distribute deficiency dividends under section 860(f) after the NOPPA has been issued.²⁵⁷ To claim this modification under section 860, the partnership has to provide the documentation of a determination, which includes a closing agreement with a qualified investment entity partner pursuant to section 7121 or Form 8927.²⁵⁸ If the entities do so in compliance with section 860 and the Regulations thereunder, the Service will treat the amount allowed as a deficiency dividend deduction under section 860(a) as having been taken into account by a partner in a manner similar to an amended return modification.

(g) Closing Agreements

As a seventh type of modification, the Proposed Regulations allow the Service to take into account any closing agreements entered into by partners pursuant to section 7121 and will allow appropriate modification based on the contents of that closing agreement.²⁵⁹ According to Treasury and the Service, this “type of modification may provide some flexibility for taxpayers for which other forms of modification may prove burdensome or difficult.”²⁶⁰ In particular, where a partner’s individual statute of limitations is otherwise closed under section 6501, the use of a closing agreement may allow partners to recalculate their closed-year tax returns without filing amended returns and agree to pay the resulting tax, interest and penalties.

(h) Catch-All

Finally, the Proposed Regulations envision that the Service may, in its discretion, consider alternative types of modification not specifically referenced in the Proposed Regulations, so a partnership can submit a request (with supporting documentation) for any other type of modification.²⁶¹

c. **Partnership Adjustments that Do Not Result in Imputed Underpayment**

As noted above, not all partnership adjustments will result in an Imputed Underpayment. The BBA provides that such an adjustment is taken into account by the partnership in the adjustment year as a reduction in non-separately stated income or as an increase in non-separately stated loss depending on whether the adjustment is to an item of income or loss.²⁶² One of the exceptions to this rule is for separately stated items under section 702.²⁶³ The Proposed Regulations provide that if an adjustment is to an item that is required to be separately stated under section 702, the adjustment shall be

²⁵⁶ Prop. Reg. § 301.6225-2(d)(7).

²⁵⁷ Prop. Reg. § 301.6225-2(d)(7)(i).

²⁵⁸ Prop. Reg. § 301.6225-2(d)(7)(ii).

²⁵⁹ Prop. Reg. § 301.6225-2(d)(8).

²⁶⁰ 82 Fed. Reg. 27334, 27356 (2017).

²⁶¹ Prop. Reg. § 301.6225-2(d)(9).

²⁶² Prop. Reg. § 301.6225-3(b)(1).

²⁶³ Prop. Reg. § 301.6225-3(b)(2).

taken into account by the partnership on its adjustment year return as an adjustment to such separately stated item.²⁶⁴ Further, the Proposed Regulations provide that an adjustment to a credit is also taken into account as a separately stated item.²⁶⁵ If, as part of the modification process, a reviewed-year partner takes into account an adjustment that would not have otherwise resulted in an Imputed Underpayment, no further adjustment has to be made to any adjustment-year partner.²⁶⁶

If a section 6226 election is made with respect to an Imputed Underpayment, these rules do not apply to adjustments that are disregarded in computing the Imputed Underpayment with respect to which the section 6226 election was made.²⁶⁷ Such adjustments are taken into account by the reviewed-year partners under section 6226.²⁶⁸

3. **Comments – Calculation of Default Imputed Underpayment**

a. **Grouping and Netting of Adjustments**

Treasury and the Service seek comments on any specific items that may require special rules or special subgroupings.²⁶⁹ In our Prior Comments, we pointed out that the BBA grouped and netted adjustments in such a way that the Imputed Underpayment could be more or less than the cumulative amount that the reviewed-year partners would have to pay if the adjustments were allocated to them. Although we proposed retaining this result in the name of administrative convenience, the Proposed Regulations attempted to resolve this imprecision only in part, by eliminating situations where the benefit would accrue to the taxpayer.

As a result, the Proposed Regulations exacerbated the potential gulf between the Imputed Underpayment amount and the cumulative amount that the reviewed-year partners would have to pay if the adjustments were allocated to them. For instance, under the Proposed Regulations, if the ordinary income adjustment were an increase of \$700 and the decrease in capital gain were \$1000, the net adjustment would be \$700 because the Proposed Regulations disallow netting of ordinary adjustments and capital adjustments. Assuming a 35% tax rate, the Imputed Underpayment would be \$245, but the partners may have overpaid by \$200 with respect to the capital gain (assuming a rate of 20%). As a result, they actually underpaid their tax by only \$45. Similarly, if the ordinary income adjustment were a decrease of \$700 and the increase in capital gain were \$1000, the net adjustment would be \$1000 because the Proposed Regulations disallow netting of ordinary adjustments and capital adjustments. Assuming a favorable capital gains rate of 20%, the Imputed Underpayment would be \$200, but the partners may have

²⁶⁴ Prop. Reg. § 301.6225-3(b)(2).

²⁶⁵ Prop. Reg. § 301.6225-3(b)(3).

²⁶⁶ Prop. Reg. § 301.6225-3(b)(5).

²⁶⁷ Prop. Reg. § 301.6225-3(b)(6).

²⁶⁸ *Id.*

²⁶⁹ 82 Fed. Reg. 27334, 27350 (2017).

overpaid by \$245 with respect to the ordinary loss. As a result, they will owe tax even though they should receive a refund of \$45.

We believe that this divergence between the Imputed Underpayment amount and cumulative amount that the reviewed-year partners would have to pay if the adjustments were allocated to them in a manner that always favors the Service will require more modification procedures and encourage more push-out elections, contrary to the goals of Treasury and the Service. Accordingly, we believe that Treasury and the Service should take a further step to ensure that the government no longer seeks an increase in tax collections solely because the partnership bears the burden for the tax. We recommend that the final Regulations ameliorate this issue using approaches such as:

- Allowing an ordinary income grouping to be reduced by a capital loss grouping to the extent of \$3,000 per direct or indirect individual partner; and
- Applying the applicable rate for net negative adjustments to the relevant subgrouping and allowing this amount to reduce the Imputed Underpayment amount.

b. The Credit Grouping

Treasury and the Service seek comments on whether additional rules should be proposed regarding how the credits are grouped together, or whether such credits should be applied in a particular order, similar to the order required for general business credits as reported on Form 3800, General Business Credit.²⁷⁰ We agree that for administrative efficiency, it would make sense to group and order credits in accordance with Form 3800. Therefore, we recommend that the final Regulations provide for grouping and ordering credits in such a manner.

c. Partnership Expenditures That May be Treated as a Credit By Partners

The Treasury and the Service also seek comments on the appropriate treatment of items reported by the partnership as expenditures that may be treated as a credit when taken into account by a partner.²⁷¹ For items that may be treated as a credit when taken into account by a partner and are not otherwise limited (for instance, by their non-creditable status against the alternative minimum tax), we recommend that the final Regulations specify that those items are credited against the Imputed Underpayment amount. For other items which may be subject to limitations at the individual level, we recommend that the final Regulations provide rules similar to those under Proposed Regulation section 301.6225-1(b), for adjustments which do not result in Imputed Underpayments, since any adjustment to a credit would not result in an Imputed Underpayment.

²⁷⁰ *Id.* at 27351.

²⁷¹ *Id.*

d. **Foreign Partners Who May Be Subject to Gross Basis Taxation or a Modified Rate under an Income Tax Treaty**

Treasury and the Service request comments on modifications where a partner is a foreign person who may be subject to gross basis taxation under section 871(a) or 881(a) or where a partner, indirect partner, or the partnership is entitled to a modified rate under the Code or as a resident of a country that has in effect an income tax treaty with the United States.²⁷² Consistent with our Prior Comments, we recommend that the final Regulations allow verification of requested modifications based on taxpayer status to be provided on expanded versions of the existing Forms W-8 and W-9. This would include verification of modifications or exemptions based on a tax exemption based on foreign status (including, without limitation, certification, if applicable, of the application of the portfolio interest exception for certain partners and the reduction of the Imputed Underpayment on U.S.-source dividends from 39.6% to 30% even in the absence of reduced treaty rates), a tax exemption based on section 892, and reduction in taxes based on eligibility for reduced rates of withholding under a tax treaty). The added benefit of this approach is that it would also include the verification of corporate versus individual tax rates (including long-term capital gain for individuals) and tax-exempt status (including certification that income from the partnership is not subject to the section 514 debt-financed unrelated business taxable income rules).

Upon verification of a foreign partner's eligibility for a rate lower than the highest applicable rate used to compute the Imputed Underpayment amount, the Service could reduce that amount by the difference in tax that would be due when applying the highest applicable rate to that partner's proportionate share of the partnership income and the rate available to that partner.

e. **Coordination with Competent Authority Procedures**

Treasury and the Service also request comments regarding how to coordinate the modification rules with mutual agreement procedures that may be available to any partnership, partner, or indirect partner.²⁷³ We recommend that the final Regulations expand the modification based on closing agreements to allow modifications based on closing agreements by and amongst the partnership and the relevant partners entered into in the course of a proceeding with the competent authority office, in particular to facilitate the implementation of any mutual agreement by the Service in a manner that is consistent with the purpose of tax treaties to avoid double taxation. This might include mutual agreement procedures but may also include requests for assistance in the context of partner-level foreign tax credits and protective claims. We also recommend that the final Regulations allow partnerships to file protective claims for refund directly, on behalf of all partners, with the competent authority office in advance of filing an AAR. We also recommend that final Regulations permit multiple closing agreements and/or provide procedures for cooperation between the competent authority and partnership

²⁷² *Id.* at 27352.

²⁷³ *Id.*

examination teams. We anticipate that flexibility will foster open conversations with competent authority, particularly where a foreign tax issue presents itself during or in connection with a partnership audit.

f. **Streamlining the Amended Return Process and Other Types of Modification**

Treasury and the Service request further comments on how best to streamline the amended return modification process as well as simplify the process for other types of modification.²⁷⁴

With respect to the amended return modification process, we note that pursuant to Proposed Regulation section 301.6225-2(d)(2)(iii), the Service will not approve a modification on the basis of an amended return filed by a reviewed-year partner (or indirect partner) unless the Partnership Representative provides to the Service an affidavit from each reviewed-year partner (or indirect partner) filing an amended return, affirming under penalties of perjury that all required amended returns have been filed and all required taxes and other amounts have been paid. The Partnership Representative must provide this affidavit to the Service within the 270-day period for requesting a modification. We believe that by ensuring that the Service receives timely confirmation that the reviewed-year partner (or indirect partner) has satisfied all relevant filing and payment requirements, this affidavit requirement would already work well in facilitating administration of the amended return modification process.

For further ease of administration, we recommend that the affidavit contain additional information that would help the Service identify and retrieve the amended return filed and payments made by the reviewed-year partner (or indirect partner). The Proposed Regulations require that the reviewed-year partner (or indirect partner) indicate in the affidavit the date on which the amended returns were filed and the date on which the corresponding taxes and other amounts were paid.²⁷⁵ We recommend that the final Regulations also require that the reviewed-year partner (or indirect partner) include in the affidavit the partner's TIN and contact information. These details would enable the Service to locate easily the amended return and payment in its databases and limit the effort needed for the Service to contact the reviewed-year partner (or indirect partner) for additional information, if necessary.

With respect to other types of modification, we recommend that the final Regulations provide for additional modification procedures based on other factors,²⁷⁶ to permit a modification of an Imputed Underpayment where only the partner experiencing additional income (or less deduction, loss, or credit) as a result of a reallocation adjustment files an amended return.

²⁷⁴ *Id.* at 27353, 27358.

²⁷⁵ Prop. Reg. § 301.6225-2(d)(iii).

²⁷⁶ I.R.C. § 6225(c)(6).

The Treasury and the Service already recognize that there could be instances where a partner may not need to file an amended return following a reallocation adjustment. Although Proposed Regulation section 301.6225-2(d)(2)(vi) generally requires, as a prerequisite for modification based on amended returns, that all partners affected by a reallocation adjustment file amended returns, the Proposed Regulations also permit the Service to determine that this requirement is satisfied if “one or more affected partners take into account their allocable share of the adjustment through other modifications approved by the IRS.” For example, where an adjustment reallocates a loss from one partner to another, and one partner takes the adjustment into account in an amended return while the other takes the adjustment into account in a closing agreement, the Service may determine that the partners have satisfied the amended return filing requirements.²⁷⁷

Additionally, where a partnership may request modification based on a partner’s tax-exempt status and the tax-exempt partner is subject to a reallocation adjustment, the Notice of Proposed Rulemaking says that “it may be unnecessary for the tax-exempt partner to file an amended return in order for the partnership to request modification in accordance with the requirements of proposed § 301.6225-2(d)(2)(vi).”²⁷⁸ In that instance, the determination “will depend on the facts and circumstances related to the particular modification and are within the discretion of the IRS.”²⁷⁹

We interpret these examples to reflect recognition by Treasury and the Service that so long as the Service could determine that the proper amount of tax has been paid, an amended return may be unnecessary for some partners. We share this view, and we note that in addition to the examples identified by Treasury and the Service, there are further instances where, after a reallocation adjustment, an amended return from any particular partner may be equally redundant or meaningless. For example, although a partnership may request modification based on a partner’s tax-exempt status where an adjustment reallocates additional income to such partner, it is not clear that the partnership would be able to request a modification on the same basis where the tax-exempt partner is allocated less income or greater deduction or loss. However, the other affected partner could file an amended return and pay the proper amount of tax regardless of whether the tax-exempt partner files an amended return.

Even where a partnership with no tax-exempt partners reallocates distributive shares of income, the failure of the partner with less allocable income to file an amended return does not preclude the partner with more income from filing an amended return and paying the proper amount of tax. In that case, the partner with less allocable income may be entitled to a refund, but this partner’s decision not to file an amended return and request such refund should not preclude a modification to the Imputed Underpayment amount due from the partnership where the partner with more income has in fact already paid the additional amount due.

²⁷⁷ Prop. Reg. § 301.6225-2(d)(2)(vi).

²⁷⁸ 82 Fed. Reg. 27334, 27354 (2017).

²⁷⁹ *Id.*

Given these possibilities, we recommend that the Treasury and the Service limit the filing of unnecessary amended returns, by including in the final Regulations a basis for reducing an Imputed Underpayment where only the partner experiencing additional income (or less deduction, loss, or credit) as a result of a reallocation adjustment files an amended return.

This rule would facilitate the administration of the amended return modification process by eliminating the need for taxpayers to file, and for the Service to process and review, amended returns that do not provide any additional information that is relevant in determining the tax due following a reallocation adjustment. Moreover, the absence of such a rule creates an asymmetrical outcome where a partner's decrease in income is not taken into account in computing the Imputed Underpayment but is taken into account for the purpose of the modification procedures even though that partner will not owe any additional tax. Such a result would be particularly problematic where a partner experiencing a reduction in allocable income is tax-exempt and might not otherwise be required to file a return (meaning that an amended return in this context is either impossible or meaningless).

g. Most Efficient Way to Request Permission to File a Subsequent Amended Return

The Proposed Regulations prohibit a partner who has amended a return as part of the modification process from amending that return again without the permission of Service.²⁸⁰ Treasury and the Service request comments on the most efficient ways that taxpayers may request permission from the Service to file a subsequent amended return.²⁸¹ We note that an amended return is itself a request for permission from the Service because there is no affirmative duty for the Service to act upon, let alone grant, the request for refund. We recommend that the Service not adopt any rules that require the submission of a request to file an amended return with a prohibition on filing the amended return until permission is granted. We have concerns that such a procedure could violate a taxpayer's constitutional right to petition the government.²⁸² This concern would be especially acute in a scenario in which a taxpayer's statute of limitations to file an amended return lapses while such a request is pending.

While we recognize the concern expressed by Treasury and the Service in the Notice of Proposed Rulemaking that a partner could undo the impact of any modification from an amended return by filing a second amended return "backing out" the prior adjustments, we see no need for an elaborate or cumbersome process. Taxpayers should be free to file an amended return at any time, subject to the statute of limitations. However, it would be reasonable for the Service to revise the amended return forms (1) to include a check-box asking if taxpayer filed a prior amended return for that same tax year that was the basis for a modification under section 6225, and (2) require any taxpayer who answers in the affirmative to attach to the subsequent amended return an explanatory

²⁸⁰*Id.*; see also Prop. Reg. § 301.6225-2(d)(2)(vii)(B).

²⁸¹ 82 Fed. Reg. 27334, 27354 (2017).

²⁸² See U.S. CONST. amend. I.

statement and certain related documents, such as the prior amended return. Such an approach should provide more than adequate notice to address the concerns identified by Treasury and the Service and prevent the Service from being “whipsawed.” Accordingly, we recommend that the final Regulations not prohibit a partner who has amended her return as part of the modification process from amending her return again without the permission of the Service. In lieu of such a prohibition, we recommend that the Service instead revise the amended return forms in the manner describe above.

h. Potential Issues Regarding Fiduciary Responsibility Rules under ERISA

The Treasury and the Service also request comments on how to address any issues under the fiduciary responsibility rules under ERISA resulting from a partnership’s decision whether to request modification.²⁸³ Treasury and the Service have observed that the decision by or on behalf of a partnership to request or not to request modification in the course of an audit could raise questions about whether the party making the decision is properly discharging its fiduciary duties under title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). Under Section 404(a)(1) of ERISA, a fiduciary is required to discharge its duties with respect to an ERISA plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries under the plan and defraying reasonable expenses of administering the plan. A violation of this duty could result if the decision maker is a fiduciary with respect to one or more ERISA plans that have invested in the partnership and must determine whether to request modification where the decision could benefit non-ERISA plan partners over ERISA plan partners. This could effectively preclude modification requests when a partnership has one or more partners that are ERISA plans and is treated as subject to ERISA pursuant to Section 3(42) of ERISA as a result. We recommend that the final Regulations provide that the Partnership Representative may solicit a vote of the partners in the partnership in determining whether to request a modification, and that the Service agrees to automatically grant a request for an extension of the 270-day period for requesting a modification if such a vote of the partners has been solicited. We also recommend that Treasury and the Service share a suggestion with the Department of Labor (“DOL”) that the DOL clarify that a Partnership Representative will not be treated as a fiduciary with respect to any ERISA plan partner if the Partnership Representative requests (or fails to request) a modification based on the results of a vote of the partners.

i. Notification of Reduction in Suspended Passive Loss Carryovers under Section 6223

The Imputed Underpayment for a publicly traded partnership is determined without regard to net decreases in specified passive activity losses allocable to a specified partner.²⁸⁴ The partnership must report any such decreases to the specified partners at

²⁸³ 82 Fed. Reg. 27334, 27355 (2017).

²⁸⁴ Prop. Reg. § 301.6225-2(d)(5)(i).

the end of the adjustment year.²⁸⁵ Treasury and the Service request comments on how a partnership requesting modification should report that it has adjusted their suspended passive loss carryovers.²⁸⁶ We suggest that the easiest way to do so is to incorporate such reporting into the Schedules K-1 distributed to such partners at the end of the adjustment year.

j. Use by RICs and REITs of Modification Procedures

The Proposed Regulations allow qualified investment entities to seek modification based on the distribution of deficiency dividends in a similar manner to the amended return modification.²⁸⁷ Because this provision is available after a NOPPA is issued and prevents a partnership from changing the position at a later date even though the NOPPA may still be challenged and adjusted, Treasury and the Service seek comments regarding whether this provision adequately permits modification.²⁸⁸ We recommend that the final Regulations provide that the allowance of a deficiency dividend be agreed to in advance of a NOPPA, but in the event of a challenge to the underlying substantive adjustment to the Office of Appeals (“Appeals”) or in court, the allowance does not become effective until final resolution of the underlying challenge. Provided that the deficiency dividend is sufficient to cover the full adjustment, allowing a delayed agreement to issue the deficiency dividend would protect a taxpayer’s right to seek judicial review of tax assessments prior to payment of tax itself.

k. Comments Regarding Credit Recapture Situations

Treasury and the Service request comments on how credit recapture situations should be managed within the Proposed Regulations.²⁸⁹ Credits that must be recaptured raise two possible problems for purposes of calculating Imputed Underpayments. First, in the case of prior credits that should be recaptured as a result of a partnership adjustment, the question is how (and to what extent) that recapture should be incorporated into Imputed Underpayments. Second, in the case of a partnership adjustment that results in a credit that is incorporated into the calculation of Imputed Underpayments (presumably as a reduction to an Imputed Underpayment), the question is how (and to what extent) partners will eventually incorporate credit recaptures into subsequent gain transactions.

In the first situation, we recommend that the final Regulations adopt what we believe is the appropriate (and only practical) solution: to incorporate any credit recapture into the calculation of any Imputed Underpayments *to the extent* that the originating credits were generated from partnership activities. For example, assume that a partnership purchased real estate that gave rise to investment tax credits for corporate partners under section 46 in a prior year and then engaged in a like-kind exchange under

²⁸⁵ Prop. Reg. § 301.6225-2(d)(5)(iv).

²⁸⁶ 82 Fed. Reg. 27334, 27355 (2017).

²⁸⁷ Prop. Reg. § 301.6225-2(d)(7).

²⁸⁸ 82 Fed. Reg. 27334, 27355–56 (2017).

²⁸⁹ *Id.* at 27357.

section 1031 in the reviewed year. Upon audit of the reviewed year, the Service determines that section 1031 should not apply to the disposal in question. It is fair to assume that if the original transaction would have resulted in investment tax credits to the partnership's corporate partners, then the Imputed Underpayment should include a corresponding amount of recapture. However, this should be limited to partnerships with partners that actually would have benefited from the original credits (*i.e.*, corporate partners).

In the second situation, where credits are incorporated into the calculation of an Imputed Underpayment but could be recaptured at a later date, we recommend that the final Regulations require partnerships to notify partners that they received the benefit of such credits, and that partners may be obligated to recapture those credits at a later date. This notice could be provided as notes to the adjustment-year Schedule K-1.

1. Comments Regarding Foreign Tax Credits

The Treasury and the Service request comments on how adjustments affecting foreign tax credit calculations should be taken into account within the Regulations, including possible ways to account for adjustments to items sourced or calculated at the partner level, such as interest expense and deemed paid credits.²⁹⁰ Here we address the impact of Service-initiated adjustments to such items. Below, in section G of these Comments regarding AARs, we address the impact for U.S. tax purposes of foreign-initiated adjustments.

We note that to the extent the Service adjusts items such as interest expense and foreign taxes paid or deemed paid, Proposed Regulation section 301.6225-1(a)(2) provides that the Imputed Underpayment treats those items “as if the adjusted item was originally taken into account by the partnership or the partners, as applicable, in the manner most beneficial to the partnership or the partners.” Because this is not always the case, we recommend that the final Regulations adopt an additional modification type that would allow the partnership to demonstrate the impact of these adjustments on one or more of its partners as not being as beneficial as assumed. For example, the audit adjustment may result in no change to the foreign tax credits that could be claimed by one or more partners. The precise documentation needed to substantiate the need for such a modification need not be specified in the final Regulations.

m. Ways to Provide More Flexibility Regarding Payments

The Proposed Regulations provide that to take advantage of the modification procedure for amended returns, the partner filing the return must pay all of the tax, including penalties, additions to tax, and interest within the 270-day period for modification.²⁹¹ The Service requests comments regarding how the Service might be able to allow more flexibility with respect to payment.²⁹² We recommend that the final

²⁹⁰ *Id.* at 27357.

²⁹¹ Prop. Reg. § 301.6225-2(d)(2)(ii).

²⁹² 82 Fed. Reg. 27334, 27358 (2017).

Regulations contain additional rules that permit partners to submit requests for installment agreements or offers in compromise within the 270-day period. This can be done as part of a closing agreement or an “other” appropriate adjustment. The Service could then review the installment agreement or offer-in-compromise request in conjunction with the modification request and approve both simultaneously. As a policy matter, this will prevent solvent partners from being on the hook for their insolvent partners’ tax liabilities, a significant risk under existing rules for calculating Imputed Underpayments. While arguably these tools would already be available to the Service under the existing discretion in Proposed Regulation section 301.6225-2(d)(9), explicitly contemplating the availability of these tools will encourage partners to negotiate over contractual terms requiring investors to take certain actions in the event of insolvency.

n. **Other Appropriate Modifications**

The Treasury and the Service also requested comments on other appropriate modifications.²⁹³

i. **Reversed Timing Differences for Former Partners**

Where a partnership has had partners transfer their interests in the partnership, we recommend that the final Regulations permit the partnership to demonstrate that such partner’s share of an adjustment was partially or fully reversed, and the calculation of the Imputed Underpayment should be reduced to give credit for taxes paid in a later year. For example, assume that between a reviewed year and the adjustment year, a partner sold its interest in the partnership. In the reviewed year, the Service adjusts the capital gain of the partnership, which would have resulted in an increased amount of capital gain of \$100 to the former partner. Rather than asking that partner to enter into a closing agreement, if the partnership demonstrates that in an intervening year, the former partner would have paid tax on capital gain in its partnership interest, and that amount of gain would have, economically, included the \$100, the partnership should be permitted to demonstrate that the Imputed Underpayment should be reduced by the refund in the intervening year, and that partnership should, therefore, only be required to pay interest and penalties. This type of modification would allow partnerships to mitigate the ill effects of a non-compliant former partner, and encourage partnerships in that type of situation to remain in the section 6225 regime (rather than electing a section 6226 “push out”).

ii. **Passive Loss Rule for Publicly Traded Partnerships**

We also recommend that Treasury and the Service revise the final Regulations so as to correct certain operational issues in the statutory rules for modification procedures for publicly-traded partnerships.

²⁹³ *Id.* at 27352.

Section 6225(c)(5) allows for a decrease in the Imputed Underpayment attributable to a net decrease in a specified passive activity loss allocable to a specified partner, provided that the partnership takes such net decrease into account in the adjustment year with respect to the partner. “Specified passive activity loss” is the lesser of the separately-determined passive activity loss of the partner in the reviewed year or such loss in the adjustment year.²⁹⁴ Proposed Regulation section 301.6225-2(d)(5) largely mirrors these statutory rules.

In our Prior Comments, we provided several suggestions for the modification procedure based on the passive activity losses of a publicly-traded partnership. We reiterate here our comment that one issue with the current rules is that the modification of the Imputed Underpayment would need to take place after the end of the adjustment year, because the partnership will not know whether there is a passive loss during the adjustment year until the end of that year. However, the term “adjustment year” (other than in instances involving a court action or an AAR) is defined by reference to a notice of final partnership adjustment mailed under section 6231 (an “FPA”), while the modification request under section 6225 is made in response to a NOPPA. Under the current rules, then, a partnership will be unable to determine whether it has passive losses in the adjustment year before the expiration of the 270-day period for requesting a modification in response to a NOPPA.

Although the request for modification generally must be submitted within the 270-day period beginning on the date on which the NOPPA is mailed, the Secretary has authority to extend this period.²⁹⁵ We recommend that the Treasury and the Service exercise this authority to specify in the final Regulations that a publicly-traded partnership may request a modification of the Imputed Underpayment after the end of the adjustment year. More specifically, we recommend that the final Regulations require the modification request to be submitted within 74 days of the end of the adjustment year, which roughly aligns with the original due date of the partnership tax return. We note, however, that any post-FPA modification request would cause the FPA and a denial of the modification request to be subject to judicial review separately.

We also recommend that the final Regulations correct a circularity issue in the mechanics of the modification rules for publicly-traded partnerships. As discussed above, “specified passive activity loss” is defined by reference to both the reviewed year and adjustment year, and the Imputed Underpayment may be reduced to the extent the reduction is attributable to a net decrease in a specified passive activity loss allocable to a specified partner and the partnership takes the net decrease into account in the adjustment year with respect to the specified partner. Because the partnership will not know whether there is a passive loss during the adjustment year until the end of that year, neither the partnership nor the Service will actually be able to determine, until that time, the amount of the specified passive activity loss or the amount of the net decrease to be taken into account during the adjustment year. If the Service waits until the immediately-following year to issue the FPA, however, then the immediately-following year becomes the

²⁹⁴ I.R.C. § 6225(c)(5)(B).

²⁹⁵ I.R.C. § 6225(c)(7).

adjustment year. As a result, the partnership and the Service must again wait until the end of the new adjustment year to determine the correct amount of the specified passive activity loss or the net decrease. This effect continues for each successive year.

To remove this circularity, we recommend that pursuant to the authority to provide for additional modification procedures on the basis of other factors,²⁹⁶ Treasury and the Service issue final Regulations that allow a publicly-traded partnership to reduce the Imputed Underpayment based on a net decrease in the passive activity loss allocable to a specified partner in the reviewed year to the extent the partnership takes such loss into account in the taxable year immediately preceding the year in which the NOPPA is issued. This rule would provide for the same tax effect as taking the passive activity loss into account in the adjustment year pursuant to Proposed Regulation section 301.6225-2(d)(5), but the rule would also allow the partnership and the Service to determine the applicable loss amounts both when the NOPPA is issued by the Service and when the modification request from the partnership is due.

o. Administrative and Judicial Challenge

We recommend that the final Regulations clarify that a partnership may protest all unagreed issues in the NOPPA or raised in the examination as well as disagreements regarding modifications to the Imputed Underpayment to Appeals and the process for doing so (to the extent different from the usual process for raising issues to Appeals). The BBA Regime requires the Service to mail a NOPPA to a partnership and the Partnership Representative.²⁹⁷ Thereafter, the partnership has 270 days to submit information to the Service to modify the Imputed Underpayment reflected in the NOPPA.²⁹⁸ The Service has discretion to extend that 270-day period.²⁹⁹

We recommend that the final Regulations allow the partnership to protest unagreed issues presented in a NOPPA to Appeals before providing information to the Service to modify the Imputed Underpayment. This is because the Appeals process may moot the need for the partnership to provide (and the Service to consider) such information. For example, a full Service concession at Appeals would eliminate the Imputed Underpayment and so moot any need to consider modifications thereto. Similarly, a significant Service concession at Appeals may reduce the Imputed Underpayment to a sufficiently small amount that the partnership decides to forgo seeking to modify the Imputed Underpayment because the costs of doing so outweigh the potential benefits. Alternatively, following an unsuccessful Appeals process, the partnership may ultimately decide to make a push-out election under section 6226. In each of those cases there are significant efficiencies to be gained by allowing the Appeals process to proceed with respect to the underlying issue before requiring the partnership

²⁹⁶ See I.R.C. § 6225(c)(6).

²⁹⁷ I.R.C. § 6231(a).

²⁹⁸ I.R.C. § 6225(c)(7).

²⁹⁹ I.R.C. § 6225(c)(7).

and the Service to expend significant (and potentially unnecessary) resources on modifying an Imputed Underpayment.

After completing an Appeals process with respect to the underlying issue, a partnership may still desire to provide information to the Service to modify the Imputed Underpayment. However, by that time the 270-day period for providing information to the Service may have expired. To preserve the partnership's ability to provide information to the Service to modify the Imputed Underpayment, we recommend that the final Regulations provide that the Service will extend the 270-day period to allow a partnership at least 270 days following the completion of the Appeals process to provide information to the Service to modify the Imputed Underpayment. Alternatively, the Service could adopt procedures similar to Early Referral³⁰⁰ that allow review by Appeals of disagreed items before the issuance of a NOPPA.

We also recommend that the final Regulations allow the partnership to protest disagreements regarding modifications to the Imputed Underpayment to Appeals. This should be the case regardless of whether the partnership initially went through the Appeals process with respect to the underlying issue. We recognize that an initial Appeals conference to address the underlying issue and a second Appeals conference to address modifications to the Imputed Underpayment is potentially less efficient than a single Appeals conference that considers both issues. Nevertheless, we believe that any potential inefficiency that may arise from allowing two Appeals conferences would be outweighed by the potential efficiencies to be realized by allowing partnerships to resolve underlying issues at Appeals before requiring the partnership and the Service to expend potentially significant resources in modifying the Imputed Underpayment.

Moreover, there are ways to mitigate the potential inefficiencies of two Appeals conferences. For example, after concluding the Appeals process with respect to the underlying issue (regardless of whether a resolution is reached), Appeals could retain jurisdiction over the case while the partnership and the Service work on modifying any remaining Imputed Underpayment. This approach would have the benefit of ensuring that the same Appeals officer handles any disputes over both the underlying issue and modifications to the Imputed Underpayment.

In addition, we recommend that the final Regulations provide that any denied modification requests be reflected in the FPA. This will ensure that any Tax Court proceeding will also address the dispute regarding the requested modification.

F. Alternative to Payment of Imputed Underpayment

1. The Statute - Section 6226

In adopting the general default rule that partnerships pay the tax that results from a Service examination, Congress also provided an opt-out of that rule that preserves to some extent the economic expectations of the partners who invested in the partnership. A

³⁰⁰ See Rev. Proc. 99-28, 1999-2 C.B. 109.

partnership is generally not subject to tax, but rather the partners, which can include multiple tiers of flow-through investors, the ultimate taxable owners, pay tax on their distributive share of partnership items.³⁰¹

Under the prior TEFRA partnership audit regime, the partnership was respected as a flow-through entity and any adjustments resulting from an examination of a partnership tax return were taken into account by the partners. In cases in which there were upper-tier flow-through entities, the effects of the partnership audit adjustments were adjusted at the various tiers of flow-through entities until reaching the ultimate taxable owners of the partnership, which then took those adjustments into account.

Section 6226(a) allows the partnership to elect to “push out” (the “Push-Out Election”) the adjustments to the reviewed-year partners, who then take those adjustments into account in determining the increase in their tax liability for the year that includes the year in which the partnership statement is issued at the conclusion of a partnership examination.

The partnership must make the Push-Out Election within 45 days of the date that the FPA is issued.³⁰² The election does not preclude the partnership from challenging the FPA in court.³⁰³

Partners who receive an amended statement must compute the increase in tax that would have resulted if the partner’s share of the partnership adjustments had been reported to the partner in the reviewed year.³⁰⁴ The partner is subject to interest from the due date of the partner’s return for the reviewed year through the date the partner pays the tax due.³⁰⁵

The partner must also take into account any changes that affect tax attributes in any intervening year that is affected by the partnership adjustments in the FPA, and to the extent that such adjustments cause an increase in tax during an intervening tax year, the partner must compute the amount of that tax to be included and paid for the partner’s reportable tax year.³⁰⁶ Interest is also due on that increased tax from the due date of the partner’s tax return for the intervening year that is affected by adjustments in the FPA.³⁰⁷

Reviewed-year partners are also liable for their allocable share of penalties that apply to any or all of the adjustments in FPA.³⁰⁸

³⁰¹ I.R.C. § 701.

³⁰² I.R.C. § 6226(a)(1).

³⁰³ I.R.C. § 6226(d).

³⁰⁴ I.R.C. § 6226(b)(2)(A).

³⁰⁵ I.R.C. § 6226(c)(2).

³⁰⁶ I.R.C. § 6226(b)(2)(B).

³⁰⁷ I.R.C. § 6626(c)(2).

³⁰⁸ I.R.C. § 6226(c)(1).

Interest is calculated at a rate computed under section 6621(a)(2), but by substituting five percent rather than the normal three percent stated in that provision.³⁰⁹

2. The Proposed Regulations

Proposed Regulations sections 301.6226-1 through 301.6226-3 provide guidance on making a Push-Out Election and its impact on reviewed-year partners.

a. **Making the Push-Out Election**

Proposed Regulation section 301.6226-1 sets forth the rules for making the Push-Out Election. The election must be made within 45 days of the issuance of the FPA, which cannot be extended.³¹⁰ The election is made and signed by the Partnership Representative.³¹¹ The partnership is permitted to make a separate election for each Imputed Underpayment amount.³¹²

The Push-Out Election is an action taken by the partnership and thus is binding on all partners.³¹³ Reviewed-year partners to which the election applies and who are furnished statements must report their share of the partnership adjustments consistently with the furnished statements.³¹⁴

b. **Furnishing Statements**

The partnership must furnish the statement to each reviewed-year partner.³¹⁵ If the statements are mailed, the partnership must mail the statement to the last known address of the partner, and if the statement is returned because of an incorrect address, the partnership must exercise reasonable due diligence to identify the partner's correct address.³¹⁶

A partnership must provide the statements no later than 60 days after the partnership adjustments become final.³¹⁷ The partnership adjustments become final after the time for filing a petition under section 6234 expires, or if the partnership adjustments are challenged in court, when the court decision becomes final.³¹⁸

³⁰⁹ I.R.C. § 6226(c)(2)(C).

³¹⁰ Prop. Reg. § 301.6226-1(c)(3).

³¹¹ Prop. Reg. § 301.6226-1(c)(4).

³¹² Prop. Reg. § 301.6226-1(a).

³¹³ Prop. Reg. § 301.6226-1(d).

³¹⁴ *Id.*

³¹⁵ Prop. Reg. § 301.6226-2(a).

³¹⁶ Prop. Reg. § 301.6226-2(b)(2).

³¹⁷ Prop. Reg. § 301.6226-2(b).

³¹⁸ *Id.*

If a partnership discovers an error on a statement within the 60-day filing period, the partnership must correct the statement.³¹⁹ If the partnership finds an error in a statement after the 60-day filing period, it must request permission from the Service to correct the statement.³²⁰ A partnership corrects a statement by filing electronically the corrected statement with the Service and issuing the statement to the affected reviewed-year partner in accordance with the forms, instructions, and other guidance prescribed by the Service.³²¹

When the Service discovers an error in a partnership statement, it can require the partnership to correct the error. If the partnership fails to correct the statement as required by the Service, the Service may treat the failure as a failure by the partnership to properly furnish statements resulting in an invalid Push-Out Election. As a result of such an invalid election, the partnership would be liable for the Imputed Underpayment to which the election relates.³²²

c. Contents of Statements

The partnership statements must contain the following information:

- i. the name and correct TIN of the reviewed-year partner;
- ii. the current or last known address of the reviewed-year partner;
- iii. the partner's share of items as originally reported on the return;
- iv. the reviewed-year partner's share of the partnership adjustments;
- v. any penalties, or additions to tax;
- vi. modifications attributable to the reviewed-year partner;
- vii. modifications of any partnership tax attributes that result in adjustments for the reviewed-year partner;
- viii. the reviewed-year partner's safe harbor amount, and if applicable, the reviewed-year partner's safe harbor interest amount;
- ix. the date the statement was issued;
- x. the partnership taxable year to which the adjustments relate; and

³¹⁹ Prop. Reg. § 301.6226-2(d)(2)(i).

³²⁰ Prop. Reg. § 301.6226-2(d)(2)(ii).

³²¹ Prop. Reg. § 301.6226-2(d)(1).

³²² Prop. Reg. § 301.6226-2(d)(3).

- xi. any other information required by forms, instructions or guidance issued by the Service.³²³

The partnership reports each reviewed-year partner's share of partnership adjustments in the same manner as the items were originally reported on the partnership tax returns unless an adjustment is allocated to a specific partner or in a specific manner.³²⁴ Under those circumstances, the adjustment will be reported to the reviewed-year partners in the manner as finally determined.³²⁵ If an item that was not reflected on the original partnership return is adjusted, the partnership adjustment will be allocated in accordance with the rules applicable to partnership allocations, including partnership allocations under the partnership agreement.³²⁶

Any penalties or additions to tax relating to specific partnership adjustments are to be allocated to the reviewed-year partners in the same manner as the partnership adjustments to which the penalties or additions to tax relate.³²⁷ If, however, a penalty or addition to tax is specifically allocated to a reviewed-year partner or is allocated in a specific manner in a court decision (or in the FPA if no petition is filed), then the penalty or additional amount is reported to the reviewed-year partners in accordance with the final determination of the allocation of the penalty or additional amount.³²⁸ If a penalty or additional amount does not relate to a specific partnership adjustment, then the penalty or additional amount will be allocated under the rules for allocating partnership items, including under the partnership agreement.³²⁹

d. **Computing the Partner's Tax**

A reviewed-year partner who receives a partnership statement is required to pay the income tax due for the partner's tax year in which the partnership statement is issued (the "reporting year").³³⁰

The tax is composed of two components or "correction amounts." The first correction amount is determined by computing the tax that would have been due in the taxable year of the partner that includes the end of the reviewed year (the "first affected year").³³¹ The partner determines the additional tax due by taking into account the adjustments on the partnership statement and calculating her tax liability as if the adjustment had occurred in the first affected year. The partner then subtracts her tax

³²³ Prop. Reg. § 301.6226-2(e).

³²⁴ Prop. Reg. § 301.6226-2(f)(1)(i).

³²⁵ Prop. Reg. § 301.6226-2(f)(iii).

³²⁶ Prop. Reg. § 301.6226-2(f)(ii).

³²⁷ Prop. Reg. § 301.6226-2(f)(3).

³²⁸ *Id.*

³²⁹ *Id.*

³³⁰ Prop. Reg. § 301.6226-3(a).

³³¹ Prop. Reg. § 301.6226-3(b)(2).

liability as previously paid (taking into account any additional assessments, refunds, or rebates for the first affected year).³³²

The second “correction amount” is the increase in tax due for any year after the first affected year and before the reporting year (the “intervening years”) that is attributable to partnership adjustments.³³³ For example, a partner may have net operating loss carryforwards that were utilized both in the first affected year and subsequent intervening years that are now reduced by the partnership adjustments in the first affected year. The resulting adjustment to the first affected year might reduce the carryforwards to an intervening year resulting in an increase in tax for that intervening year.

The correction amount for all intervening years is computed similarly to the correction amount for the affected year. The partner calculates the increase in tax for the intervening year taking into account any changes in tax attributes that result from partnership adjustments in the affected year. The partner then subtracts her previous payments (taking into account any additional tax assessments or refunds/rebates for that intervening tax year). All increases in tax liabilities for the intervening years are added together. The total increase in tax is added to the increased tax liability for the first affected year.³³⁴

Partners are not permitted to include any decreases in tax that may have resulted from the partner taking into account her share of partnership adjustments in the first affected year or any intervening year. Section 6226(b) specifically describes “correction amounts” as amounts by which a partner’s chapter 1 tax would increase for each respective year.

e. **Partner Safe Harbor Amounts**

A reviewed-year partner receiving a partnership statement is permitted an election to pay a safe-harbor amount calculated by the partnership and reported on the statement the partnership issues to the reviewed-year partner.³³⁵ The safe-harbor amount is calculated in the same manner as the Imputed Underpayment, but only the adjustments allocated to the partner are used in calculating the safe harbor tax liability for that partner.³³⁶

The partnership must also calculate a safe harbor interest amount for partners who are individuals or who have calendar year tax years.³³⁷ The interest is calculated at the rate set forth in Proposed Regulation section 301.6226-3(d)(4) from the due date of the

³³² *Id.*

³³³ Prop. Reg. § 301.6226-3(b)(3).

³³⁴ *Id.*

³³⁵ Prop. Reg. § 301.6226-3(c).

³³⁶ Prop. Reg. § 301.6226-2(g).

³³⁷ Prop. Reg. § 301.6226-2(g)(iii).

partner's return for the first affected year through the due date of the partner's reporting year return without taking into account any extensions.³³⁸

The purpose of the safe harbor amount and the safe harbor interest amount are to allow a simplified method for the reviewed-year partner to determine her tax liability and deficiency interest for the reporting year. A reviewed-year partner's tax calculation might otherwise be complicated, taking into account the adjustments to the affected year, plus any increases in tax that might result in any intervening years as a result of changes to tax attributes carried to or utilized in those years. The safe harbor amount and safe harbor interest amount provide a simplified approximation of the reviewed-year partner's liability for additional taxes and interest without having to perform what might be fairly complicated calculations. A reviewed-year partner may elect to pay the safe harbor amount and the safe harbor interest amount in lieu of calculating the amounts otherwise due under section 6226.

f. Foreign Partners

The Proposed Regulations reserve on issues of the impact on foreign partners. The Notice of Proposed Rulemaking indicates that Treasury and the Service intend to issue regulations that apply withholding with respect to items allocated to foreign partners for which withholding is required under chapters 3 and 4 of subtitle A of the Code.³³⁹

g. Petition for Readjustment under Section 6234

The Push-Out Election does not affect the partnership's ability to challenge the FPA by petitioning the Tax Court for readjustment.³⁴⁰ A partnership has 90 days from the issuance of the FPA to petition for readjustment under section 6234.³⁴¹ It has only 45 days to make the election to push out the adjustments to its reviewed-year partners.³⁴² The Proposed Regulations make it clear that a partnership's Push-Out Election does not impact its ability to challenge the FPA by filing a petition. If the FPA is challenged, the time for issuing the statements to reviewed-year partners is extended until 60 days after a court decision on the FPA becomes final.

h. Pass-Through Partners

The Proposed Regulations reserve on the issue of whether a pass-through partner or upper-tier pass-through entities with indirect ownership in the audited partnership would be permitted to make an election to push out the adjustments. Under this approach, it would be possible to flow the partnership adjustments through tiers of pass-

³³⁸ *Id.*

³³⁹ 82 Fed. Reg. 27334, 27363–64.

³⁴⁰ Prop. Reg. § 301.6226-1(e).

³⁴¹ I.R.C. § 6234(a).

³⁴² I.R.C. § 6226(a).

through entities in the partnership's ownership chain until the adjustments are flowed to a non-flow-through taxpayer who will take the adjustments into account.

Section 6226 requires a partner that is issued a statement to compute and pay the increased tax resulting from her allocable share of partnership adjustments. Section 7701(a)(2) defines a partner as a member of the partnership, which would include only direct owners in the partnership.

In enacting the BBA Regime, Congress allowed the audited partnership the Push-Out Election as an alternative to paying the tax at the partnership level. In addition, in the Tax Technical Corrections Act, Congress has indicated a willingness to extend the Push-Out Election to upper-tier flow-through entities.³⁴³

Under general partnership rules and the TEFRA partnership procedures, partnerships are not subject to tax, but rather the ultimate owners of the partnership for the tax year under audit bear the economic burden of the taxes that result from their ratable share of partnership items allocated to such partners, including any additional partnership items allocated to them as a result an examination of the underlying partnership tax year.³⁴⁴ The Push-Out Election continues to allow partnerships and all upper-tier flow-through entities to maintain the economic terms of investing in a partnership. As our comments below reflect, we recommend that the final Regulations allow flow-through entities in an audited partnership's chain of ownership to elect whether to pay the Imputed Underpayment or push out the adjustments to their owners.³⁴⁵

3. Comments

a. **General**

We appreciate the efforts of Treasury and the Service in developing the Proposed Regulations on the new partnership audit rules in general, and in the critical area of the Push-Out Election in particular. This is an important component of the rules as it provides a mechanism for the partners to maintain the economic deal that they struck. Partners who invest in partnerships do so with the understanding that the partnership will not be subject to federal income taxes (or state and local income taxes), and that the partners who owned a partnership for the particular tax year will instead be responsible for reporting their allocable share of partnership items and paying any income tax due on income, gains, and other items from the partnership.

³⁴³ See H.R. 6439, 114th Cong. § 201 (2016); S. 3506, 114th Cong. § 204 (2016).

³⁴⁴ I.R.C. § 701.

³⁴⁵ We recognize that in order to implement this recommendation, Treasury and the Service may need to first issue proposed regulations covering this topic.

b. **Push Out Elections Should Be Available to Upper-Tier Flow-Through Entities**

The Push-Out Election allows the partnership and its partners, to some extent, to maintain the economic deal that they made by having the partners who owned a partnership interest during the year under examination be responsible for any adjustments and any income due as a result of the Service's audit of the underlying partnership.

The Service has, however, reserved on the issue of whether upper-tier flow-through entities with direct and indirect interests in the partnership under examination will be permitted to make a similar election to push out their allocable share of adjustments to their partners, shareholders, or owners in order to avoid being subject to tax on the Service adjustments from the examination of the underlying partnership. We recommend that the final Regulations allow such elections by upper-tier flow-through entities because that is the most effective mechanism for the partnership and its ultimate owners to preserve the economic bargain that they made with the direct and indirect owners of the partnership.

The Notice of Proposed Rulemaking recognizes that the bipartisan Tax Technical Corrections Act would have made the Push-Out Election available to upper-tier flow-through entities with direct and indirect ownership in the underlying partnership subject to examination.³⁴⁶ Although that legislation was not enacted, it demonstrates congressional support for extending the Push-Out Election to upper-tier flow-through entities.

We recommend that the final Regulations allow such Push-Out Elections through the chain of ownership of the audited partnership to the ultimate taxable owners. That approach allows the partnership to maintain the economic relationship intended with its current and former partners. Under the partnership provisions in the Code, the partnership is not subject to tax, but rather the ultimate owners bear the burden of any income tax that results from their distributive share of partnership items. The Push-Out Election for all tiers of flow-through entities in the chain of ownership of the audited partnership would lead to the same result.

We understand the Service's concern that this would create a greater administrative burden in tracking and collecting additional tax from the ultimate owners of the partnership for the reviewed year, which is the burden that the BBA was enacted to ease. In addition, we recognize that the Service has valid concerns that the time lapse between the reviewed year and the date that the Service completes the partnership audit might make it difficult to identify the former owners during the reviewed year (for both the partnership and the Service), and to verify that reviewed-year partners properly report and pay any additional income tax on the items reported in the partnership statement.

We note that the amended statements that would result from a partnership adjustment are in many respects similar to other information returns that the Service

³⁴⁶ 82 Fed. Reg. 27334, 27365 (2017).

relies on in determining an individual or entity's income. We recommend that the Service process the amended statements to indirect owners of upper-tier flow-through entities issuing partnership statements in a similar manner as the Service treats other information returns. For example, the Service often makes additional tax assessments against individuals if it finds that income from information returns such as Forms W-2 and Forms 1099 have not been reported. The Service also has the ability to file "substitute returns" if an individual or entity fails to file returns and the Service has information returns indicating unreported income that would have required the party to file a tax return.

The Treasury and Service also expressed concern that allowing upper-tier flow-through entities in the partnership's ownership chain to make Push-Out Elections might add considerable time to the audit cycle of a partnership. The current provisions allow a partnership 45 days from the FPA to make the Push-Out Election, and 60 days from the date that the partnership adjustments become final to issue the statements. Allowing additional time for upper-tier flow-through entities to make Push-Out Elections and issue statements would add time to the partnership audit cycle.

As one possible solution to that issue, we recommend that the final Regulations provide an overall time limit for upper-tier flow-through entities in the chain of ownership to make the Push-Out Elections and issue the statements. For example, the final Regulations could provide that all upper-tier partnerships make any Push-Out Elections and issue any required statements no later than 270 days after the audited partnership is required to issue its statements.

For all these reasons, we respectfully suggest that the Push-Out Election is an important component of the change in the partnership audit procedures and recommend that the final Regulations extend the availability of this election to flow-through entities in the chain of ownership of the audited partnership.

G. Administrative Adjustment Requests and Taxpayer-Favorable Adjustments

1. The Statute – Section 6227

A partnership may file an AAR to request an adjustment to one or more items of income, gain, loss, deduction, or credit of the partnership for any partnership taxable year.³⁴⁷ The AAR may not be filed more than three years after the later of the date the return for the year in question is filed or the due date for such return (determined without regard to extensions).³⁴⁸

The adjustment resulting from the AAR may be taken into account either by the partnership under rules similar to those under section 6225 (with certain carve outs) or by the partnership and its partners under rules similar to those under section 6226 (with

³⁴⁷ I.R.C. § 6227(a).

³⁴⁸ I.R.C. § 6227(a).

certain carve outs).³⁴⁹ An AAR that does not result in an Imputed Underpayment can only be taken into account by the partnership and its partners under rules similar to those under section 6226 (with certain carve outs).³⁵⁰

2. The Proposed Regulations

Proposed Regulations sections 301.6227-1 through 301.6227-3 provide the rules for AARs.

a. **Procedures for Filing an AAR**

Consistent with the BBA, the Proposed Regulations state that “[a] partnership may file a request for an administrative adjustment with respect to one or more items of income, gain, loss, deduction, or credit of the partnership . . . and any partner’s distributive share thereof . . . for any partnership taxable year.”³⁵¹ Generally, only a partnership may file an AAR. A partner may not file an AAR unless the partner is doing so in her capacity as Partnership Representative for the partnership.³⁵² Additionally, in certain cases a partner that is itself subject to the BBA Regime may file an AAR in response to the filing of an AAR by the partnership of which it is a partner.³⁵³

An AAR may only be filed by a partnership with respect to any partnership taxable year for which a partnership return has been filed.³⁵⁴ In addition, an AAR may not be filed with respect to a partnership taxable year after a notice of administrative proceeding with respect to such taxable year has been mailed by the Service under section 6231.³⁵⁵

An AAR must include (i) the adjustments requested, (ii) statements with certain information if a reviewed-year partner is required to take into account the requested adjustments, and (iii) any other information prescribed by forms, instructions, or other guidance issued by the Service.³⁵⁶ If a reviewed-year partner is required to take into account adjustments requested in an AAR, then the partnership must furnish a copy of the statement filed with the AAR to the reviewed-year partner to whom the statement relates.³⁵⁷

Each statement must include the name and correct TIN of the reviewed-year partner; the current or last address of the partner that is known to the partnership; the reviewed-year partner’s share of items originally reported to the partner (taking into

³⁴⁹ I.R.C. § 6227(b).

³⁵⁰ I.R.C. § 6227(b).

³⁵¹ Prop. Reg. § 301.6227-1(a).

³⁵² *Id.*

³⁵³ *Id.*

³⁵⁴ Prop. Reg. § 301.6227-1(b).

³⁵⁵ *Id.*

³⁵⁶ Prop. Reg. § 301.6227-1(c)(2).

³⁵⁷ Prop. Reg. § 301.6227-1(d).

account any adjustments made pursuant to a prior AAR filed under section 6227); the reviewed-year partner's share of the adjustments requested in the AAR (as described in Proposed Regulation section 301.6227-1(c)(2)); the date the statement is furnished to the partner; the partnership taxable year to which the adjustments relate (*i.e.*, the reviewed year); and any other information required by the forms, instructions, or other guidance prescribed by the Service.³⁵⁸

The Proposed Regulations provide that filing an AAR with the Service and furnishing related statements to the reviewed-year partner are actions taken by the partnership under section 6223 and the Regulations thereunder.³⁵⁹ Accordingly, under the Proposed Regulations, unless otherwise determined by the Service, a partner's share of the adjustments requested in an AAR as reflected on the related statement are binding on the partner, and the partner must treat the adjustments on the partner's return consistently with how the adjustments are treated on the statement that the partnership files with the Service.³⁶⁰

b. How Adjustments Requested in an AAR Are Taken into Account

Proposed Regulation section 301.6227-2 describes how adjustments requested in an AAR are determined and taken into account by a partnership. The Proposed Regulations require a partnership to determine whether the adjustments requested in the AAR result in an Imputed Underpayment.³⁶¹ The determination of the amount of the Imputed Underpayment, if any, is made in accordance with the rules under Proposed Regulation section 301.6225-1.³⁶² Similarly, a partnership may reduce the Imputed Underpayment as a result of certain modifications permitted under Proposed Regulation section 301.6225-2 related to tax-exempt partners, tax rates, certain passive losses, qualified investment entities, and other modifications to the extent permitted under future Service guidance.³⁶³ Other types of modification, such as a modification based on an amended return or a closing agreement, are not available in the case of an AAR.

A partnership does not need to seek Service approval prior to modifying the Imputed Underpayment from an AAR.³⁶⁴ However, modifications to the Imputed Underpayment resulting from an AAR can be taken into account by the partnership only if the AAR includes notification of the modification, a description of the effect of the modification, an explanation of the basis for such modification, and all necessary documentation to support the partnership's entitlement to such modification.³⁶⁵

³⁵⁸ Prop. Reg. § 301.6227-1(e).

³⁵⁹ Prop. Reg. § 301.6227-1(f).

³⁶⁰ *Id.*

³⁶¹ Prop. Reg. § 301.6227-1(a).

³⁶² Prop. Reg. § 301.6227-2(a)(1).

³⁶³ Prop. Reg. § 301.6227-2(a)(2).

³⁶⁴ Prop. Reg. § 301.6227-2(a)(2)(i).

³⁶⁵ Prop. Reg. § 301.6227-2(a)(2)(ii).

If the AAR results in additional tax due, the partnership is required to either (i) pay the additional tax due at the same time the AAR is filed, or (ii) elect to have the adjustments taken into account by the reviewed-year partners and provide each partner a statement that details the adjustments.³⁶⁶ The Service retains the right to re-determine through an administrative proceeding the adjustments reported on an AAR, including the amount of an Imputed Underpayment, and any modifications, determined by the partnership.³⁶⁷

Under the Proposed Regulations, AARs that are in effect claims for refund will be taken into account by the reviewed-year partners in the reporting year (*i.e.*, the taxable year that includes the date the required statement was furnished to the partner) as an adjustment to their reporting year income, loss, or credit.³⁶⁸ A partnership filing an AAR is required to provide such statement to the partners on the same day the AAR is made.³⁶⁹

3. Comments

In the Notice of Proposed Rulemaking, Treasury and the Service specifically request comments regarding:

- i. how a partnership can fulfill the requirements of section 905(c), including those rules relating to the assessment and collection of interest on certain refunds of creditable foreign taxes, while taking into account the objectives and purposes of the centralized partnership audit regime to improve the IRS's ability to effectively audit partnerships; and
- ii. whether the election to pay a safe harbor amount under proposed § 301.6226-3(c) should be available in the case of a partner that must take into account adjustments requested in an AAR under proposed § 301.6227-3.³⁷⁰

Prior to addressing these requests, we reiterate our concern made in our Prior Comments that the new rules do not provide partners (the taxpayers) an opportunity to file a taxpayer-favorable AAR unless such partner is the Partnership Representative. Further, partners have no right to intervene when a partnership files an AAR or if the Service initiates an administrative proceeding with respect to an AAR.

As the AAR can be filed up to three years after the partnership return was filed, the make-up of the partners could easily change in the intervening years. The adjustment-year partners could cause the partnership to file an AAR that pushes the

³⁶⁶ Prop. Reg. § 301.6227-2(b), -2(c).

³⁶⁷ Prop. Reg. § 301.6227-1(g).

³⁶⁸ Prop. Reg. § 301.6227-3.

³⁶⁹ Prop. Reg. § 301.6227-1(d).

³⁷⁰ 82 Fed. Reg. 27334, 27366-67, 27368.

adjustments to reviewed-year partners, who may no longer be partners in the partnership. The binding nature of an AAR results in reviewed-year partners not having an opportunity for judicial review of adjustments pushed out by the partnership.

a. **Fulfilling the Section 905(c) Requirements**

Section 905(c) requires a taxpayer who claims a credit for foreign taxes to notify the Service and re-determine its U.S. tax liability for the year or years affected upon certain changes in the taxpayer's foreign tax liability that may affect the taxpayer's foreign tax credit. Examples of such changes include:

- i. accrued taxes that when paid differ from the amounts added to post-1986 foreign income taxes or claimed as credits by the taxpayer (such as corrections to overaccruals and additional payments);
- ii. accrued taxes that are not paid before the date two years after the close of the tax year to which the taxes relate;
- iii. any tax paid that is refunded in whole or in part; and
- iv. for taxes taken into account when accrued but translated into dollars on the date of payment, a difference between the dollar value of the accrued tax and the dollar value of the tax paid attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment.³⁷¹

Under Temporary Regulation section 1.905-4T(c)(2), the required information to be provided to the Service includes:

- the date or dates the foreign taxes were paid;
- the amount of foreign taxes paid or accrued on each date (in foreign currency) and the exchange rate used to translate each such amount . . . ; and
- information sufficient to determine any interest due from or owing to the taxpayer, including the amount of any interest paid by the foreign government to the taxpayer and the dates received.³⁷²

If the re-determination results in a reduction of foreign income taxes paid or deemed paid, the deadline for providing the notice of re-determination to the Service is generally the due date (with extensions) of the taxpayer's return for the year within which the re-determination occurs.³⁷³ However, if the re-determination results in an increase of foreign income taxes paid or deemed paid, the deadline for providing the notice of re-

³⁷¹ Temp. Reg. § 1.905-3T(c).

³⁷² See Temp. Reg. § 1.905-4T(c)(2).

³⁷³ Temp. Reg. § 1.905-4T(b)(1).

determination to the Service is generally the same as the statute of limitations for claims for refund, as this notice constitutes a claim for refund.³⁷⁴

With respect to the foreign taxes paid by the partnership, partners, not the partnership, take into account separately their distributive share of the partnership's foreign taxes paid or accrued. The extent to which a partner is able to use the foreign tax credit is a partner-by-partner determination, similar to other separately stated items. Upon a re-determination, the partnership must rely on the reviewed-year partners to determine the impact of the re-determination, including whether additional tax, and possibly interest, is due or if a refund to the partners should be issued.

Taking into account the objectives and purposes of these new rules and the desire to improve the Service's ability to effectively audit partnerships, we recommend that the final Regulations specify that a partnership is deemed to have satisfied section 905(c) by filing an AAR that includes the required information outlined in Temporary Regulation section 1.905-4T(c)(2).

For a re-determination that results in a reduction of foreign income taxes paid or deemed paid, we recommend that the final Regulations require the partnership to determine if the adjustment requested in the AAR results in an Imputed Underpayment in the reviewed year. We recommend that where the adjustment requested in the AAR results in an Imputed Underpayment, the final Regulations permit the partnership to follow the procedures outlined in Proposed Regulation section 301.6227-2 and decide whether to pay any deficiency at the partnership level or push out the adjustment to the reviewed-year partners. Under Temporary Regulation section 1.905-4T(c)(2), the partnership would be required to provide in the AAR information sufficient to allow the Service to review the calculation of any interest due on any refunds received of foreign taxes previously paid.

If the re-determination results in an increase of foreign income taxes paid or deemed paid, we recommend that the final Regulations require the partnership to submit an AAR for the reviewed year and treat such AAR as a notice of re-determination for purposes of section 905(c). Additionally, we recommend that final Regulations section 301.6227-3 provide for an exception to the rule requiring reviewed-year partners to take into account adjustments requested in AARs that do not result in an Imputed Underpayment in the reporting year, *i.e.*, the year that the AAR is filed and statement furnished. Notification to the Service of a re-determination made under section 905(c) that increases the amount of foreign taxes paid or deemed paid should be considered a claim for refund in the reviewed year.³⁷⁵ Thus, the reviewed-year partners should receive the benefit of the claim for refund in the reviewed year, not the reporting year.

³⁷⁴ *Id.*

³⁷⁵ *See* Temp. Reg. § 1.905-4T(b)(1)(iii).

b. Availability of the Safe Harbor

In the case of any adjustment by the Service in the amount of income, gain, loss, or credit of a partnership, or a partner's distributive share under section 6225, the partnership can elect not to pay the Imputed Underpayment and push out the adjustments to the reviewed-year partners. To take advantage of this election, the partnership must furnish a statement to the reviewed-year partners that provides each partner's share of the adjustments.³⁷⁶ In addition to other requirements, the partnership must include a safe harbor amount.³⁷⁷ The purpose of requiring the inclusion of a safe harbor amount is to provide the reviewed-year partner with the option of paying the safe harbor amount in lieu of the additional reporting-year tax determined under Proposed Regulation section 301.6226-3(b).³⁷⁸

Similarly, under Proposed Regulation section 301.6227-2(c), if adjustments requested in an AAR result in an Imputed Underpayment, then the partnership could elect to push out the adjustments to the reviewed-year partners, who would then be required to take into account the adjustments in the manner provided in Proposed Regulation section 301.6227-3. A partnership that elects to push out the adjustments requested in an AAR to the reviewed-year partners must issue a statement to the reviewed-year partners, the required contents of which are set forth in Proposed Regulation section 301.6227-1(e). However, Proposed Regulation section 301.6227-1(e) currently does not specify that this statement must include a safe harbor amount calculation for each partner. We believe that reviewed-year partners who are required to take into account adjustments requested in an AAR under Proposed Regulation section 301.6227-3 should have the option to pay a safe harbor amount. Thus, we recommend that the final Regulations require the partnership to calculate the safe harbor amount and include such amount in the statement to be furnished to reviewed-year partners.

H. Statute of Limitations

1. The Statute – Section 6235

Section 6235(a) provides the limitations period within which the Service must make an adjustment under the BBA Regime.³⁷⁹ Section 6235(a) provides as follows:

(a) IN GENERAL.—Except as otherwise provided in this section, no adjustment under this subpart for any partnership taxable year may be made after the later of—

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

³⁷⁶ Prop. Reg. § 301.6226-2(a), -2(e).

³⁷⁷ Prop. Reg. § 301.6226-2(e).

³⁷⁸ See Prop. Reg. § 301.6226-3(c).

³⁷⁹ See also I.R.C. § 6232(b) (no assessment may be made before the 90th day after the FPA is mailed and—if a petition is filed in the Tax Court—the decision of the court has become final.).

- (A) the date on which the partnership return for such taxable year was filed,
 - (B) the return due date for the taxable year, or
 - (C) the date on which the partnership filed an administrative adjustment request with respect to such year under section 6227, or
- (2) in the case of any modification of an imputed underpayment under section 6225(c), the date that is 270 days (plus the number of days of any extension consented to by the Secretary under paragraph (7) thereof) after the date on which everything required to be submitted to the Secretary pursuant to such section is so submitted, or
 - (3) in the case of any notice of a proposed partnership adjustment under section 6231(a)(2), the date that is 330 days (plus the number of days of any extension consented to by the Secretary under section 6225(c)(7)) after the date of such notice.

The statute of limitations on adjustments may be extended by agreement between the Service and the partnership.³⁸⁰ In addition, an adjustment may be made at any time if the partnership files a false or fraudulent return or no return.³⁸¹ The limitations period in (a) above is extended from three years to six years if the partnership makes a substantial omission from gross income.³⁸²

2. The Proposed Regulations

The Proposed Regulations do not address the statute of limitations.

3. Comments

We recommend that several clarifications be made.

a. **Time Period for Issuing the NOPPA to Avoid Partnership Statute of Limitations From Being Forever Open**

The periods under section 6235(a)(2) and (a)(3) are measured from the date the NOPPA is issued. The BBA, PATH Act, and Proposed Regulations do not address the time period during which a NOPPA must be issued. Therefore, section 6235(a)(2) and (a)(3) could be read to suggest that the Service could issue a NOPPA to revive an otherwise closed statute of limitations. That is, even if the NOPPA was issued more than three years after the return was due or filed, the Service will have up to 540 days under

³⁸⁰ I.R.C. § 6235(b).

³⁸¹ I.R.C. § 6235(c)(1), (3).

³⁸² I.R.C. § 6235(c)(2).

section 6235(a)(2)³⁸³ or 330 days under section 6235(a)(3) to issue an FPA. This would make the statute of limitations period virtually unlimited for partnership adjustments made under the BBA Regime. We believe that this would be an erroneous reading of the statute. Although there is no legislative history, we believe that it is highly unlikely that Congress intended that the Service could reopen an otherwise closed statute of limitations when it drafted section 6235(a)(2) and (a)(3).

In addition, an unlimited statute of limitations would conflict with long-standing Supreme Court case law. In *Rothensies v. Electric Storage Battery Co.*, the Supreme Court recognized that statutes of limitations are “an almost indispensable element of fairness as well as of practical administration of income tax policy” because otherwise taxpayers would be required to “stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest.”³⁸⁴ Congress could not have intended to depart from such a well-established principle, particularly without any legislative history explaining the reason for such a dramatic departure.

Moreover, a potentially unlimited statute of limitations period would be contrary to the general three-year limitations period in the Code³⁸⁵ and create a significant incentive for partners to reorganize partnership ownership to be eligible to elect out of the BBA Regime. This would likely reduce the partnerships subject to the BBA Regime and increase the partnerships that the Service must audit and assess at the partner level pursuant to deficiency procedures under subchapter B of chapter 63. As Treasury and the Service recognize, such procedures are complex and burdensome.

Therefore, a better reading of the statute is that the NOPPA must be issued within the three-year period in section 6235(a)(1). That is, the NOPPA must be issued within three years of the later of the date the partnership return was filed, the date the return was due, or the date the partnership filed an AAR. Accordingly, we recommend that the final Regulations clarify that the NOPPA must be issued within the three-year period specified in section 6235(a)(1).³⁸⁶ This requirement will protect the general three-year statute of limitations, while allowing for an extension for the partnership to submit and the Service to process documentation to reduce the Imputed Underpayment.

b. Limiting Adjustments Allowed in Extended Time Period to NOPPA Adjustments

We recommend that the final Regulations provide that, to the extent that the issuance of a NOPPA extends the statute of limitations beyond the date that would be

³⁸³ Under section 6225(c)(6), the partnership has 270 days after the date the NOPPA is issued to submit documentation to reduce the Imputed Underpayment. Therefore, section 6235(a)(2) allows the Service 540 days after the NOPPA is issued to issue an FPA.

³⁸⁴ 329 U.S. 296, 300 (1946).

³⁸⁵ *See, e.g.*, I.R.C. § 6501(a).

³⁸⁶ Comments have also suggested statutory fixes to this statute of limitations issue. *See* NYS Bar Ass’n Tax Section, “Report on the Partnership Audit Rules of the Bipartisan Budget Act of 2015,” Report No. 1347 (May 25, 2016).

applicable under section 6235(a)(1), such extension is effective only with respect to issues raised in the NOPPA. This is similar to the rule provided in Regulation section 301.6503(a)-1(a) with respect to the issuance of multiple Notices of Deficiency under section 6212.

c. Impact of Modification Request on Periods of Limitation

We recommend that the final Regulations include an explanation and example of how a request to modify an Imputed Underpayment under section 6225(c) impacts the computation of the period of limitations in sections 6235(a)(2) and 6235(a)(3). Whether section 6235(a)(2) or (a)(3) applies depends on whether the partnership submits a request to modify the Imputed Underpayment amount.

If the partnership submits a modification request under section 6225(c), section 6235(a)(2) applies to extend the statute for up to 540 days. However, this time period is not readily apparent from the text of section 6235(a)(2), which references only a 270-day period. Section 6235(a)(2) also references section 6225(c)(7), which provides:

Anything required to be submitted pursuant to paragraph (1) [relating to the modification of an Imputed Underpayment] shall be submitted to the Secretary not later than the close of the 270-day period beginning on the date on which the notice of a proposed partnership adjustment is mailed under section 6231 unless such period is extended with the consent of the Secretary.

Thus, the cross-reference to section 6225(c)(7) allows an additional 270 days or more beyond the 270 days stated in section 6532(a)(2). The period of limitations is extended by the 270-day period (or longer if extended) when the modification request may be submitted under section 6225(c)(7) and then by the 270 days stated in section 6235(a)(2) after the date on which all information required to be submitted to the Service is so submitted. Because the impact of section 6225(c)(7) on the period of limitations in section 6235(a)(2) is not readily apparent, including some explanation and an example in the final Regulations would provide helpful guidance regarding the full implications of a modification request.

If the partnership does not submit a modification request, section 6235(a)(3) would apply. The Service would have 330 days from the issuance of the NOPPA to issue the FPA. The Service cannot issue the FPA within the first 270 days after the issuance of the NOPPA,³⁸⁷ which effectively requires the Service to wait the 270 days to see if the partnership requests a modification under section 6225(c). If the partnership does not submit a modification request, the Service would then have another 60 days to issue the FPA. The parenthetical added to section 6235(a)(3) by the PATH Act, § 411(c)(2) – “plus the number of days of any extension consented to by the Secretary under section

³⁸⁷ I.R.C. § 6231(a).

6225(c)(7)”³⁸⁸ – seemingly is only meaningful if the partnership requests additional time to submit a modification request but then fails to do so. If the partnership does submit a modification request, section 6235(a)(2), discussed above, applies. If a partnership requests additional time to submit a modification request, and then opts not to do so, it should not be able to point to the original language of section 6235(a)(3) and assert that the Service was precluded from issuing the FPA. We recommend that the final Regulations provide an example illustrating the impact of the parenthetical.

Because of the impact of the extension of time granted by the Secretary under section 6225(c)(7) on the computation of the period of limitations on making adjustments, we recommend that the Service prescribe a form that must be used to consent to an extension of the 270-day period under section 6225(c)(7) to avoid confusion and disputes over when the period of limitations expires.

d. Amended Returns Filed under Section 6225(c)

As summarized above, under section 6225(c)(2), the Imputed Underpayment amount may be reduced to the extent the partners file amended returns for the reviewed year that take into account their share of the Imputed Underpayment and pay any tax due. When an amended return is filed taking into account adjustments that increase the partner’s income, the partner should be allowed to offset such adjustments by previously unclaimed deductions, consistent with Service guidance outside of the partnership area.³⁸⁹ We recommend that the final Regulations clarify this point. Specifically, we recommend that Treasury and the Service make this clarification by including in the Regulations, when finalized, the following sentence after the first sentence in Proposed Regulation section 301.6225-2(d)(2)(i): “In addition to the partnership adjustments properly allocable to such partner, an amended return filed under paragraph (d)(2) of this section may take into account adjustments other than the partnership adjustments.”

I. Notices

Under section 6231(a), an FPA may not be mailed any earlier than 270 days after the date on which the NOPPA is mailed. As discussed above, a partnership has 270 days from the date when the NOPPA is mailed to the partnership to file any documents or evidence to reduce the Imputed Underpayment. In addition, partners have 270 days after the NOPPA is issued to file amended returns to reduce the Imputed Underpayment amount. Therefore, section 6231(a) does not allow the FPA to be issued before the 270-day period expires. These provisions work well together, except that section 6225(c)(7) allows the 270-day period to be extended with the consent of the Secretary. To harmonize these provisions and ensure that an FPA may not be issued during the period when the partnership may make a modification request, we recommend that the final Regulations clarify that the 270-day period referenced in the first sentence of the flush

³⁸⁸ We note that a closing parenthesis as a technical correction should be added to the statute after “6225(c)(7)”.

³⁸⁹ See, e.g., Rev. Rul. 81-88, 1981-1 C.B. 585, Situation 2; Rev. Rul. 82-49, 1982-1 C.B. 5.

language in section 6231(a) includes the number of days of any extension consented to by the Secretary under section 6225(c)(7).

J. State and Local Implications

The new partnership audit regime will have implications for the state and local income taxation of partnerships and their partners. The rules are procedural, not substantive, and hence they will not be automatically incorporated in the laws of states that base their definition of taxable income on the federal definition. State legislatures will have to decide whether, and to what extent, to adopt the federal statutory rules. Revenue departments of states that adopt the federal statutory rules will be reviewing the Regulations carefully to determine the extent to which they should adopt similar regulations or principles.

We note that Proposed Regulation section 301.6225-1(a)(1) states that an Imputed Underpayment will be treated “in the same manner as if it were a tax imposed.” Whether the Imputed Underpayment is deemed to be a tax on the partnership or a payment of the partners’ tax liabilities by the partnership on behalf of the partners can be important for state income tax purposes. The vast majority of states do not impose a net income tax on partnerships. If the Imputed Underpayment is deemed to be a tax on the partnership, states that do not impose an entity-level tax on partnerships may not have the authority to impose additional tax similar to the Imputed Underpayment even though the Imputed Underpayment relates to adjustments made to the partnership’s calculation of taxable income. We recommend that the final Regulations clarify that the Imputed Underpayment is a payment by the partnership of its partners’ tax liabilities rather than a tax on the partnership entity. Clarification on this point would also seem necessary in order to confirm that the partner is able to deduct the payment of the state tax for federal income tax purposes.