CENTRALIZED PARTNERSHIP AUDIT PROCEDURES

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The Bipartisan Budget Act of 2015 (P.L.114-74) enacted the below Internal Revenue Code of 1986 ("Code") sections ("Sections") as new Chapter 63, Assessment, Subchapter C—Treatment of Partnerships. The Protecting Americans From Tax Hikes Act of 2015 (P.L.114-113) made minor corrections. The Tax Technical Corrections Act of 2018 (P.L.115-114, March 23, 2018) made some important changes and additions:

- Section 6221, Determination at Partnership Level;
- Section 6222, Partner's Return Must be Consistent with Partnership Return;
- Section 6223, Partners Bound by Actions of Partnership;
- Section 6225, Partnership Adjustment by Secretary;
- Section 6226, Alternative to Payment of Imputed Underpayment by Partnership;
- Section 6227, Administrative Adjustment Request by Partnership;
- Section 6231, Notice of Proceedings and Adjustment;
- Section 6232, Assessment, Collection, Payment;
- Section 6233, Interest and Penalties;
- Section 6234, Judicial Review of Partnership Adjustments;
- Section 6235, Period of Limitations on Making Adjustments; and
- Section 6241, Definitions and Special Rules.

These new Code sections, as amended, generally effective for 2018 and later tax years, represent a major overhaul of the partnership audit procedural rules familiarly known as the "TEFRA partnership audit rules" enacted in 1982 (P.L. 97-248). The new rules also apply to partnerships that used to be eligible for the now repealed, less publicized electing large partnership audit rules.[1] The TEFRA partnership audit rules had been the subject of numerous court decisions involving interpretative and other disputes between taxpayers and the IRS as applied to the particulars of many fact patterns unaddressed or inadequately addressed by the TEFRA rules.[2] The 2015 Code changes obviously reflect massive institutional experience with the TEFRA rules but not much with electing large partnership audit procedures. The 2018 Code changes reflect probably no IRS experience with the 2015 rules, but they do reflect plenty of taxpayer representative and industry lobbying organizations' comments about the 2015 Code Sections and 2017 proposed regulations. The focus of the new rules begins with the partnership as a tax paying entity, rather than an aggregate of its partners as the taxpayers, and then the focus will or can change to the tax positions of one or more of the partners depending upon what the IRS revenue agent and/or the partnership representative decides to do in situ.

This article is a fresh start not intended to be comparative with the TEFRA partnership audit rules or the now-repealed electing large partnership audit rules or the 2015 rules to the extent they were changed in 2018. The discussion is mainly based upon experience, the new Code sections, final Treasury Regulations, adopted January 2, 2018 (T.D. 9829), as to the Section 6221(b) electing out for eligible partnerships, final Treasury Regulations, adopted August 9, 2018 (T.D. 9839), as to the Section 6223 partnership representative, and final Treasury Regulations,

adopted February 21, 2019 (T.D. 9844), and their preamble (the "Preamble"), as to nearly all of the rest of these Code Sections, the legislative history to the 2018 legislation[3], and the Internal Revenue Manual's TEFRA partnership audit guidelines (IRM).[4] To know anything about the new rules, one has to pretty much know everything except special rules for RICs and REITs found in Treas. Reg. §301.6226(b)-3(b)(4). At a first glance that is impossible.[5] The article does not cover every aspect or important nuance, but should serve as a starting point for the attorney charged with representing a partnership or partner in audit or appeal or with amending or drafting partnership agreements.[6]

AUDIT ADJUSTMENTS TO PARTNERSHIP-RELATED ITEMS

Paraphrased, Section 6221(a) states *the* general rule. Any tax amount, and related penalties, additions to tax or additional amounts, and underpayment interest, attributable to an IRS audit adjustment of a "partnership-related item" (key term of art) shall be assessed and collected against the partnership (or limited liability company or any other entity that is tax classified as a "partnership" governed substantively by Subchapter K of the Code) in accordance with Section 6232; for example, a simple general partnership *per se,* and its individual general partners because they are as general partners jointly and severally liable for partnership audit adjustment amounts. Most situations will involve limited liability companies and limited partnerships with entity general partners so the IRS collects from an entity.

The biggest fork in the road, or exception to this audit procedural rule, is found at Section 6221(b) for smaller, simpler partnerships. A partnership, that taken together with any and all S corporation partners, that does not involve the combined furnishing of more than 100 Forms K-1 to partners or shareholders for a taxable year may elect out of new Chapter 63, Subchapter C, on a year-by-year basis. However, there can be no "ineligible" partners during the year. Before electing out, the potent "partnership representative" must undertake due diligence to identify any and all "ineligible" partners — a tax classified partnership, a trust, a foreign entity that would not be treated as a C corporation if it were a domestic entity, an estate of an individual other than that of a former partner, a person holding a partnership interest on behalf of another, such as an agent or mere nominee[7], or, surprisingly, a disregarded entity, meaning, typically, a limited liability company owned by one individual or corporation. Even one of a kind of these partners for any day during the partnership's year makes the election unavailable for the year. Treas. Reg. §301.6221(b)-1(b). While not the same as far as who are S corporation ineligible owners, the ineligible partner approach is analogous to S corporation ineligible shareholders rendering S corporation status unavailable.

Where the election is thought desirable, the partnership representative will be making it on each year's Form 1065. The election is not a simple matter of box checking. The election requires an eligibility statement and particularized disclosures to the IRS of partner identities and locations, tax classifications and tax ID numbers, as well as annual notification to the partners of the election having been made for the year. There will probably be a new IRS Form for this purpose at some point. The election must be filed with a timely filed Form 1065 and allowing for filing extension. The IRS has the power to declare inaccurate elections void, and it appears that there is no recourse to Federal courts.

Partnership agreement provisions can vary about the latitude or lack thereof, and personal liability or lack thereof, concerning the partnership representative's responsibilities about the annual election. For example, an agreement may mandate partnership representative election out for all eligible years. Alternatively, at least prospective, passive limited partners ordinarily would want to be advised about the consequences of not making the election for an eligible partnership. The author believes that the election out will most often be desirable from the perspectives of the partners, if for no other reasons than because they are less likely to lose control over partnership-related items that can have a material impact on partnership after-tax returns or their own tax returns and the IRS's audit burden is

greater given the repeal of the TEFRA partnership audit rules.

PARTNERSHIP REPRESENTATIVE

Section 6223 grants sole and binding authority vis-à-vis the IRS and the partnership to the "partnership representative" as further spelled out in Regulations. In addition to making an election out, Section 6223 authority extends to being sole decision maker concerning Section 6227 administrative adjustment requests (AAR) and the partnership's satisfaction of Section 6225 "imputed underpayments" and related Section 6233 penalties and interest; invoking Section 6225 procedures for modifying the notice of proposed partnership adjustment before then;[8] choosing in accordance with Section 6226 instead to have the partners take audit adjustments into account on their own income tax returns; and proceeding to Federal court under Section 6234 in order to contest the notice of final partnership adjustments.

Partnership agreement provisions can vary about who is going to be the partnership representative and successor, whether appointed, elected or de facto (think private offerings), and the means by which a partnership representative can be removed and replaced, such as "for cause" as defined. In addition, although they would not be binding on the IRS, agreement provisions can address to what extent the partnership representative has unfettered powers over the above decisions and such others as having to give notice of uncertain tax positions, making partnership tax expensing versus depreciating elections and the many other matters that had been part of many agreements concerning the "tax matters partner" under the TEFRA audit rules. For many years, of course, there have been whole sections in many partnership agreements about these sorts of things, but until post-2015 not employing the new vocabulary and addressing the new choices. Now partnership agreements should be addressing in adequate detail the "what if" an audit commences such that the new rules' choices become necessary or desirable.

As far as Section 6223 and the Regulations go, a "partnership representative" can be any individual or entity designated to the IRS on Form 8979 filed annually—much like business entity annual registrations; provided, however, that the individual or, in the case of an entity partnership representative, an individual acting for it, has a "substantial presence" in the USA. The Regulation's presence requirements are practical: the individual representative, or "designated person" in the case of an entity partnership representative, has a U.S. tax ID number, a U.S. street address, and a telephone number with a U.S. area code, and, in effect, covenants and agrees to make himself or herself available to meet in person with revenue agents at reasonable times and places as determined by the agents. Treas. Reg. §301.6223-1(b). There is a single partnership representative as far as the IRS and Federal tax courts are concerned. Representation by committee is not allowed, but partnership agreements can provide for partnership representative advisory or consenting committees.

Examples of persons eligible for designation are the sole, individual general partner of a limited partnership, the special limited partner entity of a Section 42 low income housing tax credit limited partnership, any individual non-member, manager of a limited liability company tax classified as a partnership, and any third party willing to take on the responsibilities akin to the individual, professional trustee occupation. To handle worst case situations, the IRS is empowered to deputize any person as the partnership representative. Section 6223(a).[9]

PARTNERSHIP LEVEL AUDIT AND TAXATION: THE ENTITY THEORY

The partnership audit process ordinarily will begin with a revenue agent mailing either a standard contact letter, probably along with an Information Document Request, or a "notice of administrative proceedings" for one or more "review years." Section 6221(a).[10] The contrasting "adjustment year" can be one of several years, and that fact sometimes will make for strategic thinking when advising partner representatives about what to do or expect. Fact patterns are going to vary. The adjustment year can

be the year the IRS summarily completes the audit and issues a final notice of partnership adjustment.[11] Section 6231(a)(3). It also can be at the least one of the following years: (i) the year for which a partnership files an administrative adjustment request (Section 6227); (ii) the year a partnership's imputed underpayment is mutually agreed between the IRS and the partnership representative who had invoked Section 6225(c) modification procedures; or (iii) the year final adjustments become the subject of a final decision of the relevant court. Within 90 days after the date on an IRS notice of final partnership adjustment the partnership representative may cause the partnership to file a petition with the United States Tax Court or with a district court for the district in which the partnership's principal place of business is located or with the Court of Federal Claims.[12] Section 6234(a) and Treas. Reg. § 301.6241-1(a)(1).

In all audit situations not involving a partnership representative election out of the new rules, Section 6225 directs the revenue agent first and foremost to determine a partnership's annual "imputed underpayments" flowing from adjustments to "partnership-related items" for the "reviewed years" in question.[13] Section 6225(b) directs that imputed underpayments be determined by "appropriately netting" partnership adjustments in order to ascertain increases or decreases in partnership-related items by Section 702(a) separately stated categories and the residual category, such as netting adjusted capital gains and losses that increase reported net gain. Section 6225(b)(3). Somewhat counter-intuitively, Section 6225(b)(4) provides that if an adjustment on an appropriately netted basis results in "a decrease in the amount of an imputed underpayment" or the adjustment item is one that "could be subject to any additional limitation under the provisions of this subtitle (or not allowed, in whole or in part, against ordinary income) if the adjustment were taken into account by any person," the decreasing item is taken into account by the partnership for the "adjustment year' rather than for the reviewed years.

Treas. Reg. §301.6225-1(c) elaborates with (probably consistent) long recipes beginning with "grouping" audit adjustments by four categories: adjustments that reflect reallocations of items between or among partners; adjustments affecting tax credits, such as the Section 42 low-income housing credit; adjustments affecting items that can be claimed as a tax credit or a deduction, such research and development expenses; and the big pot "residual grouping." If the grouping analysis results in no reallocations among partners and any combination for the audited year of "no changes" or only "positive adjustments", viz., increases in partnership imputed taxable income, the agent employs the Treas. Reg. § 301.6225-1(e) netting rules to arrive at the total netted partnership (positive) adjustment. The agent is directed to apply the highest of the Section 1 (non-corporate income tax rates) or Section 11 (corporate tax rates) income tax rate in effect for each reviewed year and thus arrive at the "imputed underpayment" per audit year, such as 37 percent for 2019. The agent may then issue a notice of proposed partnership adjustment or hold off. Why hold off? Treas. Reg. § 301.6225-1(g) permits, but does not require, that the agent to divide the imputed underpayment into groups and specify one or more partners or group of partners associated with that group of underpayments. An example of exercising this discretion should be a partnership with series partnership interests wherein for the audit years only the priority series partners have allocations of profit or loss and only a net increase in the residual group is relevant. Based upon the Preamble, however, one should not expect agents to exercise this discretion for the foreseeable future. The Section 6225 modification procedure is the route to this end if desirable based on the circumstances.

In any event, unlike with the TEFRA partnership audit rules, the imputed underpayment tax, with added on penalties and interest, will be one big partnership as an entity liability. The liability is codified as if it were a tax imposed by Subtitle A for the "adjustment year" instead of, as has been the case for the most part of approximately 106 years, the year being audited, n/k/a, the "reviewed year." Sections 6225(a)(1) and 6232(a).

If the grouping analysis results in a "negative adjustment" in any group for an audited year, that is decrease in income or gain or an increase in a deduction or loss within any of the four (4) groups, the agent must perform the complex Treas. Reg. § 301.6225-1(d) "subgroup" pigeon holing and § 301.6225-1(e) subgroup netting before issuing a notice of proposed partnership adjustment. For example, if the netting of the residual group results in a negative adjustment, the agent is to break down the group along Section 702 categories to identify which resulting subgroups have net negative or net positive adjustments within the subgroups.[14] For example, if subgroup netting of ordinary gains and losses reflects in increased ordinary loss, Treas. Reg. §301.6225-1(d), consistently with Section 6225(b)(4), directs the agent to place the increased loss in its own subgroup because, for example, lots of partners of lots of partnerships are subject to the Section 469 passive activity deduction limitations. Treas. Reg. §301.6225-1(d) will be frequently encountered in partnership audits. Except for negative reallocation adjustments, negative adjustments resulting from subgroup analysis are taken into account by the partnership for the adjustment year in accordance with Treas. Reg. §301.6225-3.[15] In response to comments on the August, 2017, proposed regulations, the Preamble observes that group/subgroup/net/highest rate very often is going to result in a materially higher liability than if adjustments were taken into account by the partners.

Treas. Reg. §301.6225-3(f) sets forth two exceptions to taking into account what in a general sense are tax reducing effects in the "adjustment year" rather than in reviewed years: (1) if the partnership representative invokes the Section 6225(c) modification procedures and/or (2) timely makes the Section 6226(a) election.[16] Section 6225(c) modification procedures allow for reduction in a notice of proposed partnership adjustments' imputed tax underpayment liability by reference to partner-relevant facts. The Section 6226(a) election allows for the impacted partners to take into account positive and negative adjustments for their years ending within reviewed years and other years if relevant. The new rules do not preclude a partnership representative from first invoking the Section 6225(c) modification procedures to see the result, and if unsatisfactory, make the Section 6226(a) election. These choices will most often be most beneficial. For example, in a two large corporation joint venture partnership situation, the Section 6225(c) modification procedures allow for rate reduction to 21 percent, and that may be fine if the corporations are paying tax at an effective 21 percent rate and deductibility of the imputed partnership liability for state corporate income tax purposes is favorably resolved, or the partnership audit liability is immaterial. If the corporate partners are in expiring Section 172 net operating loss deduction postures, the Section 6226(a) election is going to be most desirable.

Section 6225(c) sets forth procedures allowing "modifications" of proposed partnership imputed underpayments for reviewed years. Treas. Reg. §301.6225-2 elaborates. Both Section 6225(c) and these regulations are very detailed. They will someday merit separate treatments.[17] In short, besides the fact that only the partnership representative can request modifications, Section 6225(c)(7) imposes a 270-day deadline from the date on the notice of proposed partnership adjustment to (1) request that modifications be made and (2) submit all relevant information (with agent or group manager discretionary extensions allowed for). Dialogue during the audit between the agent and partnership representative (or partnership Form 2048 authorized professionals) will often make the request for modifications inevitable. More unusual circumstances, such as commencement of contact between a *new* partnership representative and the agent, will lead to frantic pleas for more time to make a modifications request or submit undelivered information. Some partnership agreements should and will reflect that a partnership representative can be removed, if failing to make a request for modification of a proposed imputed underpayment after a majority in interest of the partners vote for it or some other trigger.

In connection with a modification request, a partnership representative will often want the relevant partners to prepare amended returns for the "reviewed" years, which can be all or some partners depending

on the facts. Motivation to do this includes in order to have negative adjustments taken into account for reviewed years rather than fall into the adjustment year basket. In many situations partners asked to prepare amended returns should be prepared to pay the income taxes shown as due thereon, plus interest, plus possibly penalties. Section 6225(c)(2)(iii).[18] Something to think about is a provision in a partnership agreement addressing "what if" a partner volunteers to pay additional taxes and, as a result, reduces partnership imputed liability, however effectuated. Maybe then the partnership or select partners covenant and agree to make such a partner reasonably whole if that partner's actions and payment had the effect of benefitting others. Maybe an example comes to your mind. Treas. Reg. § 301.6225-2(d)(2)(x) allows for less information than partner amended returns. The Preamble indicates that this approach is going to come about as a result of future IRS guidance resulting from audit experience.[19]

Where evident in the circumstances, a partnership representative also can undertake to prove to the agent that the imputed highest tax rate (e.g., 37 percent for 2019) is inappropriate given tax-exempt entity partners, C corporation partners and/or individual partners as to partnership capital gains and qualified dividends. Section 6225(c)(3) and (4).[20] Finally, the Preamble makes the point that modifications can include changes to groups and subgroups that will have tax reducing effects.

In the Section 6225 partnership-as-liable-entity context, Section 6233(a) provides for interest on an adjustment year's increased taxes to run from the due date of a reviewed year's return to the due date of the adjustment year's return. Interest also runs on additional tax due for any and all "intervening years." Section 6232(f)(1)(A) sets the underpayment interest rate at the well-known Section 6621(a)(2) quarterly changeable base rate, but plus 5 points, rather than this long-standing base plus three points, from and after 10 days of IRS notice and demand for payment of all unpaid final partnership imputed liability amounts. In addition, under Section 6232(f)(1)(B), the "Secretary may assess" the partners extant at the close of the adjustment year (not at the close of the reviewed year) proportionate shares of the total unpaid partnership liability. Treas. Reg. § 301.6232-1, adopted February 21, 2019, makes no mention of adjustment year extant partner assessment, leading one to think that Section 6232(f)(1)(B) is not self-executing, at least for persons not also partners for the reviewed year(s).

PARTNER LEVEL TAXATION: THE AGGREGATE THEORY

In any partnership audit situation leading to a notice of *final* partnership adjustment, instead of, for example, a modification of a *proposed* partnership adjustment that leads to a reduced, final notice of adjustment to which the partnership responds by timely paying the liability and perhaps separate assessments of inconsistently reporting partners (see below regarding partner inconsistency), the partnership representative has 45 days from the date on the *final* notice to file an irrevocable (except with IRS consent—new Form 8989) election out (new Form 8988) of the partnership paying the indicated imputed underpayment liability. Section 6226(a). The election out involves the partnership representative following very specific procedures found in Treas. Reg. § 301.6226-1(c)(3) and (d) and (e). A valid and timely election absolves the partnership from imputed liability under Section 6225 and avoids assessment and collection against the partnership under Section 6232. The Preamble indicates that these results are truly absolute.

The election places payment liability on the "reviewed year(s)" partners, not the adjustment year partners, for each year under audit, not ever likely to be dollar-for-dollar, but allowing for taking into account how each partner's share of the noticed adjustments impacts a partner's tax liability. Treas. Reg. § 301.6226-1(b). The election out will ordinarily mean that the partnership representative has determined not to go to Federal court, yet the election out does not preclude a partnership representative from going to court on behalf of the partnership to contest a notice of final partnership adjustment and apparently extending to Section 6226 partner

liability issues. Treas. Reg. § 301.6226-1(f) and -2(b)(3)(iii), Example 3; § 301.6234-1(a) and §301.6241-1(a)(6). The Preamble indicates that the partnership representatives sometimes might want to pursue dual tracks. If the partnership representative goes to court post-election out, presumably the courts will also entertain partner level issues connected with Section 6226 partner specific substantive tax issues arising from "partnership adjustments." The wording of Section 6234(c) SCOPE OF JUDICIAL REVIEW also indicates that the issues reviewable are limited to those evident from the final notice of partnership adjustment, however. No rule requires a notice of final partnership adjustment not to reflect partner level adjustments or partner level penalty impositions, but there has yet to be experience with the scope of final notices. For now, in representing clients, a good idea is to ask the agent to put the partner specific matters in the final notice. The author would not be surprised if Section 6234(c) and the relevant regulations become the subject of judicial interpretations.

Treas. Reg. § 301.6226-1(c) sets forth in detail the form, time and manner a partnership representative must furnish information statements to the partners and the IRS disclosing information. For an election out to be valid, the partnership representative must timely furnish the statements to each partner extant during the reviewed year or years. The statement includes each reviewed year partner's share of IRS adjustments to partnership-related items. The tax and related liability of a reviewed year partner then arises as an additional tax due for the furnished partnership year. Treas. Reg. § 301.6226-3. That year is the year during which the partnership representative furnishes *all* the required information to the reviewed year partners. In terms of timely furnishing the statement, under the regulations, the partnership representative must furnish statements with copies to the IRS no later than 60 days after the date the final notice adjustments are "finally determined"—either the last date for filing a lawsuit in the three available courts (90 days from the date on the final notice) or the day the court of competent jurisdiction's decision becomes final.

Section 6226(b)(2) and Treas. Reg. § 301.6226-3(b) govern the partners' "correction amounts." The furnished statement is mandated to be complete enough such that a partner can calculate the partner's Chapter 1 income tax liability for the first partner impacted year by re-computing the partner's tax based upon the partner's share of IRS adjusted partnership items, as determined at the partnership level in the notice of final partnership adjustment. Later impacted years, termed "intervening years," correction amounts are also to be ascertained. Conceptually a partner re-computes the partner's audit years' taxable income flowing from the statement information. The regulations recognize that a partner's share of adjustments may decrease a partner's taxable income for a reviewed year. In theory at this early point, the information may be as straightforward as correct K-1 information ab initio for the audited year(s). On the other hand, not all partnership-related items are K-1 items. At any rate, the increase in tax is "an increase in tax imposed by chapter 1 of the Code" for the tax year of the partner during which the statement was furnished to a partner with all of the Code penalty, interest and procedural ramifications that flow from that description as *the* tax year of the partner's liability, except where pre-empted by other, more specific of the new rules, if any.

Correction will ordinarily relate to partner level increased liability flowing from the audit. The Section 6226 regulations point to potentially substantial differences between Section 6225 partnership liability as such in the notice of final partnership adjustment and the sum of the individual partners' respective tax liabilities as a result of the correction rules. Because drafters of the Treas. Reg. § 301.6226-3(b) appreciated a lot of different things can happen along the way of a partnership audit, a partner's liability is to be further adjusted by one or more of the over or underpayment situations if present, for example: (1) the particular partner had already filed an amended return and paid additional liability for a reviewed year in connection with a Section 6225 modification procedure; (2) unrelated to the audit, the particular partner had overpaid taxes for a reviewed year by understating on his Form 1040 estimated taxes paid, and this is happily, timely

discovered; (3) the IRS had erroneously made an excess refund and that is discovered. Treas. Reg. §301.6226-3(b) makes cross–reference to all Treas. Reg. §301.6664-2(d) and -2(e) situations.

Pursuant to Section 6226(b)(4), Treas. Reg. § 301.6226-3(e), after receipt of qualifying statements, each pass-through partner of an audited partnership must file a "partnership adjustment tracking report" with the IRS and furnish its partners with tax information relevant to the report. The tracking report reflects that the regulations in several respects anticipate and address the effects of partnership audits on upper-tier partnerships and other pass-through partner entities as well as on their owners or beneficiaries. The aspects of the new rules as they impact upper-tier partnerships and other pass-through entities merit separate treatment. Suffice it to say for a survey article, upper tier pass-through entity partners, as well as their shareholders or beneficiaries, can be adversely impacted by the new rules. Persons responsible for pass-through entities' administration need to be aware of the new partnership audit rules if partnership interests representing a good deal of the value of these pass-through entities are with respect to partnerships that have not been electing out or are ineligible partnerships.

Section 6226(c)(1) states, "…the partners of the partnership for the reviewed year shall be liable for any such penalty, addition to tax, or additional amount." In essence, Treas. Reg. § 301.6226-3(d)(2) makes clear that the character of the penalty, addition to tax, or additional amount passes through to each partner. The amount of each of these can be determined based upon a partner's amended return or equivalent, if any. Treas. Reg.§ 301.6226-3(d)(3) allows for "partner level defenses" such as the reasonable cause and good faith defenses under Section 6664(c). Defenses are allowed to all partners, including pass-through entity partners per se. However, this same paragraph states that the only avenue to penalty abatement is that the partner "must first pay the penalty" and then timely file a claim for refund for the "reported year." In practice, abatement becomes relevant once the auditing agent with the group manager's approval has determined to impose penalties despite partnership representative protests, if any. In light of the regulations, it does not appear that the courts will entertain divisible versus non-divisible penalties analysis. Each penalty for each reviewed year must be paid in full in order for an aggrieved partner to file a refund suit within two years of the refund claim date owing to IRS inaction on the claim, for example.

Concerning audits of partnerships that have pass-through partners, owners and beneficiaries of pass-through partners ("affected partners"), if furnished with the tracking report statement described in Treas. Reg. § 301.6226-3(e)(1), should have similar prerogatives as above. If the pass-through entity owners or beneficiaries are not furnished the statement, that will ordinarily mean that the pass-through entity will be paying its share of the imputed underpayment, penalties, if any, and interest as a cost of doing business. If it fails to pay, Section 6232(f) provides the IRS with broad and flexible assessment and collection authority. As to interest on reviewed year or affected partners liability, Section 6226(c)(2) sets the underpayment interest rate at the Section 6621(a)(2) quarterly changeable base rate, plus five points, rather than this long-standing base plus Three points. Revenue, anyone?

All tax classified partnerships' partnership agreements, whether negotiated or private offering memorandum-type, that are worth paying an attorney to draft or amend need to have tax sections reflecting whether or not a partnership representative can invoke the Section 6226 procedures without majority in interest prior approval of the partners or some other formulation. Beyond that agreements can go into more or less depth about what would follow if a Section 6226 election is duly authorized or allowed in the discretion of a partnership representative.

ADMINISTRATIVE ADJUSTMENT REQUESTS

As aforesaid, the "adjustment year" can be the year during which the partnership representative files an AAR. An AAR will nearly always take the form of Form 1065X designed as an AAR along with a

statement of what the partnership representative wants to achieve in all particulars, and probably the IRS will eventually issue a new, special form. Compare Treas. Reg. § 301.6227-1(c). Once a notice of administrative proceeding is mailed, generally, it is too late to file an AAR.[21] Aside from that deadline, Section 6227(c) also provides a statute of limitations on a partnership's filing an AAR. An AAR may not be filed more than three years after the later of (i) the date on which the partnership return for the year was filed or (ii) in the case of a partnership non-filing, the last day for filing the partnership return for a given year determined without regard to the time for extension. The AAR is like an individual's Qualified Amended Return (QAR) in that by filing it, money loss to the U.S. Treasury from penalties can be eliminated or minimized. Treas. Reg. 1.6664-2(c) (QAR obviates accuracy related penalties.) As with a QAR, though, one has to be proactive.

Treas. Reg. §301.6227-2 sets forth detailed rules concerning "what if", probably most often in practice, the AAR involves the fact that the partnership representative has determined to pay a "modified" imputed underpayment, such as can be expected with a widely held partnership that discovers material errors reflective of material tax underpayments such as a large omission from gross income for the partnership year on account of failure to properly accrue income. The additional liability as reflected on a partnership's Form 1065X/AAR statement must be paid along with the documentation, and the IRS may assess that liability immediately. Alternatively, Treas. Reg. § 301.6227-2(c) allows the partnership representative to file along with the requisite documentation an election to have "review" year partners take into account their shares of items that will, probably in most all instances, increase partner taxes. Reg. § 301.6227-1 states that the partnership representative must provide each "reviewed" year partner with a statement so as to enable him or her to comply with the then applicable Treas. Reg. § 301.6227-3. Interestingly, the partners who are not pass-through partners take into account adjustment shares for their respective tax years during which they receive the statement (the "reporting year"). They pay any and all additional taxes that result from incorporating the statement information into their return for that year. Treas. Reg. § 301.6227-3(b). Pursuant to Treas. Reg. § 301.6227-3(c), pass-through partners may pay additional taxes or furnish statements to their owner/beneficiaries, who then become responsible for increased liabilities.

CONSEQUENCES TO PARTNERS OF INCONSISTENT POSITIONS

Section 6222 concerns partners either reporting consistently with a partnership's treatment of a partnership-related item or timely notifying the IRS of positions that are inconsistent with a partnership's treatment of a partnership-related item. Conceptually, the individual partner consistency requirement was featured as part of the TEFRA partnership audit rules, but among other differences with Section 6222, its scope was limited to filing a Form 8082 inconsistency disclosure with the partner's return. Sometimes the form accompanied a partner amended return. A review of Section 6222 and its regulations, by contrast, reveals, in general, that a partner must report, amend, pay the IRS, etc., consistent with the partnership's treatment of a relevant partnership-related item, not only in the context of annual tax return filing (and sometimes via an amended return), but also all the way through the subchapter C audit process whenever consistency becomes an issue. On the other hand, the regulations reveal that a partner's timely notice of inconsistent treatment can lead to the partner prevailing, even if the opposite result is reached in the partnership audit per se. Treas. Reg. § 301.6222-1(c)(4).

A notification to the IRS of a partner's inconsistent position must be filed before the IRS mails a notice of administrative proceeding with respect to the partnership tax year in question.[22] In the pre-audit context, a partner can file an amended tax return to correct an inconsistent position when becoming aware of additional facts warranting such an amended return. A situation coming to mind concerns the proper year for a partnership's bad debt deduction under Section 166 for a gone sour substantial loan made in the course of the partnership's multifaceted, alternative investments business.

Once the IRS delivers a notice of administrative proceeding for the year(s) in question, a partner's notification of an inconsistent position is available but within the constraints of a Section 6225 modification. Notice to the IRS of an inconsistent position appears completely barred from and after the partnership representative's delivery to a partner of the statement reflecting the Section 6226 election.

A timely filed statement can be of material importance because Section 6222(b) states that any underpayment of tax by a partner who fails to treat a partnership-related item consistently with the treatment of the item on the partnership's return, and who subsequently is assessed an underpayment, has no deficiency notice recourse to the United States Tax Court, nor may the partner request an IRS abatement of the assessed tax, including within the context of preventing an IRS levy of a partnership-related item additional liability. Once barred, a partner is without recourse to the Federal courts to argue even a meritorious inconsistent position. Technically, a non-disclosed, effectively inconsistent position "shall be assessed and collected in the same manner as if the tax underpayment were on account of a mathematical or clerical error reflected on the partner's return." Section 6222(b).

Section 6222(a) states: a partner "shall, on a partner's return, treat any partnership-related items in a manner which is consistent…." What are "partnership-related items"? Section 6241(2)(B) answers, "any item or amount…which is relevant…in determining the tax liability of any person under chapter 1…[or] any partner's distributive share of any [such] item or amount." Regulation examples are: anything related to determining the adjusted basis of a partnership interest, such as the date-of-death value of the interest; the payment by a partnership to a partner other than in the partner's capacity as a partner; anything related to a partnership's business activities, such as the timing of income recognition or income character; or the eligibility of an expense for a current year deduction. Given the definition and legislative history, Congress intends a very broad construal.[23] Reading through Treas. Reg. § 301.6222, one discovers that there will often be situations where a particular partner's tax liability becomes an issue in terms that are partner exclusive. In that case, the agent can shift the partnership level audit, in whole or in part, to a chapter 63 subchapter B partner audit and make audit adjustments at that level. Treas. Reg. § 301.6222-1(c)(6), Example 2.

It will be interesting to see whether in practice agent partnership audit plans focus on partnership to partner adjustments to the exclusion of partner per se issues like step-up in basis at death or funding self-directed IRAs with closely held partnership interests and so on.

Following Section 6222(c)(1)(B), parts of paragraphs (a), (b) and (c) of Treas. Reg. § 301.6222-1, read together, allow a partner to file a return reflecting partnership items in the absence of the partnership not timely or ever filing a Form 1065 return and/or not furnishing Schedule K-1s to the partners. Such a return must include a statement (or include a to-be-promulgated IRS form) communicating that the return reflects the best evidence available of partnership items for the year in question. The best evidence might be the partner's information and belief about the partner's share of partnership-related items based on more or less incomplete information the partner has been able to obtain from the partnership's representatives and/or based on the prior year's K-1. A partner can avoid additional tax, penalties and interest assessments by doing this. So, one can foresee such affirmative action being encouraged by tax advisors. No doubt this relief reflects IRS institutional experience with non-filed partnership Forms 1065 and not issued K-1s going back to at least 1982.

Treas. Reg. §301.6222-1(d) and §301.6222-1(a)(5)(iii), Example 3, concern an IRS experience-based circumstance of the partner who receives from the partnership a "statement, schedule or other form prescribed by the IRS," and the partner does not know that it is actually inconsistent with the partnership's Form 1065. A simple example given is a partner's receipt of a Schedule K-1 reflecting a $500 ordinary income share while an agent derives from the Form 1065 that the partner's share is $1,000. By delivering

to the IRS the "Election Under Section 6221(b)" that includes all the information required by the regulations no later than 60 days after the date on an IRS notice stating that the partner's return reflects an item inconsistent with the partnership's Form 1065, the partner can avoid additional tax, penalties and interest assessments.

It is worthy to take note that the consistency rules apply to partnership-partners, that is tax classified partnerships that own interests in audited partnerships, in a special way. Treas. Reg. §301.6232-1(d). Such a partner who becomes aware of its inconsistency may file an AAR or an amended return to correct as pre-emptive actions. In the case of any such partner who first becomes aware of inconsistency because of an IRS notice, this same relief also appears to be available either within 60 days after the date on the notice in the context of "request an abatement" of its share of Section 6226 imputed liability or even thereafter.

STATUTES OF LIMITATION

Section 6235 contains a tailored set of statutes of limitations of sorts governing partnership audit adjustments. The basic idea is that there is some end point to "partnership-related adjustments." Adjustments are not liability assessments, however. The end point for adjustments is at the later of specified times and/or events. The rules work differently from the familiar operation of the Section 6501 statute of limitations on assessments frequently encountered in individual tax audits of three or more years from the return filing or due date for the IRS to make an income tax assessment or mail the 90-day letter, aside from agreed extensions.[24] The end point for IRS making partnership-related adjustments is the later of: (a) the third anniversary of the last to occur of the Form 1065 filing date, the Form 1065 due date or the date the partnership representative files an AAR, if any; or (b) if the partnership representative requests a modification to an emerging final imputed underpayment amount, and thereby must send all required information, the end date is extended for a 270-day period beginning with the date the partnership representative delivers *all* required information (plus the number of days of any agreed extensions of the modification period); or (c) whether or not the partnership representative requests a modification, the end date is extended for a 330-day period after the date on *the last* IRS notice of proposed partnership adjustment (plus the number of days of any agreed extensions for the time of mailing the last such IRS notice).[25] Reading the examples at Treas. Reg. § 301.6235-3(1)(e) will be helpful to deal with these time frames for a partnership audit representation situation. Always calendar the latest possible date.

There is overlaid on these rules a second set of considerations consisting of familiar circumstances extending the Section 6501 statute, but with regard to adjustments. The statute on adjustments never runs in cases of false, fraudulent or never filed partnership returns. A six-year statute rather than the three-year statute operates if an adjustment reveals that there is a partnership level substantial omission of gross income (more than 25 percent of actual gross income omitted from the Form 1065 reported gross income). Partnerships responsible for Section 6501(c)(8)-referenced foreign information reporting matters will have an open or closed statute on relevant and affected items in accordance with Section 6501(c)(8) and related rules; same with partnerships responsible for Section 6501(c)(10) listed transactions information reporting. A partnership bankruptcy filing suspends the adjustment period deadline as per extant rules.

Section 6232 and its regulations set forth relatively short, but seemingly broad reaching rules concerning IRS assessment and collection of Section 6225 imputed payment liability from audited partnerships or partners and of Section 6225-like liability imposed on pass-through entity partners as a result of not furnishing "tracking report" information statements to their owners or beneficiaries or their otherwise accepting paying additional liability. The ordinary U.S. Tax Court deficiency procedures found in subchapter B do not apply.[26] In addition, it's a good bet that, aside from Section 6232, the IRS is going to apply and the Federal tax courts are going to allow application of all statutes relevant to assessment

and collection associated with Subtitle A income tax liability when the result is collection. It remains to be seen, but appears to be, that collection due process (CDP) appeals should be entertained by the IRS and the courts. Whether such partners, who did not have the chance to have substantive issues aired about partnership-related items affecting them, will be able to raise such substantive issues in the CDP process remains to be seen.[27] Section 6232, its regulations and their ramifications will someday merit separate treatment.

CONCLUSION

The IRS intends to soon start auditing partnerships. It will be interesting to look back five and 10 years from now to see whether or not there arose about the same number of court controversies about the new rules as had arisen about the TEFRA audit rules within these same time frames. There are going to be plenty of legitimate controversies among a partnership's treatment of a partnership-related item, the IRS's treatment, and any given partner's treatment, so, too, it is likely that the new rules will give rise to at least a few court decisions about how exactly they operate in situations like this. Unless and until the partnership audit process ossifies as a result of experience, since the rules reflect considerable leeway to respectfully request things of the revenue agents and to be proactive during the audit, like suggesting solutions, one has opportunities to get better results. Many partners ignoring or forgetting about letters, statements and notices sent to them, including pass-through entity partners, are going to find themselves exclusively with IRS collection problems on their hands.

Notes

1. Chapter 63—Assessment, Subchapter D--Treatment of Electing Large Partnerships is traceable to P.L.114-74 and the Taxpayer Relief Act of 1997 (P.L.105-34). See former Code Sections 6240-6255. See also, Subchapter K former Code Sections 771-777.
2. See, e.g., Kaplan v. United States, 133 F.3d 469 (7th Cir. 1998) (no violation of due process or equal protection safeguards of U.S. Constitution when "non-notice" partners were blindsided by tax assessment notices and had no judicial recourse against them). Under the TEFRA partnership audit rules, less than one-percent partners in partnerships of more than 100 did not have the rights to notice of audit events.
3. The 2015 legislation lacks legislative history as defined by the Supreme Court. United States v. Wood, 134 S. Ct. 557 (2013). The Joint Committee Staff issued two "Bluebooks": JCS-144-15 (2015) and JCS-1-16 (2016), which while not legislative, are bound to be helpful sometimes.
4. REG-136118-15 (August 17, 2018) is a set of proposed regulations in response to the 2018 technical corrections act. It was largely finalized as a result of T.D. 9844 (February 21, 2019). It states that the Explanation of Provisions parts to the following earlier proposed regulations withdrawn by REG-136118-15 remain helpful to understand some of the IRS's intentions: REG 136118-15 (June 14, 2017); REG-119337-17 (November 30, 2017); REG-120232 and REG-120233 (December 17, 2017); REG-118067-17 (February 2, 2018).
5. At present, final rules are wanted about tax basis and tax attribute adjustments to be made in Section 6225 and Section 6226 procedural contexts. REG-118067-17 (February 2, 2018) contains proposed rules.
6. The Preamble indicates that the IRS anticipates the National Office of Appeals will play a role in the centralized audit process. No particulars are given. A final notice of partnership adjustment results in a 90-day deadline to file an action in court, presumably IRS procedures will be forthcoming about appeals of proposed notices of partnership adjustment. Tax Court Rule 255.1(c) (July 15, 2019) states that the court does not have jurisdiction unless a partnership representative files a petition within 90 days of the date of a final notice mailing.
7. Commissioner v. Bollinger, 485 U.S. 340 (1988) sets forth the definition of and how a mere nominee relationship is created for income tax purposes.
8. Treas. Reg. § 301.6231-1(f) gives an IRS agent authority to withdraw a notice of proposed partnership adjustment.
9. Treas. Reg. § 301.6223-1(f) includes interesting, corporate governance-like considerations to guide the relevant IRS people in designating partnership representatives. The regulations also state the IRS will mail a 30-day notice of intention to designate. In some cases, the partners will come up with their own person in time for the IRS to consider that person for the job. Tax Court Rule 255.6 anticipates disputes over who really is the "PR" when and after a petition is filed with the court.
10. The standard contact letter with or without an IRD is more innocuous in that the "notice of administrative proceedings" sets up statutory deadlines and audit consequences for not meeting them. Two instances are a partnership representative's deadline for filing an AAR and a partner's deadline filing a statement of inconsistent position. Section 6231(b). The IRM has yet to be reworked to guide agents soon to be working within the new procedures.
11. Unless waived by the partnership representative, (B) the notice of final partnership adjustment may not be mailed by the IRS earlier than 270 days after its mailing of (A) the

notice of proposed partnership adjustment. Most often this process will straddle at least two years, but could be done within one year.

12 Jurisdiction of the latter two courts is available only if the partnership deposits with the IRS on or before the date the lawsuit is filed the amount of the imputed underpayment plus any penalties, additions to tax, and additional amounts as set forth in the notice of final partnership adjustment. Section 6234(b). The deposited amount is not treated as a payment of the tax except for purposes of Chapter 67. Ergo, Section 6603(1)(d) should operate, such that interest accrues against the IRS at the short-term AFR (1.9 percent for August, 2019) on amounts deposited. For details see Rev. Proc. 2005-18, 2005-1 C.B. 798.

13 In election out circumstances IRS agents will be auditing partners with reference to their reporting of partnership-related and other items. In doing so, agents can request or summons information from partnerships. None of the new rules apply. Until the IRS writes election out audit procedures, the IRM's TEFRA audit procedures provide some valuable guidance.

14 Treas. Reg. § 301.6225-1(d) is in other respects broad and promises future guidance as audit experience fleshes out more about the meaning of the subgroup concept.

15 Treas. Reg. § 301.6225-3(b)(4) states reallocation negative adjustments are to be taken into account by the impacted partner for the adjustment year who was also a partner for the reviewed year. For other partner fact patterns, this paragraph promises future guidance.

16 Section 6226 is discussed, infra.

17 As far as the IRS in general seems concerned, the partnership representative can gather relevant tax information personal to the partners from the partners, take that information into account, and present it to the IRS revenue agent. The idea seems to be that as a consequence of providing the relevant partners' specific information, the audit assessment will be modified such that the tax amount due from the partnership at least more nearly equals the additional tax due from the respective partners had there been partnership audit level adjustments flowing up to their respective tax returns, such as Forms 1040 or 1120, as under the TEFRA procedures.

18 Treas. Reg. § 301.6225-2(d)(2) states 6225(c) modifications can lead to partners paying audit liabilities for reviewed years.

19 In at least seven places, the regulations use the phrase or close to it, "to be provided in forms, instructions and other guidance" sometimes with "except as" added and sometimes not. Some of those representing clients in the first few audit rounds will be in a position to lead the IRS to results in a case that will cause the IRS to provide guidance for other cases.

20 The overall flavor of the new Code Sections and final regulations is that, while the IRS can collect additional amounts from the partnership that satisfy in full partner tax underpayments, the partnership representative and/or the individual partners independently represented can, colloquially speaking, work with the agent so the final adjustments do not result in the overpayment of taxes by the partnership or one or more partners. Proactive partners are more likely to be rewarded than passive ones. The final rules in a sense punish the passive in the face of a partnership level audit.

21 However, Treas. Reg. §301.6231-1(f) gives an IRS agent authority to withdraw a notice of administrative proceeding, clearing the way for the partnership representative to make an AAR and file Form 1040X and other appropriate information. If so doing is likely to save time and resources, a request for withdrawal ought to be made.

22 Any notice of inconsistency must identify all partnership-related items that are being reported by the partner inconsistently with the treatment of an item on the partnership return. Section 6222(c)(1)(A)(1), as well as the regulations, further provides that the statement can be filed in cases of doubt about inconsistent treatment. "… the partner›s treatment on the partner›s return is (or may be) inconsistent with the treatment of the item on the partnership return…."

23 Nevertheless, the Joint Committee summary of P.L. 115-141 (JCX-6-18, March 22, 2018) states that the following are not to be understood partnership-related items: Chapter 2 taxes on self-employment income; Chapter 2A taxes on net investment income; Chapter 3 withholding taxes on foreign persons; Chapter 4 withholding taxes on covered foreign accounts.

24 The now long customary letter giving a taxpayer choice to pay the IRS determined amount or file a petition in Tax Court.

25 One or more forms of the 872 series, probably as soon expanded, will be utilized in practice.

26 Section 6226 per-partner liability is not covered by Section 6232. Impacted partners are to pay the liability indicated to them on the statements received from the partnership representative, absent that person's filing in a Federal tax court.

27 Sections 6320 and 6330 generally make available appeals concerning taxpayer's offering collection alternatives to IRS lien and levy for their Subtitle A liabilities; for example, proposed installment agreements. Current rules allow a taxpayer to raise the substantive issues that in the course of an audit and assessment they did not have an opportunity to make, because, for example, an IRS agent sends an incomplete case to IRS Collections for assessment and collection because the statute of limitations on assessment is due to expire.