

# INTERNAL REVENUE BULLETIN



## HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2017-28  
July 10, 2017

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

## ADMINISTRATIVE and INCOME TAX

### Announcement 2017-08, page 9.

This document contains corrections to Revenue Procedure 2017-40, as published on Monday, June 26, 2017 (I.R.B. 2017-26, 1339). In particular, this announcement corrects the following administrative item.

Correction 1: In Section 8.2.1 Effect on Other Documents, the Revenue Procedure reference incorrectly appears as 2015-55, 2015-49, I.R.B. 788. The correct reference is Revenue Procedure 2016-34, 2016-26, I.R.B 1072.

## ADMINISTRATIVE

### Reg 136118-15, page 9.

This document contains proposed regulations implementing the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015 (BBA). These proposed regulations provide rules for partnerships subject to the new regime, including procedures for electing out of the centralized partnership audit regime, filing administrative adjustment requests, and the determination of amounts owed by the partnership or its partners attributable to adjustments that arise out of an examination of a partnership. The proposed regulations also address the scope of the centralized partnership audit regime and provide definitions and special rules that govern its application, including the designation of a partnership representative. The proposed regulations affect partnerships for taxable years beginning after December 31, 2017 and any partnerships that elect application of the centralized partnership audit regime pursuant to §301.9100-22T for taxable years beginning after November 2, 2015 and before January 1, 2018.

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Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

## Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

### **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

### **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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## Part IV. Items of General Interest

### Correction to Revenue Procedure 2017–40, I.R.B. 2017–26

#### Announcement 2017–08

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Correction 1:

In **Section 8.2.1 Effect on Other Documents**, the Revenue Procedure reference incorrectly appears as 2015–55, 2015–49, I.R.B. 788. The correct reference is Revenue Procedure 2016–34, 2016–26, I.R.B. 1072.

### Notice of proposed rulemaking, notice of public hearing, and withdrawal of notice of proposed rulemaking.

#### Centralized Partnership Audit Regime

##### REG–136118–15

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, notice of public hearing, and withdrawal of notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding implementation of section 1101 of the Bipartisan Budget Act of 2015 (BBA), which was enacted into law on November 2, 2015. Section 1101 of the BBA repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level. These proposed regulations provide rules for partnerships subject to the new regime, including procedures for electing out of the centralized partnership audit regime, filing adminis-

trative adjustment requests, and the determination of amounts owed by the partnership or its partners attributable to adjustments that arise out of an examination of a partnership. The proposed regulations also address the scope of the centralized partnership audit regime and provide definitions and special rules that govern its application, including the designation of a partnership representative. The proposed regulations affect partnerships for taxable years beginning after December 31, 2017 and any partnerships that elect application of the centralized partnership audit regime pursuant to § 301.9100–22T for taxable years beginning after November 2, 2015 and before January 1, 2018. This document also provides notice of a public hearing on these proposed regulations. This document also withdraws the notice of proposed rulemaking published in the **Federal Register** on February 13, 2009 (74 FR 7205), regarding the conversion of partnership items related to listed transactions.

DATES: Written or electronic comments must be received by August 14, 2017. Outlines of topics to be discussed at the public hearing scheduled for September 18, 2017, at 10 A.M. must be received by August 14, 2017.

ADDRESSES: Send submissions to: CC: PA:LPD:PR (REG–136118–15), room 5207, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG–136118–15), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG–136118–15).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jennifer Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834; concerning the submission of comments and requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

#### Background

This document contains proposed regulations to amend the Procedure and Administration Regulations (26 CFR Part 301) under Subpart – Tax Treatment of Partnership Items to implement the centralized partnership audit regime enacted by section 1101 of the BBA, Pub. L. No. 114–74.

##### 1. In General

The BBA was enacted on November 2, 2015, and was amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113, div. Q (PATH Act) on December 18, 2015. Section 1101(a) of the BBA removes subchapter C of chapter 63 of the Internal Revenue Code (Code) effective for partnership taxable years beginning after December 31, 2017. Subchapter C of chapter 63 contains the unified partnership audit and litigation rules that were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (TEFRA). These partnership audit and litigation rules are commonly referred to as the TEFRA partnership procedures or simply TEFRA.

Section 1101(b) of the BBA also removes subchapter D of chapter 63 of the Code (subchapter D) and part IV of subchapter K of chapter 1 of the Code (part IV of subchapter K), rules applicable to electing large partnerships, effective for partnership taxable years beginning after December 31, 2017. Subchapter D contains the audit rules for electing large partnerships, and part IV of subchapter K prescribes the income tax treatment for such partnerships.

Section 1101(c) of the BBA replaces the rules to be removed by section 1101(a) and (b) with a centralized partnership audit regime. Section 1101(c) adds a new subchapter C to chapter 63, consisting of sections 6221 through 6241 of the Code. The BBA also makes related and conforming amendments to other provisions of the Code.

Pursuant to section 1101(g)(1) of the BBA, the amendments made by section 1101, which repeal the TEFRA partnership procedures and the rules applicable to

electing large partnerships and which create the centralized partnership audit regime, generally apply to returns filed for partnership taxable years beginning after December 31, 2017. Section 1101(g)(2) provides that, in the case of an administrative adjustment request under section 6227 as amended by the BBA, the amendments made by section 1101 apply to requests with respect to returns filed for partnership taxable years beginning after December 31, 2017. Similarly, section 1101(g)(3) provides that, in the case of an election to use the alternative to payment of the imputed underpayment by the partnership under section 6226 as amended by the BBA, the amendments made by section 1101 apply to elections with respect to returns filed for partnership taxable years beginning after December 31, 2017.

Section 1101(g)(4) provides that a partnership may elect (at such time and in such form and manner as the Secretary may prescribe) for the amendments made under section 1101 (other than the election out of the centralized partnership audit regime under section 6221(b) as added by the BBA) to apply to any return of a partnership filed for partnership taxable years beginning after November 2, 2015 (the date of the enactment of the BBA) and before January 1, 2018.

On December 18, 2015, President Obama signed into law the PATH Act. Section 411 of the PATH Act corrects and clarifies certain amendments made by the BBA. The amendments under the PATH Act are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

On August 5, 2016, the Treasury Department and the IRS published temporary regulations (TD 9780, 81 FR 51795) and a notice of proposed rulemaking (REG-105005-16, 81 FR 51835) in the **Federal Register**. The temporary regulations set forth in § 301.9100-22T provide the time, form, and manner for a partnership to make an election pursuant to section 1101(g)(4) of the BBA to have the centralized partnership audit regime apply to any of its partnership returns filed for a partnership taxable year beginning after November 2, 2015 and before January 1, 2018. Section 301.9100-22T(a) provides the general rule that a partnership may

elect at the time and in such form and manner as described in § 301.9100-22T for amendments made by section 1101 of the BBA, except section 6221(b) added by the BBA, to apply to any return of the partnership filed for an eligible taxable year (as defined in § 301.9100-22T(d)).

On December 6, 2016, Congress introduced the Tax Technical Corrections Act of 2016 (H.R. 6439, S. 3506) (Tax Technical Corrections Act) which contains what are described as technical corrections to the centralized partnership audit regime and other corrections to the Bipartisan Budget Act of 2015. The Tax Technical Corrections Act addresses a number of the provisions of the centralized partnership audit regime enacted as part of BBA. The Tax Technical Corrections Act, however, was not enacted by Congress.

## 2. Specific Provisions

### A. Scope of the centralized partnership audit regime

Section 6221(a), as added by the BBA, provides the scope of items that are subject to adjustment under the centralized partnership audit regime. That section provides that 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) shall be determined, and any tax attributable thereto shall be assessed and collected, at the partnership level. The applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item or share shall also be determined at the partnership level.

Prior to the enactment of TEFRA, any adjustment to an item attributable to a partner's interest in a partnership required the IRS to open an examination for each partner and follow deficiency procedures to adjust items from a partnership and determine the resulting tax. Separate proceedings for each partner often resulted in inconsistent treatment of various partners with respect to the same items from a partnership. In some cases, inconsistent results occurred in the partner-level examinations themselves. In other cases, not all partners allocated the same items from the partnership were subject to an IRS examination because, for instance, the period of

limitations on assessment had expired for some, but not all, partners. In addition, each partner could challenge the IRS adjustment in separate partner-level proceedings in different litigation forums and appellate venues, resulting in different outcomes with respect to the same partnership item. Over time, the size and complexity of partnerships increased, multiplying the disparate treatment of partners with respect to the same items from a partnership and increasing the burden on the IRS in examining and assessing tax related to partnership issues at the partner level.

In 1982, in response to these difficulties, Congress enacted the TEFRA partnership procedures to establish unified rules to allow the IRS to make adjustments to "partnership items" at the partnership level in one proceeding. Partnership items are those items that are more appropriately determined at the partnership level than at the partner level, as provided by regulation. Section 6231(a)(3) (prior to amendment by the BBA). The regulations under section 6231 (prior to amendment by the BBA) define partnership items by listing the items that are more appropriately adjusted at the partnership level within the framework of TEFRA. § 301.6231(a)(3)-1. Items on a partner return that are not partnership items are not subject to adjustment at the partnership level by the IRS under TEFRA, but rather are adjusted with respect to each partner at the partner level in a proceeding outside of the TEFRA regime (generally, under deficiency procedures).

Once a TEFRA proceeding is final, the IRS makes corresponding computational adjustments to each partner's return to reflect the proper treatment of partnership items. Section 6230(a)(1) (prior to amendment by the BBA). A computational adjustment may include adjustments to "affected items" of the partner. § 301.6231(a)(6)-1. An "affected item" is any item on a partner's return that is affected by a partnership item. Section 6231(a)(5) (prior to amendment by the BBA). When making a computational adjustment, if partner-level factual determinations are necessary to properly determine the tax, the IRS is required to follow the deficiency procedures at the partner level. Section 6230(a)(2)(A)(i) (prior to amendment by the BBA). Any item on the partner's return that is neither a partnership

item nor an affected item is not subject to TEFRA and must be adjusted in a separate deficiency proceeding. *See, e.g., Bedrosian v. Commissioner*, 144 T.C. 152, 159 (2015); *see also* section 6230(a)(2)(B) (prior to amendment by the BBA), *Desmet v. Commissioner*, 581 F.3d 297, 302 (6th Cir. 2009).

The TEFRA partnership procedures automatically exempt certain partnerships with ten or fewer direct partners. Section 6231(a)(1)(B) (prior to amendment by the BBA). For those small partnerships, the IRS must follow deficiency procedures for each partner, which requires the IRS to adjust items from the partnership on each partner's return and to assess the resulting tax subject to the deficiency procedures in a separate proceeding at the partner level.

Since the enactment of TEFRA, the number and complexity of partnerships have continued to increase. The number of large partnerships, in particular, has increased dramatically. In 1997, Congress recognized some of the difficulties facing the IRS under TEFRA when auditing complex, large partnership structures and in response enacted a streamlined, elective audit regime for certain large partnerships (ELP regime). Sections 6240 through 6255 (prior to amendment by the BBA). The ELP regime allowed certain partnerships with 100 or more partners to elect the application of simplified reporting rules and a centralized audit regime with features similar to the regime enacted under the BBA. The ELP regime was a legislative response to the recognition that:

“[a]udit procedures for large partnerships are inefficient and more complex than those for other large entities. The IRS must assess any deficiency arising from a partnership audit against a large number of partners, many of whom cannot easily be located and some of whom are no longer partners. In addition, audit procedures are cumbersome and can be complicated further by the intervention of partners acting individually.”

Joint Comm. on Taxation, JCS–23–97, *General Explanation of Tax Legislation Enacted in 1997*, 363 (1997).

Since 1997, the number and complexity of partnerships has continued to increase, reflecting a shift in how business entities are structured - toward partner-

ships and away from C corporations. The ELP regime attempted to address some of the difficulties the IRS faced auditing large partnerships under TEFRA; however, the ELP regime is elective and only a handful of partnerships elected application of the ELP regime.

In 2013, Congress requested that the Government Accountability Office (GAO) investigate partnerships and the IRS's audit rate of partnerships. The GAO report concluded that from 2002 to 2011 “the number of large partnerships with 100 or more direct and indirect partners as well as \$100 million or more in assets more than tripled to 10,099—an increase of 257 percent.” U.S. Gov't Accountability Office, GAO–14–732, *Large Partnerships: With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency*, 13 (2014) (GAO–14–732). And yet, as the number of large partnerships increased, the number of partnership audits did not keep pace. Compared to the audit rate for large corporations, which was 27.1 percent in 2012, the audit rate for large partnerships was much lower at 0.8 percent. (Large partnership is defined for purposes of the GAO report as a partnership with 100 or more direct and indirect partners and \$100 million or more in assets.) GAO–14–732, cover page, summary.

When the IRS completes an examination of a large partnership under TEFRA, the IRS must pass the audit adjustments to partnership items on to the ultimate partners, a complex and time-consuming process. This requires the IRS to link potentially thousands of partner returns, including through tiers of partners that are themselves partnerships, to determine the proper share of the adjustments for each ultimate partner flowing from adjustments to partnership items. This process is “paper and labor intensive. When hundreds of partners' returns have to be adjusted, the costs involved limit the number of audits IRS can conduct.” GAO–14–732, cover page, summary. In the meantime, while the IRS is determining these linkages, the period of limitations for the IRS to assess tax with respect to each partner continues to run.

Specifically, the GAO reported that without “legislative action, the IRS's ability [to effectively audit]” partnerships would not improve. GAO–14–732, cover page, summary. At the time of the 2014 GAO report, Congress and the Adminis-

tration had put forth legislative proposals that “would allow IRS to collect tax at the partnership level instead of having to pass it through to the taxable partners.” GAO–14–732 at 31.

In 2015, Congress enacted the BBA to replace the TEFRA partnership procedures and the ELP regime with the centralized partnership audit regime, which contained many aspects of the legislative proposals referenced in the GAO report. The centralized partnership audit regime, when fully effective for partnership taxable years beginning after December 31, 2017, will be the exclusive method by which the IRS may audit a partnership in one unified proceeding. For those partnerships that will be subject to the centralized partnership audit regime that were previously exempt from TEFRA (for example, a partnership with no more than 10 partners, none of which is a pass-through entity), the centralized partnership audit regime replaces the separate partner-level deficiency proceedings as the sole method for auditing the partnership unless an eligible partnership elects out of the centralized regime.

The centralized partnership audit regime enacted in the BBA addresses many of the shortcomings of TEFRA identified by the GAO and practitioners. For instance, “unlike prior law, distinctions between partnership items and affected items are no longer made” in the centralized partnership audit regime. Joint Comm. on Taxation, JCS–1–16, *General Explanations of Tax Legislation Enacted in 2015*, 57 (2016) (JCS–1–16). Instead, section 6221(a) provides that the centralized partnership audit 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.

Under TEFRA, the statute broadly defines a partnership item as any item more appropriately determined at the partnership level. Section 6231(a)(3) (prior to amendment by the BBA). In keeping with the statute, the regulations under TEFRA broadly define the term partnership item to include all items of income, gain, deduction, loss, or credit, as well as other related items such as expenditures, tax preferences, exempt income, partnership liabilities, guaranteed payments, certain basis adjustments, character and the per-

centage of partnership interests, and items arising from the determination at the partnership level of partnership assets, investments, transactions and operations, such as investment tax credits and at risk rules. See generally § 301.6231(a)(3)–1.

Nothing in the text or legislative history of the BBA, or the events leading to enactment of the new regime, indicates that Congress’s use of the phrase “income, gain, deduction, loss, or credit” in section 6221(a) was intended to adopt a more limited set of items to be adjusted at the partnership level than the items included in the broad definition of partnership items under the TEFRA regulations. It would be illogical to conclude that Congress intended to limit the scope of what the IRS could adjust at the partnership level under an expanded centralized partnership audit regime. Such a narrow interpretation could mean that rather than increase the ability of the IRS to audit large partnerships in one unified proceeding, BBA would significantly increase the number of issues affecting partnerships that the IRS would be required to audit at the partner level, meaning that in large partnerships with thousands of partners, the IRS would have to audit issues related to the same partnership multiple times, for each partner, rather than just once at the partnership level. Given the GAO’s criticism in GAO–14–732 of the low partnership audit rate, it does not follow that Congress enacted a new partnership audit regime that weakens the IRS’s ability to conduct audits at the partnership level and forces the IRS to open additional partner-level proceedings to re-audit the same partnership.

The centralized partnership audit regime purposefully avoids the terms partnership items, affected items, computational adjustments, and nonpartnership items that caused so much litigation under TEFRA and does so by adopting the single phrase “income, gain, deduction, loss, or credit” as the scope of the regime. Removing the distinctions between the different types of items and adjustments was an effort to streamline the examination and judicial process to allow centralized collection of the correct amount of tax had the partnership and the partners reported items from the partnership correctly. The centralized partnership audit regime limits the burden on the IRS in

both the examination of partnerships and the judicial process – changes that were designed to increase the ability of the IRS to audit large partnerships. IRS received comments in response to Notice 2016–23, 2016–13 I.R.B. 490, that agreed that the use of the term “income, gain, deduction, loss, or credit” in the centralized partnership audit regime was an attempt to reduce the challenges the IRS faced under TEFRA and does not limit the scope of items subject to audit, assessment, and collection at the partnership level.

Under the centralized partnership audit regime, the IRS is no longer required to determine each partner’s share of the adjustments made to partnership items followed by a separate computational adjustment for each partner to assess the correct tax due as a result of the partnership audit. Instead, under the default rules of section 6225, the partnership is liable for an imputed underpayment based on the adjustments made at the partnership level. The imputed underpayment calculation may, for some partnerships, overstate the amount of tax due had the partnership and partners reported the partnership adjustments properly. To correct potential overstatements, the centralized partnership audit regime includes modification procedures and provides additional discretionary authority for the IRS to further modify imputed underpayments to carry out the function of the modification provision. The Joint Committee on Taxation observed that the intent of the modification provision is to “determine the amount of tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid while at the same time to implement the most efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners.” JCS–1–16 at 65–66.

To reach the correct amount of tax, the IRS makes one set of adjustments at the partnership level and allows the partnership, through modification, to adjust the imputed underpayment amount down to the correct amount of tax. To determine the amount of an imputed underpayment that reflects “tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid,” the breadth of what the IRS must be able to adjust at the partnership level must be at

least as broad as the different type of adjustments made under TEFRA.

Furthermore, under the modification provisions, the partnership (and its partners if they may amend their returns) takes on the burden of further refining the adjustments to reflect the correct amount of tax. Where all partners amend their returns taking all of the adjustments into account, the IRS, the partnership and its partners have effectively mirrored the result of a TEFRA audit, including the final partner-level computational adjustments. This can only be possible if the scope of what the IRS may adjust at the partnership level is sufficiently broad.

As such, the proposed regulations take an expansive view of the scope of the centralized partnership audit regime to cover all items and information related to or derived from the partnership. Accordingly, under proposed § 301.6221(a)–1 all items required to be shown or reflected on the partnership’s return and information in the partnership’s books and records related to a determination of such items, as well as factors that affect the determination of items of income, gain, loss, deduction, or credit, are subject to determination and adjustment at the partnership level under the centralized partnership audit regime.

#### *B. Election out of the centralized partnership audit regime*

In general, the centralized partnership audit regime applies to all partnerships with partnership taxable years beginning after December 31, 2017 for any partnership (domestic or foreign) required to file a return under section 6031. Section 6241(1). Section 6221(b), as added by the BBA, allows eligible partnerships to elect out of the centralized partnership audit regime. The fact that all partnerships are covered by the centralized partnership audit regime unless they elect out distinguishes the centralized partnership audit regime from the TEFRA partnership procedures. Under TEFRA, only partnerships with more than 10 partners and partnerships with at least one partner that is not a U.S. individual, a C corporation, or an estate of a deceased partner are automatically covered by the regime. Section 6231(a)(1)(B) (prior to amendment by the BBA). However, partnerships not auto-

matically subject to TEFRA can make an affirmative election into TEFRA. Section 6231(a)(1)(B)(ii) (prior to amendment by the BBA).

Partnerships that elect out of the centralized partnership audit regime are subject to the pre-TEFRA audit procedures under which the IRS must separately assess tax with respect to each partner under the deficiency procedures under subchapter B of chapter 63. As described in section 2.A. of the Background section of this preamble, enactment of TEFRA was a reaction to the complexity and burden of the pre-TEFRA deficiency procedures in the case of partnerships; however, since TEFRA was enacted, the IRS and taxpayers have identified numerous issues with that regime. The centralized partnership audit regime is intended to simplify TEFRA's burdensome processes and to increase the IRS's ability to examine partnerships, particularly large and tiered partnerships, and to make the process of assessing tax resulting from those audits more efficient. The limited opt-out nature of the centralized partnership audit regime, which requires the partnership to take affirmative action to elect out of the regime, increases the likelihood that a partnership will be subject to the more streamlined adjustment, assessment, and collection procedures of the centralized partnership audit regime, thereby increasing the number of partnerships the IRS is able to examine under the centralized partnership audit regime. Limiting the number of partnerships that can elect out of the centralized partnership audit regime to those entities specifically permitted under the statute is necessary to carry out this goal.

There are two conditions that must be met for a partnership to be eligible to elect out of the centralized partnership audit regime. First, a partnership must have 100 or fewer partners. Under the statute, a partnership has 100 or fewer partners when it is required to furnish 100 or fewer statements under section 6031(b), currently Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.* (Schedules K-1), for the taxable year. Section 6221(b)(1)(B). For partnerships that have an S corporation as a partner (S corporation partner), special rules under section 6221(b)(2)(A) apply for purposes of determining the number of Schedules K-1

furnished by the partnership. Under that rule, the number of statements required to be furnished by the S corporation partner to its own shareholders under section 6037(b) for the taxable year, currently Schedule K-1, *Shareholder's Share of Income, Deductions, Credits, etc.*, are taken into account to determine the number of statements furnished by the partnership for purposes of section 6221(b)(1)(B). Section 6221(b)(2)(A)(ii).

Second, a partnership must only have eligible partners. Under the statute, eligible partners are individuals, C corporations, foreign entities that would be treated as C corporations if they were domestic, S corporations, and estates of deceased partners. Section 6221(b)(1)(C). Under section 6221(b)(1)(D)(i), a partnership may elect out of the centralized partnership audit regime only on a timely filed return for a taxable year (including extensions).

A partnership must include, in the manner prescribed by the Secretary, a disclosure of the name and taxpayer identification number (TIN) of each partner of the partnership. Section 6221(b)(1)(D)(ii). In the case of an election out by a partnership with an S corporation partner, the election also must include, in the manner prescribed by the Secretary, a disclosure of the name and TIN of each person to whom an S corporation partner is required to furnish a statement for the taxable year of the S corporation ending with or within the partnership taxable year that is subject to the election. Section 6221(b)(2)(A)(i). A partnership must notify each partner of the election in the manner prescribed by the Secretary. Section 6221(b)(1)(E).

Section 6221(b)(2)(B) permits the Secretary to prescribe alternative identification procedures for foreign partners. The Secretary may by regulation or other guidance prescribe rules similar to the rules applicable to S corporations with respect to any partners not described in section 6221(b)(1)(C). Section 6221(b)(2)(C).

### C. Consistent treatment

#### i. Consistent Treatment Under TEFRA

TEFRA includes a requirement that a partner treat items from the partnership consistent with the partnership's treatment

of such items on the partnership's return. Section 6222 (prior to amendment by the BBA). TEFRA permits the partner to notify the IRS of inconsistent treatment of an item by the partner on the partner's return and avoid having a computational adjustment made to the inconsistently treated item without the IRS first completing a proceeding at the partnership level. The IRS could either accept the partner's inconsistent treatment of the item, open up an audit of the partnership to address the item at the partnership level, or open up audit of the partner to address the inconsistent item. If the IRS examined the partnership or the partner, all items for that taxable year would be subject to the examination.

Section 6222, as amended by the BBA, includes a similar requirement of consistency and rules for notification of the inconsistency, but the consequences of failing to treat items consistently are different. Under TEFRA, the consequence of filing inconsistently is that the IRS is not required to conduct a partnership-level proceeding before making computational adjustments at the partner level and assessing any deficiency attributable to the adjustment of an item to make it consistent with the partnership return. Section 6222 now states that any underpayment of tax by a partner resulting from a failure to treat an item consistently shall be assessed and collected as if the underpayment were on account of a mathematical or clerical error appearing on the partner's return, permitting the IRS to immediately assess and collect such tax.

#### ii. Statutory Provision

Section 6222(a) requires a partner to treat on the partner's return each item of income, gain, loss, deduction or credit attributable to a partnership subject to subchapter C of chapter 63 in a manner that is consistent with the treatment of such item on the partnership return. If the partner fails to comply with the requirements of section 6222(a), any underpayment of tax resulting from that failure may be assessed and collected as if such underpayment were on account of a mathematical or clerical error appearing on the partner's return. Section 6222(b). The procedures under section 6213(b)(2), which permit a

taxpayer to request an abatement of a mathematical or clerical error assessment, do not apply in these situations. Section 6222(b).

Section 6222(c) provides an exception for situations in which a partner notifies the IRS of the inconsistent treatment on the partner's return. Under section 6222(c)(1), if the partnership has filed a return and the partner's treatment of an item on the partner's return is (or may be) inconsistent with the treatment of that item on the partnership return, the provisions of section 6222(a) (requiring consistent treatment) and (b) (allowing math error treatment to adjust inconsistent items) will not apply to that item if the partner files with the Secretary a statement identifying the inconsistency. Section 6222(c)(1)(A)(i). The exception also applies if the partnership has not filed a return, and the partner files a statement identifying the inconsistency. Section 6222(c)(1)(A)(ii).

In cases where a partner receives incorrect information in a statement furnished by a partnership, section 6222(c)(2) provides that the partner is treated as having notified the IRS of an inconsistency if the partner satisfactorily demonstrates to the Secretary that the treatment of the item on the partner's return is consistent with the treatment of the item on the statement furnished to that partner by the partnership, and the partner elects to have this provision apply. Under section 6222(d), any final decision with respect to an inconsistent position identified under section 6222(c) in a proceeding to which the partnership is not a party is not binding on the partnership.

#### *D. Partnership representative and partners bound by actions of the partnership*

Section 6223 provides that each partnership shall 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 who shall have the sole authority to act on behalf of the partnership. Section 6223(a). In any case in which such designation is not in effect, the statute provides that the Secretary may select any person as the partnership representative. Section

6223(a). A partnership and all partners of such partnership are bound by actions taken under subchapter C of chapter 63 by the partnership and by any final decision in a proceeding brought under subchapter C of chapter 63 with respect to the partnership. Section 6223(b).

Section 6223 and the concept of the partnership representative replace the tax matters partner (TMP) framework that exists under the TEFRA partnership procedures. Under TEFRA, a partnership is required to designate a TMP who acts as a liaison between the partnership and the IRS. That TMP must be a general partner and may be an individual or an entity.

The requirements placed on the designation of the TMP under TEFRA make it difficult in many cases to identify a qualified TMP. First, only general partners of the partnership may be the TMP. Because the TMP has to be a partner, the partnership cannot designate a non-partner, such as a non-partner manager, even if that person is in the best position to understand and have available the partnership's books and records. In some cases, the TMP has to be a particular partner, such as the partner with the highest profits interest, who may not be knowledgeable about the partnership's taxes. See, for example, § 301.6231(a)(7)–1(m)(2).

Even if a qualified TMP is identified, the IRS may be unable to contact the TMP because the TMP is out of the country or simply unreachable. Furthermore, in the case of a TMP that is an entity rather than an individual, the IRS must identify and track down an individual who can act for the entity. As a result, under TEFRA, partnerships and the IRS may spend a significant amount of time determining whether a person designated is even eligible to serve as the TMP before the IRS can proceed with a partnership examination.

Additionally, while the TMP has the authority to bind the partnership, it cannot bind other partners in the partnership. A partner who is not the TMP also has rights during an examination, including certain notification rights and the right to participate in the proceeding. The rights of the partners to intervene in the examination and to contradict the actions taken by the TMP cause confusion during examinations and increase the administrative burden on the IRS.

In contrast, the centralized partnership audit regime introduces the concept of the partnership representative, which is intended to address the shortcomings of the TMP as the representative of the partnership under TEFRA. First, unlike the TMP who must be a partner, a partnership representative can be any person, including a non-partner. This allows the partnership to select the person best situated to represent the partnership. The only limitation is that the partnership representative must have a substantial presence in the United States. This requirement is intended to ensure that the person selected to represent the partnership will be available to the IRS in the United States when the IRS seeks to communicate or meet with the representative. Like TEFRA, the centralized partnership audit regime does not prescribe whether a partnership representative may be an entity or an individual.

Second, unlike the TMP who could act for the partnership but whose actions did not bind other partners and could be contradicted by those partners, section 6223(b) provides that the partnership representative has the sole authority to bind the partnership, and all partners and the partnership are bound by the actions of the partnership representative and any final decision in a proceeding brought under subchapter C of chapter 63. The centralized partnership audit 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.

#### *E. Imputed underpayment and modification of imputed underpayment*

Section 6225 as amended by the BBA addresses partnership adjustments made by the IRS under the centralized partnership audit regime and the determination of any resulting imputed underpayment. Section 6225(a)(1) provides that in the case of any adjustment by the Secretary in the amount of any item of income, gain, loss, deduction, or credit of the partnership, or any partner's distributive share thereof, the partnership shall pay any imputed underpayment with respect to such adjustment in the adjustment year as provided in section 6232. Any adjustment that does



not result in an imputed underpayment must be taken into account by the partnership in the adjustment year. Section 6225(a)(2). Except for an adjustment to an item of credit, which is taken into account as a separately stated item, an adjustment not resulting in an imputed underpayment must be taken into account as a reduction in non-separately stated income or as an increase in non-separately stated loss (whichever is appropriate) in accordance with section 702(a)(8). Section 6225(a)(2)(A)–(B).

An imputed underpayment with respect to a partnership adjustment for the partnership's reviewed year is determined in accordance with section 6225(b). Under that section, adjustments to similar items of income, gain, loss, or deduction are netted with each other, treating any net increase or decrease in loss as a decrease or increase, respectively, in income. Section 6225(b)(1)(A)–(B). The net amount is then multiplied by the highest rate of tax in effect for the reviewed year under section 1 (individual rates) or section 11 (corporate rates). Section 6225(b)(1)(A). The product is then increased or decreased, as the case may be, by any adjustments to items of credit. Section 6225(c).

Section 6225(b)(2) provides that in the case of an adjustment that reallocates the distributive share of an item from one partner to another, such adjustment shall be taken into account when determining the imputed underpayment by disregarding any decrease in any item of income or gain and any increase in an item of deduction, loss, or credit.

Under section 6225(c), a partnership may modify an imputed underpayment under procedures established by the Secretary. Anything required to be submitted to the Secretary under the procedures for modification of the imputed underpayment must be submitted within 270 days following the date the notice of proposed partnership adjustment (NOPPA) is mailed under section 6231 by the IRS, unless that period is extended with the consent of the Secretary. Section 6225(c)(7). Any modification of the imputed underpayment amount shall be made only upon approval of the requested modification by the Secretary. Section 6225(c)(8).

Under section 6225(c)(2), modification procedures shall provide that if one or more partners files amended returns (not-

withstanding section 6511) for the taxable year of the partners that includes the end of the reviewed year of the partnership, such returns take into account all adjustments made by the Secretary that are properly allocable to such partners (and for any other taxable year with respect to which a tax attribute is affected by reason of the adjustments made by the Secretary), and payment of any tax due is included with the amended returns, the imputed underpayment shall be determined without regard to the portion of the adjustments taken into account in the amended returns. In the case of any adjustment that reallocates the distributive share of any item from one partner to another, a modification described in section 6225(c)(2) shall apply only if amended returns are filed by all partners affected by such adjustment.

Under section 6225(c)(3), modification procedures shall provide for determining the imputed underpayment without regard to the portion thereof that the partnership demonstrates is allocable to a partner that would not owe tax by reason of its status as a tax-exempt entity (as defined in section 168(h)(2)).

Under section 6225(c)(4), modification procedures shall provide for taking into account a rate of tax lower than the rate of tax described in section 6225(b)(1)(A) (that is, the highest rate under section 1 or section 11) with respect to any portion of an imputed underpayment that the partnership demonstrates is allocable to a partner that is a C corporation or, in the case of a capital gain or qualified dividend, is an individual. In no event shall the lower rate determined under section 6225(c)(4) be lower than the highest rate in effect for the reviewed year with respect to the type of income and taxpayer (that is, a C corporation or an individual). For the purposes of the lower rate for capital gains and qualified dividends, an S corporation shall be treated as an individual. Section 6225(c)(4)(A). The portion of an imputed underpayment to which the lower rate applies with respect to a partner shall be determined by reference to the partner's distributive share of the items to which the imputed underpayment relates. Section 6225(c)(4)(B)(i). If an imputed underpayment is attributable to the adjustment of more than one item, and any

partner's distributive share of such items is not the same with respect to all such items, the portion of the imputed underpayment to which the lower rate applies with respect to a partner shall be determined by reference to the amount which would have been the partner's distributive share of net gain or loss if the partnership had sold all of its assets at their fair market value as of the close of the reviewed year of the partnership. Section 6225(c)(4)(B)(ii).

Section 6225(c)(5) provides that, in the case of a publicly traded partnership (as defined in section 469(k)(2)), the modification procedures shall provide for determining the imputed underpayment without regard to the portion thereof that the partnership demonstrates is attributable to a net decrease in a specified passive activity loss that is allocable to a specified partner and for the partnership to take such net decrease into account as an adjustment in the adjustment year with respect to the specified partners to which such net decrease relates. Section 6225(c)(5)(A). For purposes of section 6225(c)(5), the term "specified passive activity loss" means, with respect to any specified partner of such publicly traded partnership, the lesser of which is separately determined with respect to such partnership under section 469(k) with respect to such partner's taxable year in which or with which the reviewed year of such partnership ends, or such passive activity loss so determined with respect to such partner's taxable year in which or with which the adjustment year of such partnership ends. Section 6225(c)(5)(B). For purposes of section 6225(c)(5), the term "specified partner" means any person if such person 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 is (1) a partner of such publicly traded partnership; (2) is described in section 469(a)(2); and (3) has a specified passive activity loss with respect to such publicly traded partnership. Section 6225(c)(5)(C).

Section 6225(c)(6) provides that the Secretary may by regulations or guidance provide for additional procedures to mod-

ify imputed underpayment amounts on the basis of such other factors as the Secretary determines are necessary or appropriate to carry out the purposes of section 6225(c).

#### *F. Election for the alternative to payment of the imputed underpayment*

Section 6226 provides an alternative to the general rule under section 6225(a)(1) that the partnership must pay the imputed underpayment. Under section 6226, the partnership may elect to have its reviewed year partners take into account the adjustments made by the IRS and pay any tax due as a result of those adjustments. In this case, the reviewed year partners must pay any tax resulting from taking into account the adjustments and the partnership is not required to pay the imputed underpayment.

In order to elect application of section 6226, a partnership must take two steps with respect to an imputed underpayment. First, the partnership must make an election in the manner provided by the Secretary no later than 45 days after the date the FPA is mailed by the IRS under section 6231. Section 6226(a)(1). Second, the partnership must furnish, at such time and in such manner as provided by the Secretary, a statement of each partner's share of any adjustment as determined in the FPA to its reviewed year partners. Section 6226(a)(2). If the partnership takes these two steps in the time and manner prescribed by the statute and by the Secretary, section 6225 does not apply with respect to the imputed underpayment, and each partner must take its share of the adjustments into account as provided in section 6226(b). Section 6226(a) (flush language). An election under section 6226 is revocable only with the consent of the Secretary. *Id.*

Section 6226(b) describes how the adjustments subject to the section 6226 election are taken into account by the reviewed year partners. Under section 6226(b)(1), each partner's tax imposed by chapter 1 of subtitle A of the Code (chapter 1 tax) is increased by the aggregate of the adjustment amounts as determined under section 6226(b)(2). This increase in chapter 1 tax is reported on the return for the partner's taxable year that includes the date the statement described under section

6226(a) is furnished to the partner by the partnership (reporting year).

The adjustment amounts determined under section 6226(b)(2) fall into two categories. In the case of the taxable year of the partner that includes the end of the partnership's reviewed year (first affected year), the adjustment amount is the amount by which the partner's chapter 1 tax would increase for the partner's first affected year if the partner's share of the adjustments were taken into account in that year. Section 6226(b)(2)(A). In the case of any taxable year after the first affected year, and before the reporting year (that is, the intervening years), the adjustment amount is the amount by which the partner's chapter 1 tax would increase by reason of the adjustment to tax attributes determined under section 6226(b)(3) in each of the intervening years. Section 6226(b)(2)(B). The adjustment amounts determined under section 6226(b)(2)(A) and (B) are added together to determine the aggregate of the adjustment amounts for purposes of determining the increase to the partner's chapter 1 tax in accordance with section 6226(b)(1).

Section 6226(b)(3) provides two rules regarding adjustments to tax attributes that would have been affected if the partner's share of adjustments were taken into account in the first affected year. First, in the case of an intervening year, any tax attribute must be appropriately adjusted for purposes of determining the adjustment amount for that intervening year in accordance with section 6226(b)(2)(B). Section 6226(b)(3)(A). Second, in the case of any subsequent taxable year (that is, a year, including the reporting year, that is subsequent to the intervening years referenced in 6226(b)(3)(A)), any tax attribute must be appropriately adjusted. Section 6226(b)(3)(B).

Section 6226(c) provides rules for the treatment of penalties and interest determined under section 6221 at the partnership level when an election is made under section 6226. Notwithstanding the provisions of section 6226(a) and (b) (regarding the requirements for making an election and how partners take into account adjustments), any penalties, additions to tax, or additional amounts are determined under section 6221 at the partnership level, and the reviewed year partners of

the partnership are liable for any such penalty, addition to tax, or additional amount. Section 6226(c)(1).

In contrast, section 6226(c)(2) provides that interest is determined at the partner level. Section 6226(c)(2)(A). Interest is calculated from the due date of the partner's return for the taxable year to which the increase in tax is attributable taking into account any increases attributable to a change in tax attributes for an intervening year as determined under section 6226(b)(2). Section 6226(c)(2)(B). The interest is computed at the underpayment rate under section 6621(a)(2), substituting five percentage points for three percentage points for purposes of section 6621(a)(2)(B) (the sum of the federal short-term rate plus five percentage points instead of three percentage points).

#### *G. Administrative adjustment requests*

Section 6227 provides a mechanism for a partnership to file an administrative adjustment request (AAR) to correct errors on a partnership return for a prior year. A partnership may file a request for administrative adjustment in the amount of one or more items of income, gain, loss, deduction, or credit of the partnership for any partnership taxable year. Section 6227(a). Any adjustment requested in an AAR is taken into account for the partnership taxable year in which the AAR is made. Section 6227(b). Under section 6227, only a partnership may file an AAR. Therefore, a partner who is not also the partnership representative acting on behalf of the partnership may not file an AAR.

Under section 6227(c), a partnership has three years from the later of the filing of the partnership return or the due date of the partnership return (excluding extensions) to file an AAR for that taxable year. However, a partnership may not file an AAR for a partnership taxable year after the IRS has mailed a notice of an administrative proceeding under section 6231 with respect to that taxable year.

Under section 6227(b), if an adjustment results in an imputed underpayment, the adjustment may be determined and taken into account in one of two ways. The partnership may determine and take the adjustment into account for the

partnership taxable year in which the AAR is filed under rules similar to the rules under section 6225, relating to payment of the imputed underpayment by the partnership, except that the provisions under section 6225 pertaining to modification of the imputed underpayment based on amended returns by partners, the time for submitting information to the Secretary for purposes of modification, and approval by the Secretary of any modification do not apply. Section 6227(b)(1). Alternatively, the partnership and the partners may determine and take the adjustment into account under rules similar to the rules under section 6226 relating to the alternative to the partnership payment of the imputed underpayment, except that the additional 2 percentage points of interest imposed under section 6226 does not apply. Section 6227(b)(2).

In the case of an adjustment that would not result in an imputed underpayment, section 6227(b) requires that the partnership and the reviewed year partners must determine and take the adjustment into account under rules similar to the rules under section 6226 with appropriate adjustments. This provision ensures that the partners for the year to which the adjustments relate benefit from any refund that may result from such adjustments.

## H. Definitions and special rules

### i. Definitions

Section 6241(1) defines the term “partnership” for purposes of subchapter C of chapter 63 as any partnership required to file a return under section 6031(a). Section 6241(2) defines the term “partnership adjustment” as any adjustment in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any partner’s distributive share thereof. Section 6241(3) defines the term “return due date” as the due date prescribed for filing the partnership return for such taxable year (determined without regard to extensions).

Section 6225(d)(1) defines the term “reviewed year” as the partnership taxable year to which the item being adjusted relates. Section 6225(d)(2) defines the term “adjustment year” to mean, in the case of an adjustment pursuant to the decision of

a court in a proceeding brought under section 6234, the taxable year in which such decision becomes final; in the case of an administrative adjustment request under section 6227, the taxable year in which such administrative adjustment request is made; and, in any other case, the taxable year in which a notice of the final partnership adjustment (FPA) is mailed under section 6231.

### ii. Bankruptcy

Section 6241(6)(A) provides that, in a case under Title 11 of the United States Code (Title 11 case), the running of any period of limitations provided in subchapter C of chapter 63 for making a partnership adjustment (or provided in section 6501 or 6502 for the assessment or collection of any imputed underpayment determined under subchapter C of chapter 63) is suspended for the period during which the Secretary is prohibited by reason of the Title 11 case from making the partnership adjustment or assessing or collecting any amounts due under subchapter C of chapter 63. Section 6241(6)(A)(i) provides that in the case of the period of limitations for making adjustments or making an assessment, the suspension period includes an additional 60 days. Section 6241(6)(A)(ii) provides that in the case of the period of limitations on collection, the suspension period includes an additional six months.

Section 6241(6)(A) provides that a rule similar to the rule of section 6213(f)(2) applies for purposes of section 6232(b), the limitation on assessments under subchapter C of chapter 63. Section 6213(f) clarifies that the limitation on assessment under section 6213(a) with respect to deficiencies does not prohibit the Secretary from filing of a proof of claim in a bankruptcy case. Thus, the limitation on assessment under section 6232(b) similarly does not prohibit the filing of a proof of claim in bankruptcy.

Under section 6241(6)(B), the running of the 90-day period to file a petition for readjustment under section 6234 is suspended during the period during which the partnership is prohibited by reason of a bankruptcy case from filing the petition for readjustment and for an additional 60 days.

### iii. Other Rules

Section 6241(4) provides that any payments required to be made under subchapter C of chapter 63 are nondeductible under subtitle A.

Section 6241(5) provides the general rule that, for purposes of section 6234 (regarding judicial review of partnership adjustments), a principal place of business located outside the United States is treated as located in the District of Columbia.

Section 6241(7) provides that, where a partnership ceases to exist before a partnership adjustment under subchapter C of chapter 63 takes effect, the partnership adjustment shall be taken into account by the former partners of the partnership pursuant to regulations prescribed by the Secretary.

Section 6241(8) provides that, to the extent provided by regulations, the provisions of subchapter C of chapter 63 shall extend to the taxable year of an entity for which a partnership return is filed by the entity (even if it is determined that the entity is not a partnership or that there is no entity for such taxable year), to the items of such entity, and to any person holding an interest in such entity.

### I. Withdrawal of proposed regulations under section 6231(c)

On February 13, 2009, a notice of proposed rulemaking (REG-138326-07) regarding the conversion of partnership items related to listed transactions was published in the **Federal Register** (74 FR 7205). The proposed regulations were issued under section 6231(c) (prior to amendment by the BBA), which permitted the IRS to issue regulations that address special enforcement areas, that is, areas where the application of the TEFRA partnership procedures would interfere with the effective and efficient enforcement of the internal revenue laws. Written or electronic comments responding to the notice of proposed rulemaking were received, but no public hearing was requested or held. After consideration of all the comments, the Treasury Department and the IRS have decided to withdraw the proposed regulations.

## Explanation of Provisions

### 1. *Scope of the Centralized Partnership Audit Regime*

Proposed § 301.6221(a)–1(a) provides that all adjustments and items relating to a partnership are determined at the partnership level under the centralized partnership audit regime. Accordingly, the proposed regulations provide that the centralized partnership audit regime covers any adjustment to items of income, gain, loss, deduction, or credit of a partnership and any partner’s distributive share of those adjusted items. Further, the proposed regulations provide that any chapter 1 tax resulting from an adjustment to items under the centralized partnership audit regime is assessed and collected at the partnership level. Under the proposed regulations, the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item or share is also determined at the partnership level.

Proposed § 301.6221(a)–1(b)(1) defines the phrase “income, gain, loss, deduction, or credit” for purposes of the centralized partnership audit regime broadly so that the phrase includes: 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); any items related to terminations of a partnership; and partners’ capital accounts. Proposed § 301.6221(a)–1(b)(2) defines the phrase “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.

Proposed § 301.6221(a)–1(b)(3) defines the term “tax” for purposes of § 301.6221(a)–1 to mean tax imposed by chapter 1 of subtitle A of the Code. Accordingly, for purposes of assessment and collection at the partnership level, taxes imposed by other chapters of the Code are not included in the term “tax.” Those taxes that are not covered by the centralized partnership audit regime include taxes imposed by chapter 2 (Tax on Self-Employment Income), chapter 2A (Unearned Income Medicare Contribution), chapter 3 (Withholding of Tax on Nonresident Aliens and Foreign Corporations), chapter 4 (Taxes to Enforce Reporting on Certain Foreign Accounts), and chapter 6 (Consolidated Returns). In addition, taxes imposed by other subtitles of the Code, such as subtitle C (Employment Taxes), are not included within the scope of the centralized partnership audit regime. Accordingly, the IRS may separately examine the partnership or its partners outside the centralized partnership audit regime for purposes of determining and assessing these types of taxes.

In some circumstances, adjustments made under the centralized partnership audit regime may have an effect on the determination of taxes imposed by provisions of the Code outside of chapter 1. For example, if it is determined in a proceeding under the centralized partnership audit regime that a partnership has additional unreported ordinary income, that determination could form the basis for a separate determination that one or more of the partners in that partnership owe additional self-employment tax under chapter 2 of the Code. Additionally, as clarified in proposed § 301.6221(a)–1(d), determinations regarding items covered by the centralized partnership audit regime may be relied upon by the IRS when making determinations of taxes not covered by chapter 1 to the extent they are relevant in making such determinations. For instance, if the IRS determines as part of the centralized partnership audit regime that an individual

who is treated as a partner in the partnership has received additional unreported ordinary income from the partnership, the IRS is not precluded from separately examining the partnership or that individual for purposes of determining whether that individual is an employee and not a partner of the partnership for purposes of imposing subtitle C employment taxes with regard to that income or examining the individual for purposes of determining whether the individual owes additional self-employment tax on the income. Any such determinations made in a separate examination outside the centralized partnership audit regime will be solely for purposes of the taxes not covered by chapter 1, will not constitute determinations for purposes of chapter 1, and will not constitute an administrative proceeding with respect to the partnership for purposes of subchapter C of chapter 63. The IRS may use all procedures available, such as obtaining the books and records of the partnership, to make determinations of items covered by the centralized partnership audit regime solely for purposes of taxes not covered by chapter 1. Any determinations for taxes other than chapter 1 taxes are not covered by the centralized partnership audit regime under subchapter C of chapter 63.

Proposed § 301.6221(a)–1(a) provides that the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment under subchapter C of chapter 63 is determined at the partnership level. Proposed § 301.6221(a)–1(c) provides that any defenses to any penalty, addition to tax, or additional amount under subchapter C of chapter 63 may only be raised or considered in a partnership proceeding initiated under subchapter C of chapter 63. The partnership representative (as defined in section 6223 and the regulations thereunder) is the sole representative of the partnership. Accordingly, only the partnership representative may raise defenses to penalties, additions to tax, or additional amounts, including the partnership’s defenses and defenses that relate to any partner. For example, if the partnership believes it has a viable reasonable cause defense, the partnership representative must raise this defense as part of the partnership proceeding. Any defense, whether it relies on facts and circumstances

relating to the partnership or one or more partners or any other person, that is not raised by the partnership before a final determination under subchapter C of chapter 63 is waived and will not be considered if raised by any other person, including a partner that receives a section 6226 statement as a result of the partnership making an election under section 6226.

## *2. Election Out of the Centralized Partnership Audit Regime*

### *A. Eligibility to make the election*

Proposed § 301.6221(b)–1(b) provides that only an eligible partnership may elect out of the centralized partnership audit regime. Under that section, a partnership is an eligible partnership if it has 100 or fewer partners during the year and, if at all times during the taxable year, all partners are eligible partners, as defined in proposed § 301.6221(b)–1(b)(3).

#### *i. 100 or Fewer Partners*

Under proposed § 301.6221(b)–1(b)(2), a partnership has 100 or fewer partners during the year if it is required to furnish 100 or fewer statements under section 6031(b) during the taxable year for which the partnership makes the election. When determining whether a partnership is required to furnish 100 or fewer statements under section 6031(b) during the taxable year, only statements required to be furnished by the partnership under section 6031(b) for the taxable year are taken into account, regardless of the number of statements actually furnished by the partnership. Accordingly, if contrary to the instructions to the Schedule K-1 the partnership furnishes more statements than are required under section 6031(b), any statements that are not required to be issued under section 6031(b) are not taken into account. For instance, if contrary to the instructions to the Schedule K-1 a partnership furnishes two Schedules K-1 to a partner (one for the partner's general interest in the partnership and one for the partner's limited interest in the partnership), the partnership is treated as furnishing only one Schedule K-1 for purposes of proposed § 301.6221(b)–1(b)(2) because the partner-

ship is only required to furnish one statement to that partner under section 6031(b).

The proposed regulations include a special rule for partnerships that have S corporation partners. As described in proposed § 301.6221(b)–1(b)(2)(ii), any statements required to be furnished by the S corporation partner under section 6037(b) for the taxable year of the S corporation ending with or within the partnership's taxable year are taken into account for purposes of determining whether the partnership is required to furnish 100 or fewer statements for the taxable year. For instance, if an S corporation with 50 shareholders is a partner in a partnership, in addition to the statement the partnership is required to furnish to the S corporation, the 50 statements that the S corporation is required to furnish to its shareholders under section 6037(b) are taken into account for purposes of determining whether the partnership is required to issue 100 or fewer statements. As illustrated in Example 5 of proposed § 301.6221(b)–1(b)(2)(iii), the special rule under proposed § 301.6221(b)–1(b)(2)(ii) does not apply to partners that are not S corporations.

Pursuant to section 6221(b), the determination of whether the partnership has 100 or fewer partners is made by counting the number of statements required to be furnished under section 6031(b). Under TEFRA, section 6231(a)(1)(B) (prior to amendment by the BBA) specifically states that a husband and wife were treated as a single partner for purposes of determining whether the partnership had 10 or fewer partners (the TEFRA small partnership exception). Section 6221(b) contains no similar language. Accordingly, the principles of section 6031(b), which do not treat a husband and wife as a single partner, apply for purposes of determining whether the partnership has 100 or fewer partners. Examples 1 and 2 in proposed § 301.6221(b)–1(b)(2)(iii) illustrate this point.

#### *ii. Eligible Partners*

Proposed § 301.6221(b)–1(b)(3)(i) defines the term “eligible partner” as any person who is an individual, C corporation, eligible foreign entity, S corporation, or an estate of a deceased partner. Under this proposed rule, a C corporation is an entity defined in section 1361(a)(2), including a regulated investment company

(RIC) under section 851 and a real estate investment trust (REIT) under section 856. The Treasury Department and the IRS 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 proposed § 301.6221(b)–1(b)(3), consistent with Revenue Ruling 2003–69, 2003–1 C.B. 1118 (treating tax-exempt corporations as C corporations for purposes of the TEFRA small partnership exception). This treatment does not extend to an organization that is determined to be, or claims to be, exempt from tax under section 501(a) that is not classified as a corporation under section 7701(a)(3) as a C corporation, such as trusts.

An “eligible foreign entity” is defined in proposed § 301.6221(b)–1(b)(3)(iii) as any foreign entity that is classified as a per se corporation under § 301.7701–2(b)(1), (3)–(8), is classified by default as an association taxable as a corporation under § 301.7701–3(b)(2)(i)(B), or is classified as an association taxable as a corporation in accordance with an election under the provisions of § 301.7701–3(c).

Proposed § 301.6221(b)–1(b)(3)(ii) clarifies that the term “eligible partner” does not include partnerships, trusts, foreign entities that are not eligible foreign entities, disregarded entities, nominees, other similar persons that hold an interest on behalf of another person, and estates that are not estates of a deceased partner.

A number of comments received in response to Notice 2016–23 suggested that the Treasury Department and the IRS should exercise the regulatory authority provided in section 6221(b)(2)(C) to expand the types of entities that are eligible partners for purposes of the election out. Specifically, commenters requested that entities such as disregarded entities, trusts, partnerships, and partners who use nominees should be considered eligible partners for purposes of the election out rules. The commenters also suggest that there may be certain partnership structures that could be efficiently examined at the ultimate taxpayer level even if a partner is not one of the eligible partners listed in section 6221(b). The Treasury Department and the IRS considered these comments, but have declined in these proposed regulations to exercise the authority under

section 6221(b)(2)(C) to expand the types of entities that are eligible partners for purposes of the election out rules or to create separate election out provisions for specific partnership structures. When a partnership elects out of the centralized partnership audit regime, the IRS must examine and assess tax with respect to each ultimate partner under the deficiency procedures under subchapter B of chapter 63. Enactment of TEFRA was a reaction to the complexity and burden of these deficiency procedures with respect to partnerships. The increasing number and complexity of partnerships since TEFRA was enacted revealed that the TEFRA procedures were inadequate for the IRS to effectively audit partnerships. The centralized partnership audit regime is intended to enhance the IRS's ability to examine partnerships, particularly large and highly tiered partnerships. If the proposed regulations broaden the scope of the election out provisions to include additional types of partners or partnership structures, the IRS will face additional administrative burden in examining those structures and partners under the deficiency rules. 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 IRS and not just the decreased burden on taxpayers resulting from the suggested change.

#### B. Making the election out

Proposed § 301.6221(b)-1(c) provides the time, form, and manner for the partnership to make an election out of the centralized partnership audit regime, and unless all of these requirements are satisfied an election will not be valid. The requirements under proposed § 301.6221(b)-1(c) are described below.

First, under proposed § 301.6221(b)-1(c)(1), a partnership may make the election only on a timely filed partnership return (including extensions) (that is, Form 1065, *U.S. Return of Partnership Income*) for the partnership taxable year to which the election relates. Therefore, a partnership may not make the election on a return that is filed after the due date (including extensions) for the taxable year. An election out made by a partner-

ship may only be revoked with the consent of the IRS. Proposed § 301.6221(b)-1(c)(1).

In response to Notice 2016-23, some commenters requested that the election out rules should not penalize a partnership that does not timely file a return. Section 6221(b) specifically prescribes that the election must be made on a timely filed return. Accordingly, the proposed regulations conform with the statute and require the election under section 6221(b) to be made on a timely filed return.

Second, proposed § 301.6221(b)-1(c)(2) provides that a partnership must disclose to the IRS the names, correct TINs, and federal tax classifications of all partners of the partnership and, if there is an S corporation partner, the names, correct TINs, and federal tax classifications of all persons to whom an S corporation partner is required to furnish statements during the S corporation partner's taxable year ending with or within the partnership's taxable year at issue, and any other information regarding those partners (and shareholders) as required by the IRS in forms and instructions. The Treasury Department and the IRS recognize that section 6221(b)(2)(B) grants authority to the Secretary to provide for alternative identification of any foreign partners. However, in most cases, partners (including foreign partners) in partnerships that file a Form 1065, *U.S. Return of Partnership Income*, are required to have taxpayer identification numbers, and, as a result, alternative identification procedures for foreign partners may be unnecessary. The Treasury Department and the IRS request comments describing situations in which a foreign partner in a partnership subject to the centralized partnership audit regime may not otherwise be required to have a taxpayer identification number 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.

Finally, proposed § 301.6221(b)-1(c)(3) provides that a partnership that elects out of the centralized partnership audit regime must notify each of its partners that the partnership made the election. This notification must be made within 30 days of making the election. The proposed regulations do not mandate

the form of the notice that the partnership must provide to its partners. Accordingly, the notice may be in writing, electronic, or other form chosen by the partnership.

Proposed § 301.6221(b)-1(d) clarifies that any election out of the centralized partnership audit regime by an eligible partnership that is a partnership-partner (as defined in proposed § 301.6241-1(a)(7)) has no effect on the application of the centralized partnership audit regime to that partnership-partner in its capacity as a partner in another partnership. The Treasury Department and the IRS intend this provision to make clear that the effect of adjustments on a partnership-partner that is a partner in a partnership that is subject to the centralized partnership audit regime are determined under the centralized partnership audit regime even if that partnership-partner has made a valid election under section 6221(b). The examples in proposed § 301.6221(b)-1(d)(2) illustrate these principles.

Proposed § 301.6221(b)-1(e) provides that, if a partnership makes an election under this section, the IRS may rely on that election for all purposes unless and until the IRS determines that the election is invalid. The Treasury Department and the IRS intend proposed § 301.6221-1(e) to provide certainty to partnerships and the IRS because whether an election out is valid will determine whether the IRS must conduct a proceeding with respect to the partnership under the centralized partnership audit regime or whether the IRS will follow deficiency procedures with respect to the direct or indirect partners of the partnership to examine items that, absent a valid election, would be subject to the centralized partnership audit regime. Proposed § 301.6221-1(e) provides that an election that is not fully compliant with all the applicable rules, including an election by a partnership not eligible to make the election, may still be relied upon by the partnership unless challenged by the IRS, and the IRS may also rely upon an election in determining whether a partnership is subject to the centralized partnership audit regime. As a result, it will be clear to partnerships, direct and indirect partners, and the IRS which examination and adjustment regime should apply to the items otherwise subject to the centralized partnership audit regime.

### C. Effect of election out

As discussed in the Background, the centralized partnership audit regime is designed to make it easier for the IRS to examine partnerships and collect any resulting underpayments through one centralized proceeding. For partnerships that elect out, the IRS will be required to open deficiency proceedings at the partner level to adjust items associated with the partnership, resolve issues, and assess and collect any tax that may result from the adjustments. Each partner-level deficiency proceeding is subject to its own statute of limitations and venue, which often results in separate partner-by-partner determinations with respect to the same item. Nevertheless, the IRS intends to increase the number of partnership audits for both partnerships that are subject to the centralized partnership audit regime and partnerships that have elected out of the partnership audit regime.

In addition, to ensure that the election out rules are not used solely to frustrate IRS compliance efforts, the IRS intends to carefully review a partnership's decision to elect out of the centralized partnership audit regime. This review will include analyzing whether the partnership has correctly identified all of its partners for federal income tax purposes notwithstanding who the partnership reports as its partners. For instance, the IRS will be reviewing the partnership's partners to confirm that the partners are not nominees or agents for the beneficial owner.

In addition, the IRS intends to carefully scrutinize whether two or more partnerships that have elected out should be recast under existing judicial doctrines and general federal tax principles as having formed one or more constructive or de facto partnerships for federal income tax purposes. The types of arrangements that the IRS will carefully review include those where the profits or losses of partners are determined in whole or in part by the profits or losses of partners in another partnership, and those that purport to be something other than a partnership, such as the co-ownership of property. If it is determined that two or more partnerships that have elected out of the centralized partnership audit regime have formed a constructive or de facto partnership for a

particular partnership taxable year and are recast as such by the IRS, that constructive or de facto partnership will be subject to the centralized partnership audit regime because that constructive or de facto partnership will not have filed a partnership return and, therefore, will not have made a timely election out as required under section 6221(b)(1)(D)(i) and these proposed regulations. The constructive or de facto partnership may also have more than 100 partners or an ineligible partner, making it ineligible to elect out.

### 3. Partner's Return Must Be Consistent with Partnership Return

#### A. Requirement of consistency

Proposed § 301.6222-1(a)(1) provides that a partner's treatment of each item of income, gain, loss, deduction, or credit attributable to a partnership must be consistent with the treatment of those items on the partnership return, including treatment with respect to the amount, timing, and characterization of those items. Additionally, proposed § 301.6222-1(a)(1) clarifies that the determination of whether a partner treats an item consistently with the partnership return is determined with reference to the treatment of that item on the partnership return filed with the IRS, and not with reference to any schedule or other information provided or furnished by the partnership to the partner, for example, a schedule K-1 furnished to the partner by the partnership, unless the election under proposed § 301.6222-1(d), regarding incorrect statements or information, applies.

Proposed § 301.6222-1(a)(2) provides that a partnership-partner is subject to section 6222 and the regulations thereunder regardless of whether the partnership-partner has made an election out of the centralized partnership audit regime under section 6221(b). Proposed § 301.6222-1(a)(3) provides that a partner's return is considered automatically inconsistent if the partnership does not file a return, unless the partner notifies the IRS of this inconsistency in accordance with proposed § 301.6222-1(c).

For purposes of these proposed regulations, the term "treatment of items on a partnership return" is defined under pro-

posed § 301.6222-1(a)(4) to take into account treatment of all items reported by the partnership, regardless of the form that the reporting of the partnership return position with respect to that item takes (that is, regardless of whether the return position with respect to an item is reflected on an original return or reflected on a statement issued as a result of a partnership-initiated adjustment or an IRS-initiated adjustment). Accordingly, the term treatment of items on a partnership return includes not only the treatment of an item on the partnership's return filed with the IRS under section 6031(a), but also includes any amendment or supplement to such return, such as an administrative adjustment request filed under section 6227 and the regulations thereunder, as well as the treatment of an item on any statement, schedule or list, and any amendment or supplement thereto, filed by the partnership with the IRS, including statements filed pursuant to section 6226. Proposed § 301.6222-1(a)(5) provides examples illustrating the rules requiring consistent reporting by partners.

#### B. Mathematical or clerical error adjustments

Section 6222(b) provides that when a partner fails to treat items attributable to a partnership consistently with the treatment of those items on the partnership return, the IRS may assess and collect any underpayment of tax that results from that inconsistency as if it were on account of a mathematical or clerical error appearing on the partner's return; however the ability to request an abatement of the assessment under section 6213(b)(2) does not apply. Section 6213(b) provides the general rules for assessments of amounts of tax arising out of mathematical or clerical errors. In general, section 6213(b)(1), permits the IRS to immediately assess and collect tax that arises on account of a mathematical or clerical error appearing on a taxpayer's return, notwithstanding the general restrictions on assessment and collection of deficiencies under section 6213(a). Section 6213(b)(2) gives the taxpayer 60 days to request an abatement of that assessment.

Section 6222(b) specifically states that the IRS may assess an underpayment of

tax as if it were on account of a mathematical or clerical error on the partner's return. Section 6222(b), however, does not define the term underpayment for these purposes, and the term underpayment is not defined elsewhere under subchapter C of chapter 63. The term underpayment is defined in section 6664(a); however, that definition is expressly limited to part I of subchapter A of chapter 68 of the Code. Section 6213(b)(1), which discusses assessments arising out of mathematical or clerical errors, refers to the amount of tax due in excess of that shown on the return on account of the error. Because section 6222(b) refers explicitly to mathematical or clerical error and other provisions under 6213(b), proposed § 301.6222-1(a) provides that the underpayment of tax described under 6222(b) is the amount of tax due that results from adjusting the item on the partner's return to make the treatment of the item consistent with the treatment of such item on the partnership return.

Accordingly, proposed § 301.6222-1(b) provides that the IRS may assess and collect any underpayment of tax that results from adjusting a partner's inconsistently reported item to conform that item with the treatment on the partnership return as if the resulting underpayment of tax were on account of a mathematical or clerical error appearing on the partner's return. A partner may not request an abatement of that assessment. See proposed § 301.6222-1(b)(2).

In instances where the partner is itself a partnership, section 6232(d)(1)(B) provides for the use of rules similar to the rules of section 6213(b). Accordingly, proposed § 301.6222-1(b) states that if the partner is itself a partnership, any adjustment on account of such partnership's failure to treat an item consistently will be treated as an adjustment on account of a mathematical or clerical error. Also, in accordance with section 6232(d)(2), proposed § 301.6222-1(b) states that the procedures under section 6213(b)(2) for requesting abatements do not apply.

### *C. Notice of inconsistency*

Proposed § 301.6222-1(c) states that the provisions of proposed § 301.6222-1(a) (consistent reporting requirement)

and proposed § 301.6222-1(b) (math error treatment) do not apply to items that the partner properly identifies as being treated inconsistently with the partnership return. In order to properly identify an item, the proposed regulations provide that the partner must attach a statement identifying the inconsistency to the partner's return on which the item is treated inconsistently. Proposed § 301.6222-1(c)(1).

Proposed § 301.6222-1(c)(2) coordinates the rules regarding notice of inconsistent treatment under proposed § 301.6222-1(c)(1) with situations where a partner is bound to the treatment of an item under section 6223 as result of actions taken by the partnership under subchapter C of chapter 63 or by any final decision in a proceeding brought under subchapter C of chapter 63 with respect to the partnership. For instance, as noted in the proposed regulations under section 6226, the election under section 6226 and the filing and furnishing of statements under that section are actions of the partnership under section 6223. See proposed § 301.6226-1(d). Because the partner is bound by the treatment of an item reflected in a statement filed by the partnership under section 6226, the partner is precluded from treating that item inconsistently under section 6222. The fact that the partner files a notice of inconsistent treatment does not change the fact that the partner is bound by the treatment of the items in the section 6226 statement. Any other result would undermine the purpose of section 6223, which provides certainty and finality with respect to actions taken by the partnership during the centralized partnership audit regime. Accordingly proposed § 301.6222-1(c)(2) provides that if a partner's treatment of the item is not consistent with the treatment to which the partner is bound under section 6223 with respect to such item, such as the partnership treatment of items in an administrative adjustment request or in a section 6226 statement, the provisions of proposed § 301.6222-1(a) (consistent reporting requirement) and proposed § 301.6222-1(b) (math error treatment) apply to that item, and any underpayment of tax resulting from the failure to treat the item consistently with the treatment to which the partner is bound may be assessed and collected in the same manner as if such underpayment were on account of a mathematical or clerical error.

Situations may arise in which a partner treats several items inconsistently from how the partnership treated those same items, but the partner notifies the IRS only of some, but not all, of the inconsistencies. Proposed § 301.6222-1(c)(3) clarifies that the exception to the consistent reporting requirement and math error treatment applies only to the inconsistent positions that are specifically identified to the IRS in a proper notification.

Under section 6223(b), a final decision in an administrative or judicial proceeding with respect to a partnership under the centralized partnership audit regime is binding on the partnership and all partners of the partnership. In contrast, under section 6222(d), a final determination in an administrative or judicial proceeding with respect to a partner's identified inconsistent position is not binding on the partnership if the partnership is not a party to the proceeding. Accordingly, section 6222(d) provides that the IRS may conduct a proceeding with respect to the partner, that is, a proceeding that does not involve the partnership, where the partner notified the IRS of an inconsistent position under 6222(c). Section 6222(d) does not, however, preclude the IRS from conducting a proceeding with respect to the partnership.

In some cases, the IRS may determine that conducting a partnership proceeding under the centralized partnership audit regime under subchapter C of chapter 63 is appropriate, for instance when the IRS disagrees with both the partner's and the partnership's treatment of the item or when multiple partners treat an item inconsistently from the treatment by the partnership. In other cases, the IRS may determine that a partner proceeding, which generally would be under deficiency procedures in subchapter B of chapter 63, is appropriate, for instance when the IRS determines that the partner's inconsistent treatment is incorrect. Accordingly, proposed § 301.6222-1(c)(4)(i) clarifies that in the case of an identified inconsistency, the IRS may conduct both a proceeding with respect to the partner (a proceeding in which the partnership would not be involved) and a proceeding with respect to the partnership. Proposed § 301.6222-1(c)(4)(ii) provides that any final decision with respect to an inconsistent position identified in a notice to the IRS under section 6222(c) in a proceeding to



which the partnership is not a party is not binding on the partnership.

Proposed § 301.6222-1(c)(4)(ii) also provides that if the IRS conducts a separate proceeding with respect to a partner, the IRS is not required to conform items on the partner's return to make those items consistent with the treatment of the items on the partnership return. Rather, if the IRS disagrees with the partner's treatment of an inconsistent item, the IRS may adjust the item to conform to the proper treatment of such item under federal tax law. Proposed § 301.6222-1(c)(5) provides examples illustrating the provisions under proposed § 301.6222-1(c).

Proposed § 301.6222-1(d) provides that a partner has provided notice to the IRS of an inconsistency if the partner treats an item consistently with incorrect information that the partnership furnished to the partner and makes an election to allow such treatment. The proposed regulations provide that the partner makes the election after being notified by the IRS of an adjustment due to treatment of an item on the partner's return inconsistent with the treatment of that item on the partnership's return. As part of the election, the proposed regulations require the partner to demonstrate that the treatment of the item on the partner's return is consistent with the treatment of that item on the incorrect schedule or information furnished to the partner by the partnership. Proposed § 301.6222-1(d)(2) provides that this election must be made within 60 days from the date of the notice informing the partner of the inconsistent treatment. The election must be clearly identified as an election under section 6222(c)(2)(B), signed by the partner making the election, and must be accompanied by copies of the schedule or other information furnished to the partner by the partnership as well as the notice mailed by the IRS informing the partner of the conforming adjustment. If it is not clear that the partner's treatment of the item on the partner's return is consistent with the information provided by the partnership, the election must include an explanation of how the partner's treatment is consistent. Proposed § 301.6222-1(d)(3) provides examples illustrating the provisions under proposed § 301.6222-1(d).

One comment in response to Notice 2016-23 suggested that when a partner notifies the IRS of an inconsistency, the notification of inconsistent treatment should be included with the partner's return for the tax year in which the partner took the inconsistent position, rather than create a separate notification process. The Treasury Department and the IRS agree with this comment. Accordingly, the proposed regulations require a partner to attach a notification of inconsistent treatment to the partner's return on which the item is treated inconsistently. A separate notification process is necessary, however, when a partner receives an incorrect statement, schedule, or other information from the partnership because the partner generally will not know about the inconsistency.

#### 4. *Partnership Representative*

Proposed § 301.6223-1 provides rules requiring a partnership to designate a partnership representative (proposed § 301.6223-1(a)), rules describing the eligibility requirements for a partnership representative (proposed § 301.6223-1(b)), rules describing designation of the partnership representative (proposed § 301.6223-1(c)-(f)), and rules describing the termination of a designation of a partnership representative (proposed § 301.6223-1(d)-(f)).

##### *A. Eligibility to serve as the partnership representative*

Proposed § 301.6223-1(b)(1) provides that a partnership may designate any person as defined in section 7701(a)(1), including an entity, that meets the requirements of proposed § 301.6223-1(b)(2), (b)(3), and (b)(4), to be the partnership representative. The partnership representative must have a substantial presence in the United States and must have the capacity to act. If an entity is designated as the partnership representative, the partnership must identify and appoint an individual to act on the entity's behalf. The appointed individual must also have a substantial presence in the United States and the capacity to act. Accordingly, provided the person is otherwise eligible, the partnership may appoint a partner or a

non-partner, including the partnership's management company, as the partnership representative.

Proposed § 301.6223-1(b)(2) provides that the partnership representative must have a substantial presence in the United States. Proposed § 301.6223-1(b)(2)(i) provides that a person has a substantial presence in the United States for the purposes of section 6223 if three criteria are met. First, the person must be able to meet in person with the IRS in the United States at a reasonable time and place as is necessary and appropriate as determined by the IRS. Second, the partnership representative must have a street address in the United States and a telephone number with a United States area code where the partnership representative can be reached by United States mail and telephone during normal business hours in the United States. Third, the partnership representative must have a U.S. TIN.

The proposed regulations do not use the substantial presence test as described in section 7701(b)(3) (substantial presence test) because the purpose of the substantial presence test is to determine whether an alien individual should be treated as a resident alien for U.S. tax purposes. In contrast, the purpose of requiring that the partnership representative have a substantial presence in the United States is to ensure ease of communication so the audit process can proceed smoothly. As a result, proposed § 301.6223-1(b)(2) does not adopt the substantial presence test in section 7701(b)(3).

Communication between the IRS and the partnership representative is fundamental to an efficient administrative proceeding, both for the IRS and the partnership. As a result, if the partnership designates an entity as the partnership representative (an entity partnership representative), proposed § 301.6223-1(b)(3) requires the partnership to appoint an individual (designated individual) as the sole individual to act on behalf of the entity partnership representative. Like the partnership representative itself, the designated individual must meet the substantial presence requirements of proposed § 301.6223-1(b)(2). If the partnership does not appoint a designated individual, the IRS may determine the partnership representative designation is

not in effect. See proposed § 301.6223-1(f).

In addition, a person must have the capacity to act as the partnership representative or the designated individual. Proposed § 301.6223-1(b)(4) describes specific events that cause a person to lose the capacity to act and includes a catch-all provision for unforeseen circumstances in which the IRS reasonably determines that the partnership representative or designated individual may no longer have the capacity to act.

The proposed regulations provide that a person designated by the partnership as the partnership representative is deemed to satisfy the substantial presence requirements and have capacity to act unless and until the IRS determines the person is ineligible. See proposed § 301.6223-1(b)(1). If a partnership representative never met, or no longer meets, the requirements of proposed § 301.6223-1(b), the designation of the partnership representative is valid and remains in effect until the partnership, the partnership representative, or the IRS takes an affirmative action to terminate that designation. This can happen in one of three ways. The partnership representative may resign pursuant to proposed § 301.6223-1(d), the partnership may revoke the designation pursuant to proposed § 301.6223-1(e), or the IRS may determine a designation is not in effect under proposed § 301.6223-1(f). Until one of those events occurs, the designation is valid and remains in effect. For the validity of actions taken by the partnership representative during the period when the designation was in effect, see proposed § 301.6223-2(b).

#### *B. Designating the partnership representative*

Proposed § 301.6223-1(c) describes the manner in which a partnership designates the partnership representative. A partnership must designate the partnership representative on the partnership's return filed for the partnership taxable year. A partnership must designate a partnership representative separately for each taxable year. A designation for one taxable year is not effective for any other taxable year. A designation for a partnership taxable year remains in effect until the designa-

tion is terminated under proposed § 301.6223-1(d) (resignation), proposed § 301.6223-1(e) (revocation), or proposed § 301.6223-1(f) (determination that the designation is not in effect).

Under the TEFRA partnership procedures, a TMP may be designated, including through a resignation or revocation, at any time after the filing of the initial partnership return by submitting a new designation to the IRS. The IRS processes each of these subsequent designations regardless of whether the partnership is examined, creating unnecessary work for the IRS because very often the TMP is not required to take any action on behalf of the partnership or the partners.

The partnership representative rules are intended to be an improvement over the TMP rules. As a result, the partnership representative rules have been crafted to avoid the resource drain created by processing unnecessary resignations, revocations, and subsequent designations of TMPs. Accordingly, the proposed regulations provide that a partnership representative designation may not be changed (either by resignation or revocation) until the IRS issues a notice of administrative proceeding to the partnership, except when the partnership files a valid administrative adjustment request (AAR) in accordance with section 6227 and proposed § 301.6227-1.

The proposed regulations provide that the partnership or the partnership representative may change the initial designation of the partnership representative simultaneously with filing an AAR, but the form used for filing an AAR may not be used solely for the purpose of changing the partnership representative. The Treasury Department and the IRS understand that there may be other circumstances that warrant allowing a partnership or partnership representative to change the partnership representative designation and request comments regarding such other circumstances.

Specifically, proposed § 301.6223-1(d) allows a partnership representative to resign by notifying the partnership and the IRS in writing. The partnership representative may not resign prior to the issuance of a notice of administrative proceeding (except in conjunction with the filing of an AAR), but the partnership representative

may resign at any time after the issuance of the notice of an administrative proceeding. The partnership representative may resign regardless of whether that person was designated by the partnership or the IRS. The resigning partnership representative may, but is not required to, designate a successor partnership representative. If the resigning partnership representative does not designate a successor, the IRS will determine that the designation is not in effect under proposed § 301.6223-1(f) and provide the partnership with an opportunity to designate a new partnership representative. If the partnership fails to designate a new partnership representative, the IRS will designate a new partnership representative pursuant to proposed § 301.6223-1(f)(5). A resignation is effective 30 days after the date the notice of resignation is sent to the IRS. See proposed § 301.6223-1(d)(1). Similar rules apply to designated individuals, allowing the designated individual to resign and appoint a successor. See proposed § 301.6223-1(d)(3).

Proposed § 301.6223-1(e) describes the rules which allow the partnership to revoke the partnership representative designation and designate a successor. 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. In general, a change in the partnership representative or designated individual should only occur when the partnership representative resigns and appoints a successor under proposed § 301.6223-1(d). However, there may be circumstances where the partnership would like to change the designation, and the partnership representative or designated individual will not resign. Proposed § 301.6223-1(e) provides flexibility to the partnership in these circumstances, allowing the partnership, through its partners, to revoke a prior designation.

In the case of a revocation, the partnership must notify the IRS in writing and must also notify the partnership representative whose designation is being revoked of the revocation. Like resignations under proposed § 301.6223-1(d), the partnership may not revoke the partnership representative designation prior to the issuance of a notice of an administrative

proceeding except in conjunction with the filing of a valid AAR. A revocation is effective 30 days after the date the notice of revocation is sent to the IRS. See proposed § 301.6223-1(e)(1). Upon the receipt of a valid revocation, the IRS will notify the partnership and any partnership representative whose designation is being revoked of the acceptance of the revocation.

Proposed § 301.6223-1(e)(3) provides the rules for who may sign a revocation. In general, the partnership representative is the sole representative of the partnership. The revocation provision provides a limited exception to this rule and allows, solely for purposes of revocation, other partners to act on behalf of the partnership. 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. If no general partner has the capacity to act on behalf of the partnership (as described in proposed § 301.6223-1(b)(4)(i)-(v)), proposed § 301.6223-1(e)(3)(i) provides that any reviewed year partner in the partnership may sign the revocation. Proposed § 301.6223-1(e)(3)(ii) provides definitions with respect to limited liability companies (LLCs) and rules for which members of an LLC may sign a revocation. For purposes of which partners may sign a revocation, member-managers are treated as general partners, and other members are treated as a partner other than a general partner. If there is no member-manager, the proposed regulations provide that each member is treated as a member-manager for purposes of this section.

Additionally, proposed § 301.6223-1(e) provides that any revocation must 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 partnership representative.

The combination of requiring the partner making the revocation to attest under penalties of perjury that the partner is authorized to act for the partnership and requiring the partner to notify the partnership and partnership representative helps ensure that any partnership representative

revocation is consistent with the wishes of the partnership. The notification that the revocation has been accepted that the partnership and the partnership representative receive from the IRS provides further notice to the partnership and allows for the partnership to take action against unauthorized revocations and designations.

There may be circumstances in which more than one general partner in the partnership makes a revocation within a short period of time. In that circumstance, the IRS may not be able to readily determine the identity of the proper partnership representative. To allow the IRS to identify the correct partnership representative, proposed § 301.6223-1(e)(5) provides if the IRS receives multiple revocations or subsequent designations within a 90-day period, the IRS may determine that a designation is not in effect due to multiple revocations and follow the procedures under proposed § 301.6223-1(f) to designate a new partnership representative. These rules do not require that the IRS designate a person designated in any of the revocations received. If the IRS designates a partnership representative under proposed § 301.6223-1(f), proposed § 301.6223-1(e)(4) provides that the partnership must receive the IRS's permission to later revoke the designation.

#### *C. Determination that a designation is not in effect*

Proposed § 301.6223-1(f) provides the rules regarding how the IRS makes a determination that a designation of a partnership representative is not in effect, as well as how the IRS will designate a partnership representative if a designation is not in effect.

Proposed § 301.6223-1(f) provides that when the IRS determines a designation is not in effect, the IRS will notify the partnership and the last partnership representative, if there was one, of the IRS's determination. The designation is terminated as of the day the IRS notifies the partnership that no designation is in effect. Proposed § 301.6223-1(f)(4) provides that except in cases where the partnership designation is not in effect because there were multiple revocations, the partnership will have 30 days to designate a successor partnership representative before the IRS

will designate a new partnership representative. If the IRS has already received multiple revocations from different partners and determined it is unable to ascertain which partnership representative the partnership wants to designate, proposed § 301.6223-1(f)(4) provides that the IRS will notify the partnership that the designation is not in effect and designate a new partnership representative pursuant to proposed § 301.6223-1(f)(5) without providing the partnership with an opportunity to designate a partnership representative. This rule avoids creating further confusion between the partnership and the IRS, which would delay the designation and the administrative proceeding.

#### *D. Designation of the partnership representative by the IRS*

Proposed § 301.6223-1(f)(1) provides that if there is no designation of a partnership representative in effect, the IRS may select any person to serve as partnership representative. There is no distinction between the authority of a partnership representative designated by the partnership and one selected by the IRS. For that reason, the proposed regulations refer to the IRS's *selection* of a partnership representative as a *designation*.

Under proposed § 301.6223-1(f)(5), the IRS will notify the partnership of its designation by providing the partnership with the name, address, and telephone number of the new partnership representative. Under proposed § 301.6223-1(f)(5) the designation by the IRS of a new partnership representative is effective on the day the IRS mails the notification to the partnership of the designation. Proposed § 301.6223-1(f)(5) also requires the IRS to mail a copy of the notification to the new partnership representative.

Proposed § 301.6223-1(f)(5)(ii) provides that the IRS may designate any person as the partnership representative. In designating a person as the partnership representative, the IRS will consider whether the person is a partner in the partnership, either in the reviewed year or at the time the designation is made. In addition, the IRS may consider the other remaining factors listed in proposed § 301.6223-1(f)(5)(ii).

Once the IRS has designated a partnership representative, the partnership may not revoke that designation without the consent of the IRS. See proposed § 301.6223-1(f)(3)(iii). The examples under proposed § 301.6223-1(f)(6) illustrate the operation of the rules described above.

#### *E. Authority of the partnership representative*

Proposed § 301.6223-2 describes the binding nature of actions taken by the partnership representative on behalf of the partnership under subchapter C of chapter 63 and of the partnership with respect to its partners. Under proposed § 301.6223-2, the partnership and all partners are bound by the actions of the partnership and the partnership representative and by any final decision in a proceeding brought under subchapter C of chapter 63. The partnership representative binds the partnership and its partners by the partnership representative's actions, including: agreeing to settlements, agreeing to a notice of final partnership adjustment, making an election under section 6226, and agreeing to an extension of the period for adjustments under section 6235. In addition, all persons whose tax liability is determined, in whole or in part, by taking into account, directly or indirectly (such as indirect partners), adjustments to any item within the scope of the centralized partnership audit regime under section 6221(a), by the IRS in a notice of final partnership adjustment in a proceeding brought under subchapter C of chapter 63, or in a final decision of a court under subchapter C of chapter 63 are similarly bound. This binding authority extends to all partners, including those partners who have elected out of the centralized partnership audit regime under section 6221(b).

Proposed § 301.6223-2(c)(1) provides that the partnership representative has the sole authority to act on behalf of the partnership in any examination or other proceeding under subchapter C of chapter 63. Similarly, proposed § 301.6223-2(c)(2)(ii) provides that a designated individual has the sole authority to act on behalf of the partnership representative and the partnership. Except for a partner that is also the partnership representative or a designated individual, proposed § 301.6223-2(c)(1) provides that partners may not participate in or contest the

results of an examination or other proceeding involving a partnership without permission of the IRS. Proposed § 301.6223-2(c)(1) also provides that no other person, regardless of whether that person's tax liability is affected by the actions of the partnership, may participate in the partnership proceeding under subchapter C of chapter 63.

Proposed § 301.6223-2(c)(1) states that the broad authority of the partnership representative may not be limited by state law, partnership agreement, or any other document or agreement. Any action taken by the partnership representative with respect to the centralized partnership audit regime under the Code and federal tax regulations is valid and binding on the partnership for purposes of tax law regardless of any other provision of state law, partnership agreement, or any other document or agreement.

Proposed § 301.6223-2(c)(2)(i) provides that the partnership representative, by virtue of being designated, has the authority to bind the partnership for purposes of the centralized partnership audit regime. Similarly, under proposed § 301.6223-2(c)(2)(ii), the designated individual's authority to bind the partnership representative and the partnership is derived by virtue of the appointment of that designated individual.

The examples under proposed § 301.6223-2(d) illustrate the operation of the rules described above.

#### *F. Notice 2016-23 comments regarding the partnership representative*

A number of comments made specific suggestions about whom the IRS should designate as the partnership representative when no partnership representative designation is in effect. The suggestions ranged from designating the partner with the largest profits interest or the greatest percentage ownership interest to designating any partner that can sign the partnership return. Commenters suggested that partners with small investments, nominal profits interests, or other minor roles in the partnership would not be suitable to adequately represent the partnership during an administrative proceeding. The proposed regulations, however, establish rules to provide more flexibility for the IRS to designate a partnership representa-

tive to avoid some of the shortcomings of TEFRA, including the complexity and difficulty of locating a qualified TMP.

Accordingly, the proposed regulations allow the IRS to designate any person after first considering partners from the reviewed year or at the time the designation is made, but it also provides several factors that the IRS may consider in determining whom to select. This rule balances the needs of the government and the partnership.

Other suggestions included requiring that the IRS select a partnership representative that has authority to bind the partnership under state law. The proposed regulations do not limit whom the IRS may designate based on state law. The sole authority to bind the partnership for all purposes is derived from the Code and applies for purposes of the internal revenue laws. Therefore, proposed regulations are drafted so that federal, rather than state law, controls with respect to the rules regarding the partnership representative for purposes of the centralized partnership audit regime.

Some commenters requested that there be no restrictions on whom the partnership can designate as the partnership representative other than the requirement of substantial presence in the United States. These suggestions included allowing entities, even entities with no employees, to be appointed as the partnership representative. The proposed regulations adopt these suggestions by allowing the partnership to designate any person, including an entity, to be the partnership representative provided, in the case of an entity designated as partnership representative, the partnership also identify a designated individual to act on behalf of the entity partnership representative. The proposed regulations require that both an entity partnership representative and the designated individual have substantial presence in the United States. Provided an entity with no employees otherwise meets the requirements of proposed § 301.6223-1, the proposed regulations would allow that entity to be the partnership representative.

Some commenters suggested that the proposed rules require the partnership representative to provide notice to all partners of significant developments in an administrative proceeding and to allow

partners other than the partnership representative to participate in the administrative proceeding. The proposed regulations do not adopt these suggestions. 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. Whether and how the partnership representative communicates with the partners in the partnership is best left to the partnership to determine. Likewise, it is more efficient for the IRS to interact solely with the partnership representative during an administrative proceeding.

## 5. *Imputed Underpayment and Modification of Imputed Underpayment*

### A. *General rules regarding the imputed underpayment*

Proposed § 301.6225-1(a) provides the general rule that if a partnership adjustment results in an imputed underpayment, the partnership must pay the imputed underpayment in the adjustment year. As described in proposed § 301.6225-1(a)(3), the partnership adjustments and any imputed underpayment resulting from such adjustments are set forth in a NOPPA mailed to the partnership and partnership representative. The partnership may request modification with respect to an imputed underpayment set forth in the NOPPA under the procedures described in proposed § 301.6225-2.

The IRS and taxpayers both have an interest in resolving the issues raised by the IRS under the centralized partnership audit regime in the most efficient manner. An administrative proceeding under the centralized partnership audit regime is conducted under the same principles applicable to examinations generally. For instance, after providing the partnership and partnership representative with a notice of administrative proceeding, consistent with IRS general examination procedures, the IRS will endeavor to work with the partnership representative to set a schedule for information document requests (IDRs) and partnership responses to the IDRs. In general, the IRS informs the partnership representative about potential items and transactions that raise issues and provides

information about adjustments that will be included in the NOPPA.

As part of this process, the IRS may agree to review certain information prior to the issuance of the NOPPA in an effort to resolve issues in an expedited fashion and eliminate the need to make certain adjustments. In addition, the modification process may move faster if relevant information is provided to the IRS employees conducting the administrative proceeding prior to issuance of the NOPPA. However, once the NOPPA is issued, the modification procedures under proposed § 301.6225-2 are the partnership's only formal route to request changes to an imputed underpayment set forth in the NOPPA.

Proposed § 301.6225-1(a)(2) provides that unless the IRS determines otherwise, all applicable preferences, restrictions, limitations, and conventions will be taken into account as if the adjusted item was originally taken into account by the partnership or the partners in the manner most beneficial to the partnership or partners. Therefore, the IRS calculates an imputed underpayment by taking into account the applicable internal revenue laws, including provisions that may limit or restrict the ability of a partner to reduce income or take advantage of tax benefits flowing from the partnership. For instance, if the adjustment is a reduction of qualified research expenses, the IRS may determine the amount of the adjustment as if all partners claimed a credit with respect to their allocable portion of such expenses under section 41, rather than a deduction under section 174. To the extent supported by the facts, the partnership may take steps through the modification procedures set forth in proposed § 301.6225-2 to provide the IRS with information about specific partners and how those partners took items from the partnership into account.

The modification process, discussed later in this preamble, is the method for the partnership to request that the IRS modify an imputed underpayment to more closely reflect the tax consequences that would have resulted if the partners had taken the adjusted items into account correctly on their original returns for the year that includes the reviewed year of the partnership.

### B. *Calculation of the imputed underpayment*

Proposed § 301.6225-1(c) provides rules for the calculation of an imputed underpayment. Proposed § 301.6225-1(c)(1) provides that the imputed underpayment is calculated by multiplying the total netted partnership adjustment by the highest rate of federal income tax in effect for the reviewed year (as defined in proposed § 301.6241-1(a)(8)) under section 1 or 11. The product of that amount is then increased or decreased by any adjustment made to the partnership's credits. If the result of this summation is a net positive adjustment, the resulting amount is the imputed underpayment, and, if it results in a net non-positive amount, the result is an adjustment that does not result in an imputed underpayment. See proposed § 301.6225-1(c)(2).

Proposed § 301.6225-1(c)(3) defines the *total netted partnership adjustment* for purposes of calculating the imputed underpayment in proposed § 301.6225-1(c)(1) as the sum of all net positive adjustments in the residual grouping as determined in accordance with paragraph (d)(2)(v) of this section, plus the sum of all net positive adjustments in the reallocation grouping as determined in accordance with paragraph (d)(2)(ii) of this section.

#### i. *Grouping and Netting of Adjustments*

Under proposed § 301.6225-1(d), adjustments are grouped together, which provides a framework for the netting of adjustments appropriately. Within each grouping, adjusted items may be further divided into subgroupings depending on their character or to account for preferences, sources, categories, limitations, or other restrictions under Title 26 (for example, adjustments to short-term capital gain will generally be in a different subgrouping from adjustments to long-term capital gain). See proposed § 301.6225-1(d)(1). The groupings and subgroupings provide the IRS with the ability to net adjustments according to applicable limitations and restrictions, but the Treasury Department and the IRS seek comments on any specific items that may require special rules or special subgroupings.

Proposed § 301.6225-1(d)(2)(i) provides that there are three types of groupings, and that the adjustments are divided in order into those groupings. First, adjustments that reallocate items among the partners (reallocation grouping) are grouped together. Second, adjustments to the partnership's credits (credit grouping) are grouped together. Third, all remaining adjustments (residual grouping) are grouped together according to the character, preferences, restrictions, and other limitations of the item adjusted. Within each grouping, there might be more than one subgrouping based on a partnership's particular adjustments. For instance, within the residual grouping, there might be an ordinary subgrouping as well as a capital subgrouping. Adjustments that generally affect, or that are affected by, the application of any rules related to preferences, limitations, restrictions, or conventions, will generally be taken into account within their own respective grouping or subgrouping.

Proposed § 301.6225-1(d)(2)(ii) describes the reallocation grouping. Any adjustment that reallocates an item from one or more partners to one or more other partners is treated as two adjustments. The first adjustment is a decrease in the amount of the items allocated by the partnership on its return to one or more partners. The second adjustment is an increase in the amount of the items allocated by the IRS to the other partner(s). Each adjustment is grouped in its own reallocation subgrouping to prevent the two adjustments from netting to zero. After application of the netting rules under proposed § 301.6225-1(d)(3), any net non-positive adjustment is disregarded in the calculation of the imputed underpayment under proposed § 301.6225-1(d)(3)(ii)(A). An adjustment that results in a net non-positive adjustment is an adjustment that does not result in an imputed underpayment because the reallocation of an item among partners is one of the circumstances described in proposed § 301.6225-1(c)(2).

The credit grouping described in proposed § 301.6225-1(d)(2)(iii) includes all adjustments to items that the partnership claimed or could have claimed as a credit on the partnership's return. The Treasury Department and the IRS 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*.

A paragraph is reserved in proposed § 301.6225-1(d)(2)(iv) for special rules relating to the treatment of certain creditable expenditures. This paragraph is reserved to provide rules applicable with respect to adjustments to items that are, or could be, reported by the partnership as expenditures that may be treated as a credit when taken into account by a partner. The Treasury Department and the IRS 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.

The third grouping is the residual grouping, which is described in proposed § 301.6225-1(d)(2)(v). The residual grouping includes all other adjustments, which are grouped according to character (for instance, ordinary or capital) and other limitations under the Code. The adjustments of a particular partnership may warrant further subgroupings for other items (for instance, long-term capital versus short-term capital). An adjustment that recharacterizes 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 recharacterized by the IRS. Each adjustment is grouped separately with similar items.

Proposed § 301.6225-1(d)(3) describes the rules for netting items after separating the items into their groupings and subgroupings. First, proposed § 301.6225-2(d)(3)(i) provides that the IRS will net items within the same grouping or subgrouping. For instance, all ordinary adjustments (assuming no other restrictions under the Code) are netted against each other, regardless of whether such adjustments were part of related transactions or whether they were increases or decreases to income, but none of the ordinary adjustments are netted against the adjustments in the capital subgrouping. Adjustments in the capital subgrouping are

netted against each other within that subgrouping. Adjustments from one taxable year may not be netted against adjustments from another taxable year, even if they would otherwise be part of the same subgrouping. See proposed § 301.6225-1(c)(4).

Once adjustments within each subgrouping have been netted, each grouping or subgrouping will have either a net positive adjustment (as defined in proposed § 301.6225-1(d)(3)(ii)(B)) or a net non-positive adjustment (as defined in proposed § 301.6225-1(d)(3)(ii)(C)). Any netted amount that is a net non-positive adjustment in the reallocation grouping or the residual grouping is an adjustment that does not result in an imputed underpayment under proposed § 301.6225-1(c)(2), and the rules described in proposed § 301.6225-3 apply regarding the treatment of the partnership adjustments that were netted giving rise to that net non-positive adjustment. Any such net non-positive adjustment is disregarded for the remaining purpose of calculating the imputed underpayment. See proposed § 301.6225-1(c)(2) (which lists this netting step as another circumstance in which net non-positive adjustments are adjustments that do not result in an imputed underpayment) and § 301.6225-1(d)(3)(ii)(A).

The exception to this rule under proposed § 301.6225-1(d)(3)(ii)(A) (regarding disregarding net non-positive adjustments) is with respect to the credit grouping because adjustments to credits are applied to the total netted partnership adjustment after the rate is applied as described in proposed § 301.6225-1(c)(1). If the net credits reduce the amount calculated under proposed § 301.6225-1(c)(1) to zero or less than zero, the partnership adjustments resulting in the total netted partnership adjustment and the adjustments to credits taken into account in calculating the zero or less than zero amount are all partnership adjustments that do not result in an imputed underpayment under proposed § 301.6225-1(c)(2).

Proposed § 301.6225-1(d)(3)(iii) describes how adjustments are treated within each particular grouping or subgrouping (other than the credit grouping) for purposes of netting. Increased gain is treated as increased income, decreased gain is

treated as decreased income, increased loss is treated as decreased income, and decreased loss is treated as increased income. The credit grouping is excluded from this treatment because any adjustment to a credit does not result in an increase or decrease of income but rather in an adjustment to the amount of tax owed after the tax rate is applied under proposed § 301.6225-1(c)(1).

#### ii. Multiple Imputed Underpayments

Proposed § 301.6225-1(e) provides rules for multiple imputed underpayments. Each administrative proceeding that ends with the determination by the IRS of an imputed underpayment will result in a general imputed underpayment. The IRS may determine, in its discretion, a specific imputed underpayment 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. There may be multiple specific imputed underpayments depending on the adjustments. For instance, some transactions may not involve all partners, and there may be a reason to place certain adjustments or even entire groupings into a specific imputed underpayment (described in proposed § 301.6225-1(e)(2)(iii)), while other adjustments remain in a general imputed underpayment (described in proposed § 301.6225-1(e)(2)(ii)).

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

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. If the partnership would like to change the number or composition of the imputed underpayments that are listed on the NOPPA, the partnership may request modification under proposed § 301.6225-2(d)(6).

The examples in proposed § 301.6225-1(f) demonstrate the rules of this section.

#### C. *Modification of an imputed underpayment*

Proposed § 301.6225-2(a) provides general rules for modification of an imputed underpayment. A partnership that has received a NOPPA may request modification of a proposed imputed underpayment. The effect of modification on the proposed imputed underpayment is described in proposed § 301.6225-2(b). Only the partnership representative may request modification of an imputed underpayment.

With respect to adjustments that do not result in an imputed underpayment, modification is only permissible if the partnership also has an imputed underpayment that is eligible to be modified under proposed § 301.6225-2. Section 6225(c) refers to modification of the imputed underpayment and does not address modification with respect to adjustments that do not result in an imputed underpayment. Section 6225(c)(2)(B), however, requires a partner whose allocable share of a reallocation adjustment does not result in an imputed underpayment to file an amended return and take into account the partner's share in order for the partnership to receive modification of the imputed underpayment. As a result, section 6225 clearly contemplates the possibility of requesting modification with respect to an adjustment that does not result in an imputed underpayment. Accordingly, proposed § 301.6225-2(a) allows for such modifications provided the partnership has an imputed underpayment that is set forth in the NOPPA. If the NOPPA does not set forth an imputed underpayment, the partnership may not request a modification with respect to adjustments

that do not result in an imputed underpayment under proposed § 301.6225-2.

#### i. Effect of Modification

Proposed § 301.6225-2(b) provides the rules describing the effect of modification on the calculation of the imputed underpayment. Some modifications may result in excluding certain adjustments, or portions thereof, from the calculation of the imputed underpayment, such as modification under proposed § 301.6225-2(d)(2), (d)(3), (d)(5), (d)(7), (d)(8), and, if applicable, (d)(9). When the IRS approves one of those types of modification, the portion of the partnership adjustment attributable to that partner (or indirect partner) is removed from the calculation of the netted grouping amounts under proposed § 301.6225-1, resulting in a reduction of the total netted partnership adjustments underlying the calculation of the imputed underpayment. This reduction in the total netted partnership adjustments does not, however, affect the amount of the partnership adjustment itself, only whether the adjustment is included in the calculation of the imputed underpayment. For instance, assume the IRS makes an adjustment by increasing the valuation of an asset from \$100 to \$1100 (a \$1000 adjustment). One partner files an amended return to take into account that partner's 50 percent share of the adjustment. The result is that only \$500 worth of adjustments are included in the imputed underpayment calculation. The value of the asset remains \$1100 as determined by the IRS, and the adjustment remains \$1000, notwithstanding the amended return that is filed by the partner.

Proposed § 301.6225-2(b)(3) provides that modification with respect to a partnership with partners for which rate modification under section 6225(c)(4) and proposed § 301.6225-2(d)(4) is approved affects the taxable rate applied to the total netted partnership adjustment and does not affect the extent to which partnership adjustments factor into the calculation of the imputed underpayment. This rule may also apply in appropriate circumstances to modifications under proposed § 301.6225-2(d)(8) and proposed § 301.6225-2(d)(9). Proposed

§ 301.6225-2(b)(3) provides the method for calculating the partnership's "rate-modified netted partnership adjustment" and imputed underpayment when rate modification under proposed § 301.6225-2(d)(4) is approved.

A specific rule applies to rate modification with respect to special allocations that requires each partner's distributive share to be determined based on the amount of net gain or loss to the partner that would result if the partnership had sold all of its assets at their fair market value as of the close of the reviewed year of the partnership. See proposed § 301.6225-2(b)(3)(iv). If a partnership requests more than one type of modification, proposed § 301.6225-2(b)(1) provides an ordering rule that states that rate modification is applied after the other types of modification specified in proposed § 301.6225-2(d).

Proposed § 301.6225-2(b)(4) provides that the IRS may prescribe other guidance regarding the effect of other modifications referenced in proposed § 301.6225-2(d)(9), and the Treasury Department and the IRS seek comments on other appropriate modifications and their effect on the calculation of an imputed underpayment. In particular, the Treasury Department and the IRS request comments on modifications that may be considered appropriate where a partner is a foreign person and thus 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.

## ii. Time, Form, and Manner for Requesting Modification

Proposed § 301.6225-2(c) provides time, form, and manner rules for when a partnership may request modification. Modification must be requested in the form and manner prescribed by the IRS within the 270-day period described in proposed § 301.6225-2(c)(3)(i). The Treasury Department and the IRS request comments on the coordination of these rules with the mutual agreement procedures available under income tax treaties that a partnership, partner, or indirect part-

ner may invoke in order to determine eligibility for treaty benefits that may affect the calculation of the imputed underpayment.

Proposed § 301.6225-2(c)(1) provides that a determination with respect to a modification request does not preclude the IRS under section 7605(b) from initiating an administrative proceeding with respect to a partner, even if the IRS approves modification based on the partner's actions or status. The IRS may rely on the facts provided to the IRS by the partnership representative to determine whether a modification request is proper and is not required to conduct an examination of the partners that form the basis of any modification request. Any determination by the IRS with respect to a modification request is a determination as part of the administrative proceeding with respect to the partnership. The IRS may approve modification based on an adjustment in an amended return filed for modification purposes and also examine the amended return in a separate proceeding with respect to that partner.

Similarly, if the IRS approves a modification based on the tax-exempt status of a partner, the IRS is not precluded from examining whether the partner was in fact tax-exempt for the same year in a separate proceeding. A review of or request for any information or documents provided as part of modification does not constitute an examination, inspection, or administrative proceeding with respect to any person other than the partnership. Accordingly, even in the case of an election under section 6226, and where certain modifications may affect what adjustments a partner take into account under proposed § 301.6226-3, nothing in these proposed regulations prohibits the IRS from examining that partner's return and re-determining items that were affected by a previously approved modification.

A partnership requesting modification must substantiate the facts supporting a request for modification to the satisfaction of the IRS. The particular documents and other information that may be required are based on the type of modification requested. The IRS may, in forms, instructions, or other guidance, require particular documents or other information to substantiate a particular type of modification

or impose other information-reporting or recordkeeping requirements on partnerships requesting modification.

For all requests, the partnership representative must furnish to the IRS upon request, a detailed description of the structure, allocations, ownership, and ownership changes of the partnership, its partners, and, if relevant, any indirect partners for each taxable year relevant to the request, as well as all partnership agreements (including side agreements) for each relevant taxable year with respect to each modification request. In the case of a modification requested by the partnership with respect to an indirect partner, the IRS may require certain information related to the pass-through partner(s) through which the indirect partner holds its interest in the partnership subject to the administrative proceeding. For instance, in the case of amended return modification by an indirect partner, the IRS may require the partnership to provide any information necessary to determine whether the indirect partner has taken the correct amount of the adjustments into account. Such information may include information similar to amended returns for any partnership-partner through which the adjustments are flowed before being taken into account by the indirect partner. The IRS will deny modification if a partnership fails timely to provide information the IRS determines is necessary to support and substantiate a request for modification.

Proposed § 301.6225-2(c)(3)(ii) provides that the partnership may request an extension of the 270-day period described in proposed § 301.6225-2(c)(3)(i), and proposed § 301.6225-2(c)(3)(iii) provides that the 270-day period described in proposed § 301.6225-2(c)(3)(i) closes early when the partnership representative and the IRS agree, in writing, to waive the 270-day delay between the mailing of the NOPPA and when the IRS may first issue an FPA described in section 6231(a) (flush language). The waiver of the 270-day period would prevent the partnership from providing modification-related information after the date the waiver was executed, and it would also allow the IRS to issue an FPA earlier than normal. This may be desirable for a partnership if the partnership does not intend to seek modification, but the partnership does want to



litigate the adjustments or make an election under section 6226. This could also occur in conjunction with the partnership's waiver of the requirement that the IRS issue an FPA before making a partnership adjustment, for example, if the partnership agrees to the adjustments. Proposed § 301.6225-2(c)(4) describes the method by which the IRS will approve modification requests.

#### D. Types of modification

Proposed § 301.6225-2(d) provides seven enumerated types of modifications the IRS will consider if requested by the partnership. Additionally, the IRS may consider alternative forms of modification under proposed § 301.6225-2(d)(9). Unless otherwise stated in proposed § 301.6225-2(d), a partnership may request any or all of the types of modification described in that paragraph. See proposed § 301.6225-2(d)(1).

##### i. Amended Returns

A partnership may request modification of an imputed underpayment if a reviewed year partner (or indirect partner) of a partnership files one or more amended returns that take into account a partnership adjustment or a portion of a partnership adjustment. See proposed § 301.6225-2(d)(2)(i). The reviewed year partner (or indirect partner) filing the amended return(s) must take into account the appropriate adjustments (or portion thereof) and also address the effects of such adjustments on any tax attributes (as defined in proposed § 301.6241-1(a)(10)) that must be adjusted because the partnership adjustments were taken into account. 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. The Treasury Department and the IRS seek comments on how best to streamline this process for ease of administering the amended return modification process.

The partners' amended returns must be filed with the IRS in accordance with the applicable forms and instructions pre-

scribed by the IRS, and the partnership representative must provide affidavits from each partner for which modification is sought that the partner did in fact file amended returns and make appropriate payments. See proposed § 301.6225-2(d)(2)(iii). Any payment due as a result of adjustments taken into account on an amended return is due at the time the partner's amended return is filed. See proposed § 301.6225-2(d)(2)(ii).

Any partner that files an amended return for modification purposes and is required to make a payment of any kind with that amended return must do so prior to the expiration of the period of limitations under section 6501 for the modification year(s). See proposed § 301.6225-3(d)(2)(v). Section 6225(c)(2) provides that partners may file amended returns "notwithstanding section 6511," and consequently, a partner may file an amended return that seeks a refund (such as in the case of a reallocation of a distributive share as described in proposed § 301.6225-2(d)(2)(vi)) at any time. A request for refund filed as part of an amended return filed for modification purposes outside the period set forth in 6511 may only request a refund for adjustments related to the partnership proceeding and relevant correlative adjustments. A partner may not request a refund through the amended return modification procedures outside the period set forth in section 6511 for adjustments that are not a direct result of the partnership adjustments determined in the partnership-level proceeding. See proposed § 301.6225-2(d)(2)(v)(B).

If, however, the IRS must make an assessment to collect a payment due with respect to an amended return filed during modification, the partner's period of limitations under section 6501 must not have expired at the time the amended return is filed. Nothing in the proposed regulations prevents partners from signing an extension of the period of limitations for partnership adjustments at the time the IRS initiates the partnership administrative proceeding or at any other time prior to the expiration of the period of limitations under section 6501. The IRS recognizes that securing such extensions may not be possible in all cases, but doing so may be an option for certain partners and partnerships. Alternatively, there may be other modification alternatives for a partner

whose assessment period under section 6501 with respect to the modification years (as defined in proposed § 301.6225-2(d)(2)(iv)) has expired. A partner may, for example, be able to enter into a closing agreement that allows for treatment similar to an amended return and to make a payment on behalf of the partnership's liability in recognition of what the partner would have filed and paid if the partner's assessment period had not already expired.

In general, there is no requirement that all reviewed year partners of a partnership file amended returns for the partnership to request amended return modification. However, in the case of a reallocation adjustment, in general, in order for the IRS to approve the modification, all partners affected by the reallocation adjustment must file amended returns related to the reallocation adjustment. See proposed § 301.6225-2(d)(2)(vi). In certain cases, a partnership may be able to demonstrate that a partner subject to a reallocation adjustment has taken into account that partner's relevant adjustment via some other type of modification that may not require an amended return. For instance, if one partner is a tax-exempt entity for which the partnership may request modification based on that partner's tax-exempt status (as described in proposed § 301.6225-2(d)(3)), and that partner is subject to a reallocation adjustment, 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). Such determinations will depend on the facts and circumstances related to the particular modification and are within the discretion of the IRS.

The Treasury Department and the IRS propose a specific rule that addresses pass-through partners in proposed § 301.6225-2(d)(2)(vii). A pass-through partner (as defined in proposed § 301.6241-1(a)(5)) may, for modification purposes only, file an amended return and take into account its allocable share of the adjustments. A pass-through partner that does so must pay an amount calculated in the same manner as the safe harbor amount under proposed § 301.6226-2(g) on the pass-

through partner's share of the partnership adjustment except that, for purposes of calculating the payment amount, instead of using the tax rate under section 6225(b)(1)(A), the tax rate 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) of the Code (determined without regard to section 1(h)).

An amended return filed by a pass-through partner without a payment (when required based on the adjustments) will not result in modification for the partnership. See proposed § 301.6225-2(d)(2)(vii). An amended return filed by a pass-through partner is not an administrative adjustment request as defined in section 6227 and the regulations thereunder, but rather is a stand-alone document that is filed solely for modification purposes.

Regardless of the number of pass-through partners or tiers involved in a partnership structure, all amended returns filed by a pass-through partner and its owners must be filed with the IRS and any tax, penalties, additions to tax, and interest due with respect to such amended returns must be paid within the 270-day modification period described in proposed § 301.6225-2(c)(3)(i). Modification is allowed to the extent amended returns are filed and any necessary payments are made within the 270-day time period.

Because amended return modification requires a partner to fully take into account all adjustments allocable to that partner, a partnership may not request additional modification with respect to a partner who files and takes into account adjustments on an amended return. See proposed § 301.6225-2(d)(2)(i). This restriction exists because a partner that files an amended return has fully accounted for the adjustment and allowing, for example, a further rate reduction would produce a double benefit at the partnership level.

If a partner files an amended return for modification purposes which leads to a reduction in the imputed underpayment based on the IRS's approval of that modification request, the partner waives its ability to file further amended returns for the modification years with respect to items related to the partnership adjustments and the imputed underpayment un-

less the partner receives permission from the IRS to do so. See proposed § 301.6225-2(d)(2)(vii)(B). The intent of this provision is to prevent a partner from filing an amended return for modification purposes, paying some additional amount due and then, after the partnership receives modification, filing another amended return claiming a refund for the same amount on which the partnership relied as part of its modification request.

In addition, partners filing amended returns under section 6225 do so as part of the proceeding under subchapter C of chapter 63, which means that they are bound by the partnership representative's actions pursuant to section 6223. If the partnership representative agrees to an imputed underpayment that was modified due to a partner filing an amended return, the partner is bound to that modification through section 6223 and may not change the partner's position related to the partnership adjustments that were taken into account in a way that is inconsistent with the partnership representative's actions. Nonetheless, the IRS understands that situations may arise in which a partner needs to file a further amended return for an unrelated reason, and the partner may request permission from the IRS to do so if necessary. The Treasury Department and the IRS seek comments on the most efficient ways that taxpayers may request permission from the IRS to file a subsequent amended return.

In addition, a partner can only file an amended return with respect to items stemming from a partnership under the procedures set forth in subchapter C of chapter 63, that is, the amended return modification procedures. See proposed § 301.6225-2(d)(2)(vii)(A).

## ii. Tax-exempt Partners

A partnership may request modification based on the status of its tax-exempt partners. If the IRS approves that modification, the imputed underpayment is calculated without regard to the portion of the partnership adjustment that is allocable to the tax-exempt partner and with respect to which the partner would not be subject to tax for the reviewed year by reason of its status as a tax-exempt entity.

The modification request is based on the tax-exempt status of the partner during the reviewed year. See proposed § 301.6225-2(d)(3)(i).

For the purposes of modification, section 6225(c)(3) provides that a tax-exempt entity is defined pursuant to section 168(h)(2). Proposed § 301.6225-2(d)(3)(ii) further provides that status as a tax-exempt entity for purposes of modification is determined in accordance with the definitions provided under section 168(h)(2)(A), (C), and (D) without reference to section 168(h)(2)(B) and (E). Section 168(h)(2)(B) and (E) do not define categories of entities that are treated as tax-exempt entities, but rather impose limits on the extent to which certain property leased to tax-exempt entities is entitled to special treatment as "tax-exempt use property" with respect to depreciation deductions available to a lessor. As such, those provisions are inapplicable to the determination of tax-exempt status for purposes of the modification process.

Some tax-exempt entities may receive income for which they are subject to tax. For example, section 511 imposes a tax on unrelated business taxable income received by certain tax-exempt entities. Additionally, section 871, section 881, and section 882 impose tax on certain income received by foreign persons. A partnership may request modification based on an adjustment allocable to a tax-exempt partner only to the extent that the partnership demonstrates to the satisfaction of the IRS that the tax-exempt partner would not have been subject to tax with respect to the adjustment allocable to the partner for the reviewed year. See proposed § 301.6225-2(d)(3)(iii).

A partnership's decision either to request or not to request modification in the course of an audit under these proposed regulations may raise issues concerning whether and to what extent any benefit that might result from its request or failure to request modification could be considered to have been provided to any person in lieu of to a tax-exempt partner (whether a current or former partner, and at any "tier" of the partnership). For example, such a transfer of benefit may raise issues for one or more partners with respect to: (1) the status of a tax-exempt partner because of private inurement or private ben-

efit under section 501(c); (2) excise taxes under chapter 42 of subtitle D of the Code or under sections 4975, 4976, or 4980; or (3) requirements under title I of the Employee Retirement Income Security Act of 1974, Public Law No. 93-406 (88 Stat. 829 (1974)) as amended (ERISA), such as the fiduciary responsibility rules under part 4 thereof. Some of these issues may be addressed by including appropriate provisions in the partnership agreement. However, the Treasury Department and the IRS request comments from the public on whether guidance is needed to address these potential issues and, if so, on possible ways to resolve such issues. Any such comments related to title I of ERISA will be shared with the Department of Labor.

### iii. Rate Modification

Section 6225(c)(4) provides the opportunity for a partnership to request to modify an imputed underpayment by changing the tax rate applied to the portion of the total netted partnership adjustment allocable to a C corporation or an individual with respect to capital gains and qualified dividends. If the partnership has partners that are C corporations or individuals, the partnership may request that a lower rate apply to those portions, but that lower rate will be the highest rate in effect with respect to the type of income and partner for whom modification is requested. See proposed § 301.6225-2(d)(4).

### iv. Certain Passive Losses of Publicly Traded Partnerships (PTPs)

Section 6225(c)(5) provides an opportunity for publicly traded partnerships (as defined in section 469(k)(2)) to request to modify an imputed underpayment in the case of a net decrease in a specified passive activity loss for specified partners. Proposed § 301.6225-2(d)(5)(ii) defines specified passive activity losses, and proposed § 301.6225-2(d)(5)(iii) defines specified partners. This modification is available both to partnerships that are publicly traded partnerships and with respect to partners (and indirect partners) that are publicly traded partnerships. 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. The reduction in suspended passive loss carryovers is binding on the specified partners pursuant to section 6223 and the regulations thereunder. The Treasury Department and the IRS seek comments on how the requirement to notify partners can most efficiently be accomplished.

### v. Other Forms of Modification under Section 6225(c)(6)

Section 6225(c)(6) provides that the IRS may prescribe additional types of modification through regulations. In these proposed regulations, the IRS is proposing three specific additional methods of modification and one general provision for additional types of modification to be considered at a later time.

Proposed § 301.6225-2(d)(6) allows a partnership to request modification of the number and composition of imputed underpayments. This provision specifically allows modifications of the process described in proposed § 301.6225-1(e), in which a specific imputed underpayment may be appropriate. The IRS 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. For instance, the IRS may determine it is appropriate to deny the calculation of a specific imputed underpayment by the partnership if, as a result of the specific imputed underpayment calculation, there is an increase in number of the partnership adjustments that net to a net non-positive amount, causing them to be disregarded and treated as adjustments that do not result in an imputed underpayment, which would shift the net losses away from the partnership and the reviewed year and to the adjustment year.

A special modification has been allowed in proposed § 301.6225-2(d)(7) for partners that are qualified investment entities described in section 860. These entities may distribute deficiency dividends after the NOPPA has been issued, and, if the entities do so in compliance with section 860 and the regulations thereunder, the IRS 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. One concern regarding this form of modification is that a NOPPA proposes an imputed underpayment, but it is not a final amount, in that the partnership may still challenge the amount in the IRS Office of Appeals or in court, but, once a deficiency dividend is distributed and claim therefore is filed, the qualified investment entities have no opportunity to change their position if the partnership obtains a favorable result at a later date. Given this lack of finality, the Treasury Department and the IRS seek comments on whether this provision adequately allows qualified investment entities to use the modification process.

Finally, the IRS may 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. See proposed § 301.6225-2(d)(8). This type of modification may provide some flexibility for taxpayers for which other forms of modification may prove burdensome or difficult. In certain cases, however, closing agreements may not be appropriate for partners seeking to modify an imputed underpayment because the finality of a closing agreement may limit a partnership's ability to challenge the underlying adjustments in the IRS Office of Appeals or in court.

In addition to the enumerated types of modification described in proposed § 301.6225-2(d)(2) through (8), the IRS may, in its discretion, consider alternative types of modification not specifically discussed in proposed § 301.6225-2(d); the documentation necessary to substantiate such modifications may be set forth in forms, instructions, or other guidance prescribed by the Department of Treasury or the IRS. See proposed § 301.6225-2(d)(9). The IRS may issue further guidance to establish procedures related to additional alternative forms of modification. As with all forms of modification, the partnership must demonstrate that an alternative modification is accurate and appropriate.

The examples in proposed § 301.6225-2(e) demonstrate the rules of § 301.6225-2.

### *E. Treatment of adjustments that do not result in an imputed underpayment*

Proposed § 301.6225-1(c)(2) sets forth the three circumstances in which partnership adjustments do not result in an imputed underpayment. Under that paragraph, a partnership adjustment does not result in an imputed underpayment: (1) if the adjustment relates to a distributive share reallocation that is disregarded under proposed § 301.6225-1(d)(2)(ii), (2) if after grouping and netting the adjustments, the result is a net non-positive adjustment under proposed § 301.6225-1(d)(3)(ii), or (3) if the calculation under proposed § 301.6225-1(c)(1) of this section results in an amount that is zero or less than zero.

Proposed § 301.6225-3 sets forth the rules for the treatment of adjustments that do not result in an imputed underpayment. In general, 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. One of the exceptions to this rule is for separately stated items under section 702. Proposed § 301.6225-3(b)(2) provides that if an adjustment is to an item that is required to be separately stated under section 702, the adjustment shall be taken into account by the partnership on its adjustment year return as an adjustment to such separately stated item. Proposed § 301.6225-3(b)(3) provides that an adjustment to a credit is also taken into account as a separately stated item. However, 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. Such adjustments are taken into account by the reviewed year partners under section 6226.

#### **i. Allocation of Adjustments That Do Not Result in an Imputed Underpayment**

Generally, the proposed regulations are silent with respect to the allocation of adjustments that do not result in an imputed underpayment, leaving their allocation to the partnership agreement. Section 301.6225-3(b)(3) proposes rules, how-

ever, governing those allocations, or lack thereof, in limited circumstances.

An adjustment that does not result in an imputed underpayment pursuant to § 301.6225-1(c)(2)(i) is allocated to those adjustment year partners who are the reviewed year partners with respect to whom the amount was reallocated. This rule is intended to prevent the allocation of such an item back to the partner from whom it was reallocated in connection with the audit. If the reviewed year partners with respect to whom the amount was reallocated are not adjustment year partners, then such adjustment is allocated to the adjustment year partners who are the successors to those reviewed year partners or, if no successors are identifiable or do not exist, among adjustment year partners according to the adjustment year partners' distributive shares.

If as part of the modification process under § 301.6225-2, a partner takes into account an adjustment that would otherwise not result in an imputed underpayment, the adjustment is not allocated to any partner for the adjustment year because the reviewed year partner has already taken its share of the adjustment into account. See proposed § 301.6225-3(b)(5). Allocating such an adjustment in the adjustment year would result in double counting.

In addition, if proposed § 301.6226-3 applies with respect to an adjustment that does not result in an imputed underpayment, proposed § 301.6225-3 does not apply to that adjustment, and the adjustments are taken into account under the rules governing section 6226. See proposed § 301.6225-3(b)(6). Finally, the rules of subchapter K apply with respect to adjustments taken into account under § 301.6225-3. See proposed § 301.6225-3(c).

### *F. Notice 2016-23 comments related to section 6225*

As discussed above, section 6225 generally requires that adjustments be taken into account for purposes of computing the imputed underpayment, except that adjustments that do not result in an imputed underpayment are taken into account in the adjustment year. Section 6241(4) prescribes the treatment of the imputed underpayment as a nondeductible payment by the partnership, but is other-

wise silent regarding the effect of the adjustments themselves on the partnership, the reviewed year partners, or the adjustment year partners. In response to Notice 2016-23, 2016-12 I.R.B. 490, commenters requested that the effect of partnership adjustments on basis be addressed in the regulations. One commenter recommended that regulations provide that a partnership that pays an imputed underpayment attributable to an adjustment to an item of income, gain, loss, or deduction, allocate that item in the adjustment year to the adjustment year partners treating such items as items of income, gain, loss, or deduction as non-taxable or deductible under sections 705(a)(1)(B) or (2)(B). The commenter explained that adjustments to basis and capital accounts are necessary to ensure that inside and outside basis remain congruent and to ensure that income, gain, loss, and deduction are not taxed twice. The Treasury Department and the IRS intend to adopt the approach the commenter recommended and to provide additional rules providing for adjustments to the inside basis and book value of any partnership property if the partnership adjustment is a change to an item of gain, loss, amortization or depreciation (i.e., the change is basis derivative). Adjustment items taken into account on an amended return in connection with a modification to an imputed underpayment should not be allocated in the adjustment year. The proposed regulations reserve a place for these rules.

The commenter that recommended that a partnership allocate adjustment items in the adjustment year to the adjustment year partners as items described in sections 705(a)(1)(B) or (2)(B) also recommended that the allocations should be made in accordance with the partnership agreement and subject to the existing "substantial economic effect" requirements under section 704. The Treasury Department and the IRS request comments on whether, instead, it would be appropriate to allocate partnership adjustments that result in an imputed underpayment (meaning they are not taken into account by the partnership in the adjustment year under section 6225(a)(2)) only to adjustment year partners that are allocated part of the section 705(a)(2)(B) expense related to the partnership's payment of the imputed

underpayment. The Treasury Department and the IRS also request comments on whether partnership adjustments arising from a reviewed year allocation that is reallocated from one partner to another partner require special rules restricting their allocations in the adjustment year to the partners from and to whom the item was reallocated and how to address successor partners or situations where the reviewed year partner has received a liquidating distribution and is no longer a partner.

Another commenter suggested that the IRS should have to provide evidence of a net underpayment of tax prior to making an adjustment because in some cases the tax may simply have been paid by the wrong partner (for example, with a reallocation adjustment). This suggestion is contrary to the compliance function of the IRS, and therefore, the IRS has declined to propose such a rule. The suggestion is also contrary to the statutory framework of the centralized partnership audit regime generally, and the rules for determining the imputed underpayment specifically. Section 6225(b)(2) specifically provides rules for how the IRS should make reallocation adjustments, which appear to be contrary to the commenter's suggestion.

Another commenter asked for safeguards similar to the mitigation provisions to prevent an overpayment of tax. The proposed regulations do not specifically address the mitigation provisions already in place under the Code, but there is nothing in the proposed regulations related to the centralized partnership audit regime that would prevent a partner or the partnership from pursuing mitigation, if appropriate. Therefore, no change in the mitigation procedures is necessary.

Commenters requested that the IRS address credit recapture situations and how those items are affected by the centralized partnership audit regime. The proposed regulations do not specifically address those issues. However, proposed § 301.6225-1(a)(2) provides that the calculation of the imputed underpayment will take into account all applicable preferences, restrictions, limitations, and conventions under the Code. Therefore, the proposed regulations provide flexibility to permit the IRS, during the examination, to account for credit recapture. The Treasury Department and IRS re-

quest additional comments on how credits should be managed within the framework of the proposed regulations.

One commenter discussed several ways to account for adjustments to creditable foreign tax expenditures (CFTEs) under the BBA. One recommended approach was to account for a decrease to CFTEs as a decrease to credits, while treating an increase to CFTEs as an adjustment that is disregarded for purposes of the imputed underpayment (to account for limitations and other considerations). Under this recommendation, an increase in CFTEs that is disregarded for purpose of calculating the imputed underpayment would be reported as a separately stated item in the adjustment year. The commenter noted that taxpayers would have the option to achieve an accurate result through the modification process. This recommendation is generally consistent with the broader approach taken in the proposed regulations; however, the Treasury Department and the IRS are reserving on the treatment of CFTEs and other adjustments affecting the amount of foreign tax credit that might be allowable to partners. The comments received did not provide a detailed recommendation with respect to the treatment of other adjustments relating to the foreign tax credit calculation, and the Treasury Department and IRS request comments on how adjustments affecting foreign tax credit calculations should be taken into account within the framework of the centralized partnership audit regime, including possible ways to account for adjustments to items sourced or calculated at the partner level, such as interest expense and deemed paid credits.

Commenters asked that the tax attributes of adjustment year partners be taken into account when determining modification. This suggestion was not adopted for a number of reasons. First, section 6225(d) and proposed § 301.6241-1(a)(1) provide that the adjustment year is not determined until the adjustments are final. The partnership must seek modification prior to when the adjustment year is determined, potentially more than a calendar year before and even longer if the partnership seeks judicial review of the FPA. Because the adjustment year has not yet been determined at the time modification

must be requested, there would be no way for the IRS or the partnership to know who the adjustment year partners should be.

Further, the text of section 6225 indicates that reviewed year partners are the appropriate partners with respect to which modification may be requested. For instance, the amended return modification provision under section 6225(c)(2)(A)(i) explicitly requires a partner to file an amended return for the partner's taxable year which includes the end of the reviewed year of the partnership. When filing that amended return, the partner must take the adjustments "properly allocable to such partners" in the reviewed year into account. Section 6225(c)(2)(A)(ii). It would be nonsensical for an adjustment year partner that was not also a reviewed year partner to file an amended return for the reviewed year taking any amount into account. Similarly, section 6225(b)(1)(A) provides that the imputed underpayment is calculated based on the highest tax rate in effect for the reviewed year, and rate modification under section 6225(c)(4)(A) relates specifically to a reduction in the rates in effect for the reviewed year by allowing for application of the rate of tax lower than the rate described in subsection (b)(1)(A), that is, the reviewed year rates. Finally, with respect to rate modifications under the rule for special allocations in section 6225(c)(4)(B)(ii), by statute, the rate modification is based specifically on a partner's distributive share of net gains and losses if the partnership had sold all of its assets at the close of the reviewed year. Such a rule cannot be applied to an adjustment year partner that was not also a reviewed year partner. In light of the statutory references to the reviewed year, it would be incongruous to key certain modifications off of the reviewed year partners and others off of adjustment year partners.

In addition, the partnership can control who its current year partners are and could admit partners to the partnership for the sole purpose of improving the results of a modification, even attempting to inappropriately eliminate the imputed underpayment. As a result, modification generally must take into changes to tax that result from the reviewed year partner taking the partnership adjustments into account. Finally, modification applies to reviewed

year partners because their attributes are the most relevant to determining the proper amount of taxes and other liabilities owed by the partnership and its partners with respect to partnership adjustments related to the reviewed year. Adjustment year partners' tax attributes are generally relevant to what is reported on the adjustment year return, not to the reviewed year exam.

Commenters requested clarification as to how modification would apply if only some of the partners filed amended returns. Section 6225(c)(2)(B) requires that all affected partners file amended returns only in the case of an adjustment involving the reallocation of distributive shares among partners. Proposed § 301.6225-2(b) provides the rules for how modification adjustments are taken into account in calculating the modified imputed underpayment, and proposed § 301.6225-2(d)(2) provides specific rules related to amended return modification. Other than in the case of a reallocation adjustment, these rules allow some partners to file amended returns without requiring that all partners file amended returns. A partnership will be granted amended return modification to the degree that the partners (or indirect partners) in a partnership participate in the amended return modification process.

Even in the case of a reallocation adjustment, if the partners can demonstrate the affected partners' adjustments were fully taken into account through some other form of modification, the IRS may determine that that requirement was met without all partners' filing amended returns because the partners have met the spirit of the statute's requirements (that is, taking into account adjustments at the partner level). With the exception of the reallocation adjustment rule, if some partners choose to participate in amended return modification, the partnership will receive modification for those partners' amended returns. The partnership will not receive modification for partners that choose not to file amended returns unless those partners satisfy another modification provision as demonstrated by the partnership.

Commenters requested clarification regarding whether a partner may file an amended return if the statute of limitations

on assessment was closed for the year the partnership return was filed or to allow partners to file limited amended returns related to closed years. Proposed § 301.6225-2(d)(2)(v) prevents partners from filing amended returns for modification purposes that require payment of tax after the period of limitations on assessment under section 6501 is closed. Although section 6225(c)(2) provides that amended returns may be filed "notwithstanding section 6511," the statute provides no such exception for the statute of limitations under section 6501. As a result, there are limits on which partners will be permitted to file an amended return under the modification procedures. Partners that are precluded from filing amended returns due to an expired section 6501 period may be eligible for other forms of modification, such as closing agreement modification under proposed § 301.6225-2(d)(8), or partners and the partnership may choose to make other arrangements where the partner pays the imputed underpayment on behalf of the partnership outside of the modification procedures.

Commenters requested that partners be able to modify at various tiers within a partnership's ownership structure (that is, modification of indirect partners). This suggestion has been adopted. For example, see the amended return modification under proposed § 301.6225-2(d)(2)(vii), which provides a special rule for pass-through partners. Under these rules, if the modification provisions are satisfied with respect to indirect partners, partnerships may seek modification with respect to the partners as well as the indirect partners.

Another commenter asked for an additional 270 days after the issuance of the notice of final partnership adjustment, during which the partners could file amended returns. Section 6225(c) provides that the information required for modification purposes must be provided to the IRS within 270 days of the issuance of the NOPPA unless the IRS consents to an extension. The proposed regulations closely follow these rules. Accordingly, a request for an extension of the 270-day period will be considered by the IRS on a case by case basis. See proposed § 301.6225-2(c)(3).

Commenters requested that partners be allowed to certify that they have filed amended returns so that the partners do not have to provide their amended return information directly to the partnership or the partnership representative. This suggestion was incorporated in proposed § 301.6225-2(d)(2)(iii). Under this section, partners must file their returns in accordance with forms and instructions for filing amended returns for modification purposes, and the partnership representative must provide certifications from those partners to the IRS employee conducting the administrative proceeding.

Commenters requested that the IRS allow the partners to pay any taxes due related to their amended returns either at the time the amended returns are filed or through any available IRS administrative collection process. The Treasury Department and the IRS declined to propose this rule at this time. The IRS seeks comments as to how the IRS might allow more flexibility for taxpayers with respect to payment, while at the same time ensuring that partners in partnerships that request amended return modification are committed to taking into account the adjustments relevant to their amended returns.

Commenters requested that an alternative modification be available to partners that involved a summary or schedule of adjustments that reflect what would happen if an amended return were filed, rather than requiring the partners to file amended returns. The IRS will take into account closing agreements entered into as partners to the degree they affect the imputed underpayment, and partners could use this modification option to accomplish the goal of avoiding amended returns. The Treasury Department and the IRS request comments on additional possible options for modification that would simplify the amended return process as well as the process for other types of modification.

Commenters requested that the IRS permit modifications for taxes already paid, for example, on a partner's reviewed year return filed inconsistently with the partnership's reviewed year return. This suggestion was not adopted, but the IRS will allow modification with respect to closing agreements entered into by partners and other modification options. See proposed § 301.6225-2(d). Other com-

menters requested that the IRS allow qualified investment entities to use the deficiency dividend procedures under section 860 in modification. The proposed regulations adopt this suggestion. See proposed § 301.6225-2(d)(7).

#### *6. Election for the Alternative to Payment of the Imputed Underpayment*

Proposed § 301.6226-1(a) provides that a partnership may elect under section 6226 to “push out” adjustments to its reviewed year partners rather than paying the imputed underpayment determined under section 6225. If a partnership makes a valid election in accordance with proposed § 301.6226-1, the partnership is no longer liable for the imputed underpayment. A partnership may make an election under this section with respect to one or more imputed underpayments identified in an FPA. For example, where the FPA includes a general imputed underpayment and one or more specific imputed underpayments, the partnership may make an election under this section with respect to any or all of the imputed underpayments.

Proposed § 301.6226-1(b)(1) provides that if a partnership makes a valid election in accordance with proposed § 301.6226-1, the reviewed year partners of the partnership are liable for tax, penalties, additions to tax, and additional amounts, as well interest on such amounts, after taking into account their share of the partnership adjustments determined in the FPA. Any modifications approved by the IRS under proposed § 301.6225-2 are also reported to the reviewed year partners. In addition, under proposed § 301.6226-1(b)(2), adjustments that do not result in an imputed underpayment described in § 301.6225-1(c)(2)(i) and (ii) are not taken into account by the partnership in the adjustment year and instead are included in the reviewed year partners’ share of the partnership adjustments reported to the reviewed year partners of the partnership.

Under proposed § 301.6226-1(c), an election under section 6226 is not valid unless the partnership complies with all the provisions for making the election under proposed § 301.6226-1 and the provisions under proposed § 301.6226-2 requiring the partnership to furnish statements to the reviewed year partners

and file those statements electronically with the IRS. An election under proposed § 301.6226-1 may only be revoked with the consent of the IRS.

Proposed § 301.6226-1(c)(2) provides that if the IRS determines that an election under section 6226 is invalid, the IRS will notify the partnership and the partnership representative (within 30 days of the determination) that the election is invalid and provide the reason why the election is invalid. Proposed § 301.6226-1(c)(2) provides that a final determination that the election is invalid means that the partnership is liable for any imputed underpayment to which the election related, as well as any penalties and interest with respect to the imputed underpayment determined under section 6233. An election under proposed § 301.6226-1 is valid until the IRS determines the election is invalid.

#### *A. Making the election under section 6226*

Under proposed § 301.6226-1(c)(3), a partnership may only make an election under section 6226 within 45 days of the date the FPA was mailed by the IRS. The time for filing the election may not be extended. The election must be signed by the partnership representative and filed with the IRS in accordance with forms, instructions, and other guidance. Proposed § 301.6226-1(c)(4)(i). Proposed § 301.6226-1(c)(4)(ii) provides that the election must include the name, address, and correct taxpayer identification number (TIN) of the partnership, the taxable year to which the election relates, the imputed underpayment(s) to which the election applies (if there is more than one imputed underpayment in the FPA), each reviewed year partner’s name, address, and correct TIN, and any other information required under forms, instructions, and other guidance. A copy of the FPA to which the election relates must also be attached to the election.

As stated in proposed § 301.6226-1(d), an election under section 6226, which includes filing and furnishing the statements described in proposed § 301.6226-2, is an action taken by the partnership under section 6223 and the regulations thereunder. Accordingly, all reviewed year partners are bound by the election and each reviewed year partner

must take the adjustments on the statement into account in accordance with section 6226(b) and report and pay additional chapter 1 tax (if any) pursuant to proposed § 301.6226-3. Therefore, a reviewed year partner may not treat items reflected on a statement described in proposed § 301.6226-2 inconsistently with how those items are treated on the statement that the partnership files with the IRS. See proposed § 301.6222-1(c)(2) (regarding items the treatment of which a partner is bound to under section 6223).

The Treasury Department and the IRS request comments from the public on whether guidance is needed on how to address potential issues arising with respect to tax-exempt entities as a result of an election under section 6226 and, if so, on possible ways to resolve such issues. For instance, if a tax exempt entity’s share of the amounts under section 6226 is investment income, issues may arise regarding how a section 6226 election might affect the entity’s public support calculation (if the entity is a publicly-supported organization) or the applicable net investment income tax (if the entity is a private foundation).

#### *B. Filing statements with the IRS and furnishing statements to reviewed year partners*

Proposed § 301.6226-2(a) provides that a partnership making an election under section 6226 must furnish statements to the reviewed year partners with respect to the partner’s share of the adjustments and file those statements with the IRS in the time, form, and manner prescribed by proposed § 301.6226-2(b) and (c). Proposed § 301.6226-2(a) further provides that the statements furnished to the reviewed year partners under section 6226 are in addition to, and must be filed and furnished separate from, any other statements required to be filed with the IRS and furnished to the partners for the taxable year, including any Schedules K-1, *Partner’s Share of Income, Deductions, Credits, etc.*. Therefore, the partnership may not include the partnership adjustments that are to be taken into account by the reviewed year partners under section 6226 in any Schedule K-1 required to be

furnished to the partner under section 6031(b). Similarly, the partnership must furnish separate statements for each reviewed year at issue and cannot combine multiple reviewed years (if any) into a single statement.

Under proposed § 301.6226-2(b), the statements must be furnished to the reviewed year partners no later than 60 days after the date the partnership adjustments become finally determined. The partnership adjustments become finally determined upon the later of the expiration of the time to file a petition under section 6234 or, if a petition is filed under section 6234, the date when the court's decision becomes final. Accordingly, if an FPA is mailed on June 30, 2020, and no petition is filed by the partnership, the partnership adjustments reflected in the FPA become finally determined on September 28, 2020 (at the conclusion of the 90-day petition period under section 6234). An example under proposed § 301.6226-2(b)(3) illustrates these rules.

Under proposed § 301.6226-2(b)(2), a partnership must furnish the statement to each reviewed year partner in accordance with the forms, instructions, or other guidance prescribed by the IRS. If the statements are mailed, it must mail the statements to each reviewed year partner using the current or last address for that partner that is known to the partnership. If a statement is returned to the partnership as undeliverable, a partnership must exercise reasonable due diligence to identify a correct address for the reviewed year partner to which the statement relates. Examples under proposed § 301.6226-2(b)(3) illustrate this rule. Under proposed § 301.6226-2(c), the partnership must electronically file the statements with the IRS, along with a transmittal that includes a summary of the statements and any other information required in the forms and instructions, by the date the partnership is required to furnish the statements to the reviewed year partners.

Under proposed § 301.6226-2(d), if a partnership discovers an error on a statement filed with the IRS, the partnership must correct the error within 60 days of the due date for furnishing the statements to partners and filing the statements with the IRS, as described in proposed § 301.6226-2(b) and (c). Under proposed

§ 301.6226-2(d)(2)(ii), if a partnership discovers an error after this 60-day period, the partnership may only correct the statements with the permission of the IRS in accordance with the forms, instructions, or other guidance prescribed by the IRS. If the IRS discovers an error in the statements, the IRS may require the partnership to correct the errors. If a partnership fails to correct an error as required by the IRS, the IRS may treat this as a failure to properly furnish statements to partners and file the statements with the IRS, and thus, allow the IRS to determine that the election under proposed § 301.6226-1 is invalid with the result that the partnership is liable for the imputed underpayment to which the election related. A partnership corrects an error in a statement by electronically filing the corrected statement with the IRS and furnishing the corrected statement to the affected reviewed year partner in accordance with the forms, instructions, and other guidance prescribed by the IRS. The adjustments contained on a corrected statement are taken into account by the reviewed year partner in accordance with proposed § 301.6226-3 for the reporting year (as defined in proposed § 301.6226-3(a)). Proposed § 301.6226-2(d)(4). Because reviewed year partners cannot file inconsistently with any statements furnished by the partnership under proposed § 301.6226-2 (see proposed § 301.6226-1(d)), this provision provides a partner a period during which the partner may notify the partnership of any errors in a statement and have the partnership furnish a corrected statement to the partner and file the corrected statement with the IRS.

#### i. Contents of the Statements

The statements described in proposed § 301.6226-2 must include the name and correct TIN of the reviewed year partner; the current or last address of the reviewed year partner that is known to the partnership; the reviewed year partner's share of items originally reported to the partner (taking into account any adjustments made under section 6227); the reviewed year partner's share of the partnership adjustments and any penalties, additions to tax, or additional amounts; modifications attributable to the reviewed year partner;

the reviewed year partner's share of any amounts attributable to adjustments to the partnership's tax attributes in any intervening year (as defined in proposed § 301.6226-3) resulting from the partnership adjustments allocable to the partner; the reviewed year partner's safe harbor amount and interest safe harbor amount (if applicable), as determined in accordance with proposed § 301.6226-2(g); the date the statement is furnished to the partner; the partnership taxable year to which the adjustments relate; and any other information required by the forms, instructions, or other guidance prescribed by the IRS. Proposed § 301.6226-2(e).

#### ii. Partner's Share of Adjustments and Other Amounts

Under proposed § 301.6226-2(f), a reviewed year partner's share of the adjustments that must be taken into account by the reviewed year partner must be reported to the reviewed year partner in the same manner as originally reported on the return filed by the partnership for the reviewed year. If the adjusted item was not reflected in the partnership's reviewed year return, the adjustment must be reported in accordance with the rules that apply with respect to partnership allocations, including under the partnership agreement. However, if the adjustments, as finally determined, are allocated to a specific partner or in a specific manner, the partner's share of the adjustment must follow how the adjustment is allocated in that final determination. Proposed § 301.6226-2(f)(1). In all cases, adjustments taken into account on any amended returns or closing agreements that are approved during the modification process under proposed § 301.6225-2(d)(2) and that are disregarded in determining the imputed underpayment are ignored for purposes of determining the reviewed year partners' share of the adjustments. However, these modifications are listed separately on the statements provided to the reviewed year partners. Although modifications are ignored for purposes of reporting the adjustments to the reviewed year partners, any reviewed year partner that took an adjustment into account and paid tax through an amended return or closing agreement as part of modification



with respect to that adjustment will not be taxed a second time with respect to that adjustment. This is true for two reasons. First, the partnership will inform the partner of any such adjustment in the statement furnished to that partner, per proposed § 301.6226-2(e). Therefore, the partner will know upon receipt of a statement that certain adjustments were taken into account by the partner and that those adjustments were disregarded in determining the imputed underpayment. Second, when computing the partner's tax that stems from such an adjustment (as described in proposed § 301.6226-3), the partner will account for the adjustment as part of that process, and the computation of the tax will reflect that the partner had already paid tax with respect to that adjustment during the modification phase of the audit. An example in proposed § 301.6226-3(g) illustrates this concept.

Any penalties, additions to tax, or additional amounts are reported to the reviewed year partners in the same proportion as each partner's share of the adjustments to which the penalties relate, unless the penalty, addition to tax, or additional amount is specifically allocated to a specific partner(s) or in a specific manner by a final court decision or in the FPA, if no petition is filed. Proposed § 301.6226-2(f)(2). Accordingly, if a penalty is determined with respect to a specific item or items, that penalty is reported to the reviewed year partners in the same manner as the adjustments to that specific item or items, unless otherwise provided in the FPA or a final court decision, for instance in a situation where there are partner-specific defenses to a penalty determined at the partnership level. If a penalty, addition to tax, or additional amount does not relate to a specific adjustment, each reviewed year partner's share of the penalty, addition to tax, or additional amount is determined in accordance with how such items would have been allocated under rules that apply with respect to partnership allocations, including under the partnership agreement, unless it is allocated to a specific partner in a specific manner in a final determination of the adjustments, in which case it is allocated in accordance with the final determination.

### *C. Computation of the tax resulting from taking adjustments into account*

Under proposed § 301.6226-3, a reviewed year partner that is furnished a statement under proposed § 301.6226-2 is required to pay any additional chapter 1 tax (additional reporting year tax) for the partner's taxable year which includes the date the statement was furnished to the partner in accordance with proposed § 301.6226-2 (the reporting year) that results from taking into account the adjustments reflected in the statement. The additional reporting year tax is either the aggregate of the adjustment amounts, as determined in proposed § 301.6226-3(b), or, if an election is made under proposed § 301.6226-3(c), a safe harbor amount.

In addition to being liable for the additional reporting year tax, the reviewed year partner of a partnership that makes an election under section 6226 must also pay, for the reporting year, the partner's share of any penalties, additions to tax, or additional amounts reflected in the statement, and any interest on such amounts. Interest is determined in accordance with proposed § 301.6226-3(d).

#### *i. Calculating the Aggregate of the Adjustment Amounts*

Under proposed § 301.6226-3(b), the aggregate of the adjustment amounts is the aggregate of the correction amounts determined under proposed § 301.6226-3(b). There are two correction amounts for these purposes – one for the partner's taxable year which includes the reviewed year of the partnership (first affected year) and a second correction amount for the partner's taxable years after the first affected year and before the reporting year (intervening years). These correction amounts cannot be less than zero, and any amount below zero after applying the rules in proposed § 301.6226-3(b) does not reduce any correction amount, any tax in the reporting year, or any other amount.

Under proposed § 301.6226-3(b)(2), the correction amount for the first affected year is the amount by which the reviewed year partner's chapter 1 tax would increase for the first affected year by taking into account the adjustments reflected in the statement provided to

the reviewed year partner under proposed § 301.6226-2. The correction amount for the first affected year is calculated by first determining the amount of chapter 1 tax that would have been imposed for the first affected year if the items as adjusted in the statement had been correctly reported in the first affected year. From that amount is subtracted the sum of the amount of chapter 1 tax shown by the partner on the return for the first affected year (which includes amounts shown on an amended return for such year, including an amended return filed under section 6225(c)(2) by the reviewed year partner) plus any amounts not shown but previously assessed (or collected without assessment) less any rebates made (as defined in § 1.6664-2(e)). In other words, the correction amount is equal to A minus (B plus C minus D). A is the amount of chapter 1 tax that would have been imposed had the items as adjusted been properly reported on the return for the first affected year. B is the amount shown as chapter 1 tax on the return for the first affected year (including amended returns filed under section 6225(c)(2) by a reviewed year partner). C represents any amounts not so shown previously assessed (or collected without assessment). D is the amount of rebates made. For purposes of applying this definition, an amount previously assessed includes an amount that was previously assessed as a result of the partner taking into account adjustments under section 6226(b) pursuant to an election made by a partnership other than the partnership making the current election.

Under proposed § 301.6226-3(b)(3), the aggregate correction amount for all intervening years is the sum of the correction amounts for each intervening year. Determining the correction amount for each intervening year is a year-by-year determination. The correction amount for each intervening year is the amount by which the reviewed year partner's chapter 1 tax would increase by taking into account any adjustments to any tax attributes. The correction amount for each intervening year is calculated by determining the amount of chapter 1 tax that would have been imposed for the inter-

vening year if any tax attribute for the intervening year had been adjusted after taking into account the partner's share of the adjustments for the first affected year (and if any tax attribute for the intervening year had been adjusted after taking into account any adjustments to tax attributes in any prior intervening year(s)). From that amount is subtracted the sum of the amount of chapter 1 tax shown by the partner on the return for the intervening year (which includes amounts shown on an amended return for such year, including an amended return filed under section 6225(c)(2) by the reviewed year partner) plus any amounts not shown but previously assessed (or collected without assessment) less any rebates made (as defined in § 1.6664-2(e)).

For instance, if a partner had a net operating loss on his original return for the first affected year that was carried forward into the intervening years, the net operating loss (a tax attribute as defined in proposed § 301.6241-1(a)(10)) in the first intervening year after the first affected year is reduced by any portion of the net operating loss utilized to offset the adjustments in the first affected year. This reduction may not only affect the first intervening year after the first affected year, but if not fully absorbed in that intervening year, it may have a cascading effect through the intervening years as the intervening years are adjusted to reflect the adjustment to the net operating loss carryforward.

A number of comments received in response to Notice 2016-23 suggested that the Treasury Department and the IRS should permit calculation of the additional reporting year tax to account for any decreases in chapter 1 tax that may have resulted in the first affected year or any intervening year after taking into account the partner's share of the partnership adjustments. However, section 6226(b) specifically describes the correction amounts as amounts by which a partner's chapter 1 tax would increase for each respective year. Section 6226(b)(2)(A) and (B). Accordingly, the proposed regulations reflect the statute and do not permit any decreases in chapter 1 tax that would result for the first affected year or for any intervening year to factor into the calculation of the additional reporting year tax.

## ii. Election to Pay the Safe Harbor Amount

Under proposed § 301.6226-3(c), a partner that is furnished a statement described in proposed § 301.6226-2 may elect under this section to pay the safe harbor amount (or the interest safe harbor amount, in the case of certain individuals) shown on the statement in lieu of the additional reporting year tax. The election is made on the partner's return for the reporting year. If a partner is furnished multiple statements described in proposed § 301.6226-2, the partner may elect to pay the safe harbor amount from some or all of the statements. For instance, if the IRS examined two partnership taxable years in the same administrative proceeding, and an election under section 6226 was made with respect to all imputed underpayments for both years, the partnership would be required to furnish separate statements to its reviewed year partners and to calculate separate safe harbor amounts for each year. A reviewed year partner could elect to pay the safe harbor amount for one taxable year, but not the other taxable year. If a partner elects to pay the safe harbor amount, the partner must report the safe harbor amount on the partner's timely-filed return (excluding extensions) for the partner's reporting year. If the partner fails to do so, the partner may not utilize the safe harbor amount, but instead must compute the additional reporting year tax under proposed § 301.6226-3(b) as if no election under proposed § 301.6226-3(c) had been made.

Proposed § 301.6226-2(g) provides rules for the partnership to compute the safe harbor amount and the interest safe harbor amount, which cannot be less than zero, for inclusion in the section 6226 statement furnished to each reviewed year partner and filed with the IRS. For purposes of calculating the safe harbor amount, all of the allocation rules of proposed § 301.6226-2(f) apply. Under proposed § 301.6226-2(g), the safe harbor amount for each reviewed year is calculated in the same manner as the imputed underpayment under proposed § 301.6225-1 except that the adjustments allocated to the partner on the statement (including any amounts attributable to adjustments to

partnership tax attributes) are used instead of the adjustments that are taken into account for purposes of determining the imputed underpayment under proposed § 301.6225-1. With one exception, any approved modifications of the imputed underpayment, including a rate modification under section 6225(c)(4), has no effect on the determination of the safe harbor amount for any partner.

The one exception is where a reviewed year partner filed an amended return, or entered into a closing agreement, during the modification phase under section 6225(c)(2), and as a result, the imputed underpayment, to which an election under this section relates, was determined without regard to the adjustments taken into account on the amended return or in the closing agreement. In that case, such adjustments are not taken into account in determining that partner's safe harbor amount.

In addition to the safe harbor amount, a partnership must calculate an interest safe harbor amount for partners who are individuals and who have a calendar year taxable year. The interest safe harbor amount is calculated at the rate set forth in proposed § 301.6226-3(d)(4) from the due date (without extension) of the individual reviewed year partner's return for the first affected year until the due date (without extension) of the individual reviewed year partner's return for the reporting year.

A separate safe harbor amount (and interest safe harbor amount, if applicable) is calculated for each separate statement furnished to the partner under proposed § 301.6226-2. For example, if there are multiple reviewed years, the partner would receive a separate statement for each reviewed year, and there would be a separate safe harbor calculation and amount for each statement.

The purpose of the safe harbor amount (and the interest safe harbor amount) is to provide a simplified method for the reviewed year partner to take into account the reviewed year partner's share of the adjustments with respect to the partnership's reviewed year. Determining what the reviewed year partner's increase in chapter 1 tax would be in the partner's first affected year if the adjustments were taken into account in that year, the increase in chapter 1 tax that would have

occurred as a result of any adjustment to the tax attributes for each intervening year, and interest due for the first affected year and each intervening year could be very complex. In addition, because the statute only permits adjustments to increase, but not decrease, chapter 1 tax for any taxable year, adjustments taken into account under section 6226(b) do not fully reflect the tax consequences of treating the items correctly in the reviewed year. While the safe harbor amount also does not reflect the tax consequences of treating the items correctly in the reviewed year any better than the method prescribed by the statute, it is a reasonable alternative to approximate the tax that would have been due. In some cases, many years may have lapsed between the first affected year and the last intervening year, further complicating the calculation. Accordingly, while determination of the aggregate of the correction amounts provides a close but imperfect approximation of the partner's tax that would have been due if the partnership return was correct in the reviewed year, some partners may decide that the complexity and cost of doing the calculations necessary to determine the aggregate of the correction amounts is not worth the effort given that the aggregate of the correction amounts may not be exactly what the tax due would have been if the partnership return was correct in the reviewed year.

Under the proposed regulations, the safe harbor amount is computed so that partners filing amended returns under section 6225(c)(2) or entering into closing agreements are not paying tax twice on the same adjustment. In addition, the safe harbor amount is determined by multiplying the net adjustments against the highest tax rate under section 6225(b)(1)(A). Use of a fixed rate rather than requiring the reviewed year partner to determine the rate in the first affected year and the intervening years allows the partnership to compute the safe harbor amount for the reviewed year partner, further reducing burden on the reviewed year partner.

The election under section 6226 is a partnership election and the partners are bound by the election. See section 6223(b); proposed § 301.6226-1(d). Although reviewed year partners can avoid the computation under section 6226(b) by

filing an amended return (or entering into a closing agreement) and paying the tax and interest due in accordance with section 6225(c)(2) during the modification phase of the audit, not all partners are willing or able to amend their returns for the relevant year. Therefore, the Treasury Department and the IRS believe that it is important to allow partners an option to pay a simplified safe harbor amount in lieu of computing the correction amounts described under proposed § 301.6226-3(b) and a simplified interest safe harbor amount for certain individuals in lieu of computing the interest on the safe harbor amount under proposed § 301.6226-3(d)(2).

Any reviewed year partner may elect to pay the safe harbor amount, including reviewed year partners that are partnership-partners or S corporation partners.

### iii. Interest

Reviewed year partners are also liable for interest on any correction amount for the first affected year and any intervening years under proposed § 301.6226-3(d)(1). If the partner elects to pay the safe harbor amount, a reviewed year partner that is an individual may also elect to pay the interest safe harbor amount. For all other partners and individuals that do not elect the safe harbor amount, interest applies under proposed § 301.6226-3(d)(2). Interest on the correction amounts and the safe harbor amount is determined at the partner level. Under proposed § 301.6226-3(d)(4), the rate of interest is calculated using the underpayment rate under section 6621(a)(2), except that when determining that rate, five percentage points are used instead of three percentage points, with the result that the underpayment rate for purposes of section 6226 is the federal short-term rate plus five percentage points.

Under proposed § 301.6226-3(d)(1), a reviewed year partner is liable for interest on any correction amount from the first affected year and any intervening years from the due date of the return (without extension) for the applicable tax year (that is, the year to which the additional tax is attributable) until the correction amount is paid. For purposes of calculating interest, the safe harbor amount and any penalties, additions to tax, or additional amounts are

attributable to adjustments taken into account for the first affected year. Therefore, proposed § 301.6226-3(d)(2) and (3) provide that the reviewed year partner is liable for interest on the safe harbor amount and any penalties, additions to tax, or additional amounts from the due date of the return for the corresponding first affected year (without extension) until the reviewed year partner pays such amounts.

### D. *Qualified investment entities (QIEs): Regulated investment companies (RICs) and real estate investment trusts (REITs)*

The proposed regulations under section 6226 coordinate the rules under the centralized partnership audit regime with the deficiency dividend procedures under section 860 for partners that are RICs and REITs. In general, section 860 allows RICs and REITs to be relieved from the payment of a deficiency in (or to receive a credit or refund of) certain taxes including, among certain others, taxes imposed by sections 852(b)(1) and (3), 857(b)(1) or (3), and, if the entity fails the distribution requirements of section 852(a)(1)(A) or 857(a)(1), as applicable, the corporate income tax imposed by section 11(a) or 1201(a). The procedure provided by section 860 is to allow an additional deduction for “deficiency dividends” within the meaning of section 860(f) that meets the requirements of section 860 in computing the deduction for dividends paid for the taxable year for which a “determination” within the meaning of section 860(e) is made. Under proposed § 301.6226-2(h), if a statement described in proposed § 301.6226-2 is furnished to a reviewed year partner that is a RIC or REIT, the RIC or REIT may take into account the adjustments reflected in the statement that also are “adjustments” within the meaning of section 860(d) by using the deficiency dividend procedures set forth in section 860, subject to the limitations described in proposed § 301.6226-3(b)(4). Accordingly, a REIT or a RIC may utilize the deficiency dividend procedures under section 860 if the REIT or RIC receives a statement from a partnership under proposed § 301.6226-2 that includes adjustments within the meaning of section 860(d).

Section 301.6226-3(b)(4) of the proposed regulations coordinates rules for the deficiency dividend procedures set forth in section 860 with the rules for determining the additional reporting year tax under § 301.6226-3(b) with respect to any adjustments shown on a statement furnished to a RIC or REIT under proposed § 301.6226-2. Under these rules, if the statement described in proposed § 301.6226-2 results in any adjustment (within the meaning of section 860(d)) to a RIC or REIT for the first affected year or any intervening year, the RIC or REIT may make a determination under section 860(e)(4) and Rev. Proc. 2009-28, 2009-1 C.B. 1011, and avail itself of the deficiency dividend procedures set forth in section 860 and the regulations thereunder. If the RIC or REIT utilizes the deficiency dividend procedures with respect to adjustments in a statement described in proposed § 301.6226-2, the RIC or REIT may claim a deduction for deficiency dividends against the adjustments furnished to the RIC or REIT (to the extent they qualify as adjustments under section 860(d)) in calculating any correction amounts for the first affected year and any intervening year to the extent that the RIC or REIT makes deficiency dividend distributions under section 860(f) and complies with all requirements of section 860 and the regulations thereunder.

Also, if a RIC or REIT claims a deficiency dividends deduction, interest under proposed § 301.6226-3(d) is only calculated on any correction amount determined after deducting any deficiency dividend deduction from the adjustments taken into account by the RIC or REIT. Nothing in proposed § 301.6226-3(b)(4) affects a RIC's or REIT's liability for any interest on the deficiency dividend distribution under section 860(c)(1). Therefore, a RIC or a REIT will be liable for interest under section 860(c)(1) as to any deficiency dividend distribution as well as interest on any correction amount as determined under proposed § 301.6226-3(d). Because the deficiency dividend distribution is deductible in calculating the correction amounts, in no event will a RIC or REIT pay both interest under section

860(c)(1) and section 6226 as to the same amount.

Finally, as clarified in proposed § 301.6226-3(b)(4), a deficiency dividend deduction used in calculating any correction amount has no effect on a RIC or REIT's liability for any penalties reflected in the statement furnished to the RIC or REIT under proposed § 301.6226-2.

#### *E. Foreign partners and certain U.S. partners*

The proposed regulations reserve on rules that would apply when statements described in proposed § 301.6226-2 are provided to foreign partners, including foreign entities, or certain domestic partners. In general, certain amounts received by a partnership that are allocable to a foreign partner may be subject to withholding under chapter 3 of subtitle A of the Code (chapter 3), and certain amounts allocable to a foreign or domestic partner may be subject to withholding under chapter 4 of subtitle A of the Code (chapter 4). To the extent that amounts are withheld by the partnership or other withholding agent under chapter 3 or 4, and remitted to the IRS, such amounts are creditable by the foreign partner or domestic partner to offset the chapter 1 tax that the partner otherwise would owe in the absence of the withholding. The purpose of chapter 3 withholding is to ensure compliance by foreign persons with respect to income subject to tax under chapter 1, by requiring the partnership (or other withholding agent) to withhold and remit the tax that would normally be paid by the foreign person on payments or income allocated to the foreign person. The purpose of chapter 4 withholding is to ensure that information reporting about U.S. persons that use certain offshore financial accounts or passive foreign entities is available to the IRS to enhance tax compliance. The withholding imposed under chapter 4 may be imposed on certain foreign financial institutions, account holders of a financial account, or passive non-financial foreign entities with substantial U.S. owners, to incentivize the information required under chapter 4 to be reported and available to the IRS.

It is the view of the Treasury Department and the IRS that, consistent with the

purposes of chapters 3 and 4, if adjustments in a statement described in proposed § 301.6226-2 represent additional income allocable to a foreign or domestic partner that was not accounted for in the reviewed year, and the partnership elects under section 6226 to have the partners take into account the adjustments, such income should be subject to the rules in chapters 3 and 4 in the adjustment year to the same extent that such amounts would have been if they had been properly accounted for by the partnership in the reviewed year. Accordingly, the Treasury Department and the IRS intend to issue regulations that coordinate the application of the rules under chapters 3 and 4 to income allocable to a foreign partner or domestic partner where a partnership elects the application of section 6226. Comments are requested on how to efficiently coordinate the election under section 6226 with the withholding rules under chapters 3 and 4, while taking into account the objectives and purposes of BBA to improve the IRS's ability to effectively audit partnerships. In particular, the Treasury Department and the IRS request comments on: (1) how the partnership should satisfy its reporting obligations under chapters 3 and 4 in the reporting year with respect to income allocable to a foreign partner or domestic partner; (2) whether the partnership should be required to obtain new documentation from partners to support a lower withholding rate or whether the partnership should be able to rely on documentation obtained with respect to the reviewed year; and (3) how the rules under chapters 3 and 4 should apply when a statement described in proposed § 301.6226-2 includes additional income allocable to a foreign partner that is an intermediary or flow-through entity.

Additionally, the Treasury Department and the IRS also intend to issue regulations to address situations where a direct partner in the partnership is a foreign entity, such as a trust or corporation, that may not be liable for U.S. federal income tax with respect to one or more adjustments, but an owner of the direct partner is, or could be liable for tax with respect to such amount. For example, if a direct partner in the audited partnership is a controlled foreign corporation, the foreign corporation as a direct partner may not

have a U.S. tax liability with respect to a given adjustment; however, the adjustment may impact the tax liability of its U.S. shareholder(s). The tax effects on the U.S. shareholder(s) may arise in the adjustment year, an intervening year, or some subsequent year, depending on the specific facts and circumstances. Comments are requested on how the reporting obligations concerning foreign entities should be modified to ensure that statements issued under section 6226 are timely reflected on the returns of the U.S. owners of such entities.

#### F. Section 6226 election and section 6234 petition for readjustment

Section 6226(a) provides that the election under that section must be made within 45 days of the date the FPA is mailed. Section 6234(a) provides that the partnership may petition for readjustment within 90 days of the date the FPA is mailed. The proposed regulations coordinate these rules so that an election can be made during the time frame provided under section 6226 without cutting off the partnership's right to challenge the adjustments in court within the time frame provided for in section 6234.

As clarified under proposed § 301.6226-1(e), an election under proposed § 301.6226-1 does not affect the partnership's ability to file a petition under section 6234 to challenge adjustments determined in an FPA. The proposed regulations do this by providing that while the election under section 6226 must be filed within 45 days of the date the FPA is mailed, the filing and furnishing of the statements, is not required until 60 days after the adjustments are finally determined. Proposed § 301.6226-2(b). Under proposed § 301.6226-2(b), the partnership adjustments become finally determined upon the later of the expiration of the time to file a petition under section 6234 or, if a petition is filed under section 6234, the date when the court's decision becomes final. Accordingly, a partnership can make an election under section 6226, petition for readjustment, and then file and furnish statements once the adjustments are finally determined. If, after going to court, a partnership that filed the election within the 45-day period determines that it no longer

wishes to have section 6226 apply, the partnership can request IRS consent to revoke the election.

#### G. Pass-through partners

A number of comments received in response to Notice 2016-23 suggested that a pass-through partner who receives a statement described in proposed § 301.6226-2 should be able to flow through the adjustments to its owners instead of paying tax on the adjustments at the first tier. Under this approach, the adjustments would flow through the tiers until a partner that is not a pass-through partner receives the adjustment. The proposed regulations reserve on this issue.

Under section 6226(a)(2), if a partnership elects the alternative to the payment of the imputed underpayment, the partnership is required to furnish statements to "each partner of the partnership for the reviewed year." Under section 6226(b), a reviewed year partner's tax imposed by chapter 1 for the reporting year is increased by the aggregate of the correction amounts for the first affected year and any intervening years. Section 7701(a)(2) defines "partner" as a member in a partnership (that is, a direct partner). Accordingly, if a partnership makes an election under section 6226, section 6226(b) requires the partnership's direct partners from the reviewed year to take into account the adjustments. Neither section 7701(a)(2) nor section 6226 makes any distinction in this respect between those direct partners that are themselves pass-through entities, and direct partners that are not pass-through entities, such as individuals and C corporations.

Section 6226 is prescriptive regarding the election to push out the partnership adjustments resulting from a centralized partnership audit proceeding rather than paying the imputed underpayment. First, the partnership subject to the proceeding must make the election no later than 45 days after the FPA is mailed to the partnership, and the partnership must furnish and file statements reflecting the reviewed year partners' shares of the adjustments. Section 6226(a)(1) and (2). Second, section 6226(b) provides that each direct partner's chapter 1 tax for the taxable year

including the date the statement is furnished (reporting year) is increased by an amount that represents the tax that should have been paid by the partner if in the reviewed year the items adjusted were correctly reported on the partnership's return and taken into account by the direct partner.

In the case of a partnership that is itself a partner, the General Explanation of Tax Legislation Enacted for 2015 (Bluebook) explained that the partnership-partner "pays the tax attributable to adjustments with respect to the [first affected year] and the intervening years, calculated as if it were an individual . . . for the taxable year . . ." JCS-1-16 at 70. To account for the fact that partnerships are not liable for chapter 1 tax, the Bluebook provides that, "a partnership that receives a statement from the audited partnership is treated similarly to an individual who receives a statement from the audited partnership." *Id.* (omitting footnote providing "[s]ection 703, which states that 'the taxable income of a partnership shall be computed in the same manner as in the case of an individual . . . .'"). In consideration of the fact that direct partnership-partners must pay the tax, the Bluebook further states that the audited partnership, the partnership receiving the statement under section 6226, and that partnership's partners "may have entered into indemnification agreements under the partnership agreement with respect to the risk of tax liability of reviewed year partners being borne economically by partners in the year that includes the date of the statement. Because the payment of tax by a partnership under the centralized system is nondeductible, payments under an indemnification or similar agreement with respect to the tax are nondeductible." *Id.*

In December 2016, both the House of Representatives and the Senate introduced bipartisan technical corrections that would resolve this issue by providing that a partner that is a partnership or S corporation may elect to either pay an imputed underpayment under rules similar to section 6225 or flow the adjustments through the tiers. See Tax Technical Corrections Act of 2016 (H.R. 6439, 114th Cong. (2016)); Tax Technical Corrections Act of 2016 (S. 3506, 114th Cong. (2016)).

The Technical Corrections Act's approach to allow a partnership or S corporation to flow adjustments through the tiers presents significant administrative concerns. First and foremost, allowing such entities to flow through the tiers will result in complexities, challenges, and inefficiencies similar to what occurred under TEFRA. Under TEFRA, following the conclusion of an administrative or judicial proceeding, the IRS was expected to work through the various tiers and calculate, assess, and collect the tax at the ultimate partner level. Allowing partners under BBA to flow adjustments through the tiers presents similar, if not greater, burdens since multiple returns are implicated, from the reviewed year through the adjustment year and all intervening years, in verifying, assessing and collecting the tax, interest and penalties. The IRS would have to undertake this labor intensive process of tracking, validating, and reconciling adjustments and payments through countless tiers. Indeed, as the GAO noted in its most recent report on large partnerships and TEFRA, almost two-thirds of large partnerships in 2011 had more than 1,000 direct and indirect partners, and hundreds of large partnerships had more than 100,000 direct and indirect partners.

Another significant concern is that BBA presents a bifurcated process where the tax is determined and later assessed and collected through a self-reporting process by the partners. The process of flowing adjustments to the reviewed year partners occurs after the audit/litigation is concluded. The assessment process under BBA, whereby the partners are required to calculate the tax, interest, and penalties and report them on their next filed return, presents a challenge because of the passage of time. Even compliant taxpayers, who receive statements in the middle of the tax year may not understand their significance, and may not know exactly how to utilize this information. This would necessitate additional compliance resources by the IRS to check the adjustment year reporting to verify that the adjustments were indeed correctly reported by every tier and by all direct and indirect partners.

The costs involved in administering these processes will limit the overall number of audits that can be undertaken, which in turn will limit the IRS's ability to

meaningfully address tax noncompliance for this segment of taxpayers, as well as limit the overall revenue collection from these entities, including, for example, as partners die, dissolve, become insolvent, or are not able to be located due to the passage of time.

In light of these administrative concerns and the need for public comment on more immediately relevant aspects of these regulations, the proposed regulations reserve this issue. See proposed § 301.6226-2(e). However, the Treasury Department and the IRS are considering an approach under section 6226 for tiered partnerships for pushing the adjustments beyond the first tier partners that will be the subject of other proposed regulations to be published in the near future. The Treasury Department and the IRS seek comments on how the IRS might administer the requirements of section 6226 in tiered structures, including comments on the information tracking and other information sharing from the partnership under examination with respect to its direct and indirect partners to the IRS that are necessary for the IRS to monitor whether adjustments are properly flowed through the tiers and to determine that the proper taxpayers take into account the correct amount of adjustments and report the correct amount of any resulting tax, interest, and penalties. The Treasury Department and the IRS are also specifically interested in comments on reducing noncompliance and collection risk in tiered structures, while at the same time limiting the administrative costs of the IRS.

In addition, the Treasury Department and the IRS are interested in comments as to how to treat under section 6226 a direct partner in the partnership that is an estate or trust, or a foreign entity, such as a trust or corporation that may not be liable for U.S. federal income tax with respect to one or more adjustments, but an owner of the direct partner is, or could be, liable for tax with respect to such amount. For instance, if a direct partner in the audited partnership is a controlled foreign corporation, the foreign corporation as a direct partner may not have a U.S. tax liability with respect to a given adjustment; however, the adjustment may impact the tax liability of its U.S. shareholder(s). The tax effects on the U.S. shareholder(s) may

arise in the first affected year, an intervening year, or some subsequent year, depending on the specific facts and circumstances. The Treasury Department and the IRS request comments on how the safe harbor amount should be computed with respect to such foreign partners.

#### *H. Adjustments to partners' outside bases and capital accounts and a partnership's basis and book value in property*

As discussed previously in this preamble, section 6226(b)(3) requires that any tax attribute which would have been affected if the partnership adjustments were taken into account for the reviewed year, be appropriately adjusted for purposes of computing the amount by which the tax imposed under chapter 1 would increase for any intervening year. As with section 6225, however, section 6226 does not explicitly provide that tax attributes affected by reason of a partnership adjustment should be adjusted for all purposes, and not just for purposes of taking the adjustments into account to calculate the additional reporting year tax, and that the adjustments to tax those attributes should continue to have effect after the adjustment year.

As in the case of a partnership that did not elect the application of section 6226 with respect to an imputed underpayment, the Treasury Department and the IRS have determined that it is appropriate to adjust the adjustment year partners' outside bases and capital accounts and a partnership's basis and book value in property when one of those tax attributes is affected by reason of a partnership adjustment. However, given that the tax imposed under section 6226 includes the amount by which the tax imposed under chapter 1 would increase for any intervening year, a different approach is appropriate.

The purpose of the partnership adjustments is to create a new, accurate starting point for later taxable years; therefore, it is necessary to adjust the adjustment year partners' outside bases and capital accounts despite the fact that it is the reviewed year partners who pay additional tax under section 6226. Providing mechanical rules to govern the adjustments

to adjustment year partners' outside bases and capital accounts and a partnership's basis and book value in property raise a myriad of technical issues on which the Treasury Department and the IRS request comments. As a result, the proposed regulations reserve a place for rules regarding adjustments to a partner's outside basis or capital account and a partnership's basis or book value in property when a partnership elects the application of section 6226 with respect to an imputed underpayment.

The Treasury Department and the IRS have determined that, in the adjustment year, adjustment year partners' outside bases and capital accounts and a partnership's basis and book value in property should be adjusted to what they would have been if the adjustments were made in the reviewed year to reviewed year partners and property and then modified to take into account all intervening events considered in computing the amount by which the tax imposed under chapter 1 would increase for any intervening year—for example, amortization or depreciation of property. In some cases, the reviewed year partner may not be an adjustment year partner, or the partnership might, in an intervening year, have disposed of property to which an adjustment relates. Accordingly, rules will also need to provide how adjustments to adjustment year partners' outside bases and capital accounts and a partnership's basis and book value in property are made when there have been: (1) sales of property, (2) distributions of property to partners, (3) contributions of property to corporations or lower-tier partnerships, (4) other nonrecognition transfers of property, (5) sales of partnership interests, (6) transfers of partnership interests in nonrecognition transactions, and (7) contributions to the partnership. In addition, the Treasury Department and the IRS are considering whether partnerships should be required to recompute basis adjustments under sections 734 and 743 that resulted from distributions or transfers in intervening years to take into account adjustments to partners' outside bases and a partnership's basis in property. The Treasury Department and the IRS are also considering whether and how an adjustment should be made to the basis of property distributed in an intervening year when an adjustment to the partnership's basis in that

property or an adjustment to the recipient partner's outside basis would otherwise have been appropriate.

It seems appropriate that any outside basis and capital account adjustments that need to be made are made with respect to the adjustment year partners who are the reviewed year partners who received a statement of the partner's share of any adjustment to income, gain, loss, deduction or credit. The Treasury Department and the IRS believe that if a reviewed year partner transfers its partnership interest in an intervening year, it is appropriate for the transferee adjustment year partner's capital account and outside basis to be adjusted in the adjustment year. Whether the interest was transferred in a recognition transaction or a nonrecognition transaction, however, is relevant to the amount of the adjustment to the transferee's outside basis, but not capital account, because the transferee in either case succeeds to the capital account of the transferor, however, in a recognition transaction, the transferee would have taken a cost basis in the interest upon a transfer in which gain was recognized. The Treasury Department and the IRS request comments regarding whether and how to adjust the outside bases and capital accounts of adjustment year partners if the reviewed year partner whose basis and capital account should have been adjusted is no longer a partner as a result of a liquidating distribution and thus no other partner has succeeded to the liquidating partner's capital account.

Finally, comments are requested on how, or if, these regulations should address partnerships that do not maintain capital accounts.

## 7. Administrative Adjustment Requests

### A. Procedures for filing an administrative adjustment request

Proposed § 301.6227-1(a) describes the general rules for filing an administrative adjustment request (AAR). In accordance with section 6227(a), proposed § 301.6227-1(a) provides that a partnership may file an AAR 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 as determined under section 6221 and the regulations thereunder. Proposed § 301.6227-1(a) requires a partnership to determine whether the adjustments requested in the AAR result in an imputed underpayment in accordance with proposed § 301.6227-2(a) for the reviewed year, that is, the taxable year to which the adjustments relate (see proposed § 301.6241-1(a)(8)). If the requested adjustments result in an imputed underpayment, proposed § 301.6227-1(a) provides that the partnership takes the adjustments into account under proposed § 301.6227-2(b), which requires the partnership to pay the imputed underpayment unless the partnership makes an election under proposed § 301.6227-2(c). If the partnership makes an election under proposed § 301.6227-2(c), the reviewed year partners take the adjustments into account in accordance with proposed § 301.6227-3, which provides rules similar to section 6226. Under proposed § 301.6227-1(a), if the adjustments do not result in an imputed underpayment, the reviewed year partners must take the adjustments into account under the rules of proposed § 301.6227-3.

Proposed § 301.6227-1(a) clarifies that only a partnership may file an AAR and that a partner may not file an AAR unless the partner is doing so in his or her capacity as partnership representative for the partnership. Additionally, in certain cases, a partner that is itself a partnership subject to subchapter C of chapter 63 (that is, the partnership has not elected out of the centralized partnership regime under section 6221(b)) may file an AAR in response to the filing of an AAR by the partnership of which it is a partner. See proposed § 301.6227-3(c) for the rules regarding certain partnership-partners filing AARs. In addition, proposed § 301.6227-1(a) clarifies that a partnership may not file an AAR solely to provide the partnership an opportunity to change a designation of the partnership representative.

Proposed § 301.6227-1(b) provides that an AAR may only be filed by a partnership with respect to any partnership taxable year for which a partnership return has been filed. In general, a partnership may not file an AAR with respect to a partnership taxable year more than three years after the later of the date the part-

nership return for such partnership taxable year was filed or the last day for filing such partnership return determined without regard to extensions. In addition, the proposed regulations provide that 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 IRS under section 6231.

The proposed regulations reserve on rules to coordinate the rules under section 6227 with the requirements in section 905(c) when the AAR includes an adjustment to the amount of creditable foreign tax incurred by the partnership. Comments are requested on 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.

Proposed § 301.6227-1(c)(1) provides that an AAR must be filed in accordance with the forms, instructions, and other guidance prescribed by the IRS and must include any required statements, forms, and schedules. An AAR must be signed under penalties of perjury by the partnership representative. This requirement is consistent with section 6223 which states that the partnership representative has the sole authority to act on behalf of the partnership under subchapter C of chapter 63. See proposed § 301.6223-2.

Under proposed § 301.6227-1(c)(2), a valid AAR must include the adjustments requested; any required statements described in proposed § 301.6227-1(e), including any transmittal with respect to such statements as prescribed in forms, instructions, and other guidance; and any other information prescribed by the IRS in forms, instructions, or other guidance. Proposed § 301.6227-1(d) provides that where reviewed year partners are required to take into account adjustments requested in an AAR, the partnership must furnish a copy of the statement filed with the IRS to the reviewed year partner to whom the statement relates. If the partnership mails the statement, it must be mailed to the current or last address of the reviewed

year partner that is known to the partnership. The copy of the statement must be furnished to the reviewed year partner on the date the partnership files the AAR with the IRS.

Proposed § 301.6227-1(c) describes the statements that must be issued to reviewed year partners in the case of an election under proposed § 301.6227-2(c) or an AAR not resulting in an imputed underpayment under proposed § 301.6227-2(d). 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 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 § 301.6227-1(c)(2)); the date the statement is furnished to the partner; the partnership taxable year to which the adjustments relate (the reviewed year); and any other information required by the forms, instructions, or other guidance prescribed by the IRS. Proposed § 301.6227-1(e).

Proposed § 301.6227-1(e)(2) describes the reviewed year partners' share of the adjustments requested in an AAR for purposes of the statements described in proposed § 301.6227-1(e)(1). Under proposed § 301.6227-1(e)(2), except when a specific partner's share of an item is reflected on an AAR in a specific manner in accordance with the provisions of the partnership agreement and in accordance with the principles of section 704(b), each reviewed year partner's share of an adjustment must be determined and reported to the reviewed year partner in the same manner as the item to which the adjustment relates was originally determined and reported on the partnership return for the reviewed year. If the item to which the adjustment relates was not reflected on the partnership's reviewed year return, the reviewed year partners' respective shares of the adjustment must be determined and reported to the reviewed year partners in accordance with the manner in which the allocation of the items to which the adjustment relates would have been made under the part-

nership agreement and subject to the principles of section 704(b) in the reviewed year. If the adjustments, as requested in the AAR, allocate items to a specific partner or in a specific manner, the statement must reflect the adjustment as allocated in accordance with the AAR.

Proposed § 301.6227-1(f) provides that the filing of an AAR under proposed § 301.6227-1(b) and the filing and furnishing of statements as described in proposed § 301.6227-1(c) and proposed § 301.6227-1(d) are actions taken by the partnership under section 6223 and the regulations thereunder. Section 6223 states that a partnership and all partners of such partnership shall be bound by actions taken by the partnership under subchapter C of chapter 63. Accordingly, proposed § 301.6227-1(f) provides that, unless otherwise determined by the IRS, a partner's share of the adjustments requested in an AAR as reflected on a statement described in proposed § 301.6227-1(e) are binding on the partner. Under proposed § 301.6227-1(f), a 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 IRS. See proposed § 301.6222-1(c)(2) (regarding items the treatment of which a partner is bound to under section 6223).

Proposed § 301.6227-1(g) provides that the IRS may, within the period provided under section 6235, conduct a proceeding with respect to the partnership for the taxable year to which the AAR relates and adjust items subject to subchapter C of chapter 63, including the items adjusted in the AAR. In the case of an AAR, the Service may make adjustments with respect to the partnership taxable year to which the AAR pertains within three years from the date the AAR is filed. Proposed § 301.6227-1(g) provides that the IRS may re-determine adjustments requested in an AAR, including modifications applied by the partnership to the imputed underpayment. If the partnership adjustments determined by the IRS increase any imputed underpayment, the additional amount is assessed in the same manner and subject to the same restrictions as any other imputed underpayment. See section 6232.



## *B. Adjustments requested in an AAR taken into account by the partnership*

Proposed § 301.6227-2 describes how adjustments requested in an AAR are determined and taken into account by a partnership. Proposed § 301.6227-2(a)(1) provides the rules for determining whether an imputed underpayment results from adjustments requested in an AAR by referring to the proposed § 301.6225-1.

Under proposed § 301.6227-2(a)(2), in the case of an AAR, a partnership may reduce the imputed underpayment as a result of certain modifications permitted under proposed § 301.6225-2. Those modifications are modifications that relate to tax-exempt partners, rate modification, modification related to certain passive losses of publicly traded partnerships, modification applicable to qualified investment entities described in section 860, and other modifications to the extent permitted under future IRS guidance. The modifications described in proposed § 301.6227-2 are the only modifications a partnership can use in an AAR context. Other types of modification, such as modifications under proposed § 301.6225-2 with respect to amended returns and closing agreements are not available in the case of an AAR.

In addition, proposed § 301.6227-2(a)(2)(i) provides that a partnership does not need to seek IRS approval prior to modifying an imputed underpayment that results from adjustments requested in an AAR. However, proposed § 301.6227-2(a)(2)(ii) provides that modifications to the imputed underpayment resulting from adjustments requested in an AAR can be taken into account by the partnership only if the AAR that is filed includes notification to the IRS of the modification, a description of the effect of the modification on the imputed underpayment, an explanation of the basis for such modification, and all necessary documentation to support the partnership's entitlement to such modification. These rules differ from the modification procedures under section 6225, where the imputed underpayment is not modified prior to approval by the IRS.

## *C. Adjustments resulting in an imputed underpayment*

### *i. Partnership Pays the Imputed Underpayment*

Proposed § 301.6227-2(b)(1) provides that when the adjustments requested in an AAR result in an imputed underpayment, the partnership must pay the imputed underpayment (as reduced by modifications meeting the requirements of proposed § 301.6227-2(a)(2)(ii)) at the time the partnership files the AAR, unless the partnership makes the election under proposed § 301.6227-2(c) to have its reviewed year partners take such adjustments into account. The partnership's payment of the imputed underpayment is treated as a nondeductible expenditure under section 705(a)(2)(B) in accordance with proposed § 301.6241-4.

Proposed § 301.6227-2(b)(2) provides the rules for determining penalties and interest with respect to an imputed underpayment resulting from adjustments requested in the AAR. As provided in proposed § 301.6227-2(b)(2), the IRS may impose any penalty, addition to tax, and additional amount with respect to such an imputed underpayment in accordance with section 6233(a)(3). In the case of any failure to pay an imputed underpayment at the time an AAR is filed, the IRS may impose any penalty, addition to tax, and additional amount in accordance with section 6233(b)(3). Interest on an imputed underpayment is determined under chapter 67 for the period beginning on the date after the due date of the partnership return for the reviewed year (determined without regard to extension) and ending on the earlier of the date payment of the imputed underpayment is made with the AAR, or the due date of the partnership return for the adjustment year. See section 6233(a)(2). In the case of any failure to pay an imputed underpayment before the due date of the partnership return for the adjustment year, any interest is determined in accordance with section 6233(b)(2).

The Treasury Department and the IRS intend in future guidance to cross reference proposed § 301.6225-4 for rules regarding adjustments to partners' outside bases and capital accounts and a partner-

ship's basis and book value in property when the adjustments requested in an AAR result in an imputed underpayment and the partnership does not elect under proposed § 301.6227-2(c) to have its reviewed year partners take such adjustments into account.

### *ii. Election to Have the Reviewed Year Partners Take the Adjustments into Account*

Proposed § 301.6227-2(c) provides that a partnership may elect to have its reviewed year partners take into account adjustments requested in an AAR that result in an imputed underpayment in lieu of the partnership paying that imputed underpayment. If the partnership makes a valid election under proposed § 301.6227-2(c), the partnership is no longer required to pay the imputed underpayment resulting from the adjustments requested in the AAR. Rather, each reviewed year partner must take into account its share of such adjustments in accordance with proposed § 301.6227-3. For these purposes, any modification requested under proposed § 301.6227-2(a)(2) is disregarded, and all adjustments requested in the AAR are taken into account by each reviewed year partner in accordance with proposed § 301.6227-3.

## *D. Adjustments requested in an AAR not resulting in an imputed underpayment*

When the adjustments requested in an AAR do not result in an imputed underpayment, the reviewed year partners must take into account their shares of such adjustments in accordance with proposed § 301.6227-3. Proposed § 301.6227-2(d) provides that in that situation the partnership must furnish statements to the reviewed year partners and file a copy of those statements with the IRS in accordance with proposed § 301.6227-1.

## *E. Rules for reviewed year partners to take adjustments into account*

Reviewed year partners take adjustments requested in an AAR filed by the partnership into account in two circumstances: (1) the adjustments requested in the AAR result in an imputed underpay-

ment and the partnership elects under proposed § 301.6227–2(c) to have its reviewed year partners take the adjustments into account, or (2) the adjustments requested in the AAR do not result in an imputed underpayment as described in § 301.6227–2(d). Proposed § 301.6227–3 describes how reviewed year partners take into account adjustments requested in an AAR.

#### i. Rules Under Section 6226 Apply With Certain Changes

Generally, under proposed § 301.6227–3, a reviewed year partner who receives a statement described in proposed § 301.6227–1(e) must treat that statement as if it were provided under section 6226(a)(2). Under proposed § 301.6227–3(b), the reviewed year partner must pay any amount of tax, penalties, additions to tax, additional amounts, and interest that results from taking into account such adjustments in accordance with proposed § 301.6226–3, except that, the rules under proposed § 301.6226–3(c) (allowing the reviewed year partner to elect to pay a safe harbor amount), proposed § 301.6226–3(d)(2) (regarding interest on the safe harbor amount), and proposed § 301.6226–3(d)(4) (regarding the increased rate of interest) do not apply. Comments are requested regarding 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.

Furthermore, proposed § 301.6227–3(b)(1) provides that the restriction in proposed § 301.6226–3(b)(1) that the correction amount for the first affected year and any intervening year cannot be less than zero does not apply in the case of taking into account adjustments requested by the partnership in an AAR. The reason for this is two-fold. First, unlike an adjustment request under section 6227, which is a voluntary request for adjustment initiated by the partnership, the rules under sections 6225 and 6226 are designed to address adjustments that are determined by the IRS after it initiated a proceeding with respect to of the partnership. In cases where the partnership is requesting adjustments that will reduce a partner’s tax liability, such adjustment request mirrors the

voluntary compliance of a partnership self-reporting amounts on its original return, which may include losses resulting in refunds for partners. For this reason, partners taking adjustments into account should similarly be able to claim refunds when applicable. In cases where adjustments in an AAR would increase tax due, such voluntary compliance by partnerships should be encouraged and only allowing unfavorable effects from such adjustments would discourage partnership voluntary compliance.

Second, section 6226(b)(2) specifically provides that only increases in tax are taken into account by the reviewed year partners. In contrast, section 6227 does not similarly limit adjustments taken into account by the reviewed year partners; although section 6227 explicitly provides that adjustments requested in an AAR that do not result in an imputed underpayment may only be taken into account by the reviewed year partners under rules similar to the rules of 6226 with appropriate adjustments to those rules. The lack of a specific restriction in section 6227 on taking into account decreases to tax in the first affected year and intervening years, combined with section 6227’s requirement that adjustments that do not result in an imputed underpayment must be taken into account by the reviewed year partners (the partners who originally overpaid tax due) indicates that in the AAR context both favorable and unfavorable adjustments should be given effect when taken into account by the reviewed year partners. Therefore, it is appropriate in the AAR context to remove the restriction in proposed § 301.6226–3(b)(1) that the correction amount for the first affected year and any intervening year as described in that section cannot be less than zero.

Proposed § 301.6227–3(b)(2) allows the reviewed year partner to claim a refund where the partnership incorrectly allocated items from the partnership in the reviewed year and provides that when a partner (other than a pass-through partner) takes into account adjustments requested in an AAR, and those adjustments result in a decrease in tax, the partner may use that decrease to reduce the partner’s chapter 1 tax for the taxable year which includes the date the statement was furnished to the partner (reporting year), and

may make a claim for refund of any overpayment that results. The reduction is treated in a manner similar to a refundable credit under section 6401(b). Nothing under the proposed rules, however, will entitle a pass-through partner to a refund to which the pass-through partner would not otherwise be entitled under the Code. Proposed § 301.6227–3(b)(3) provide examples to illustrate the operation of these rules.

The Treasury Department and the IRS intend in future guidance to cross reference proposed § 301.6226–4 for rules regarding adjustments to partners’ outside bases and capital accounts and a partnership’s basis and book value in property when reviewed year partners take adjustments requested in an AAR filed by the partnership into account.

#### ii. Pass-through Partners

Proposed § 301.6227–3(c) is reserved to provide rules for pass-through partners (as defined in proposed § 301.6241–1(a)(5)) to take into account adjustments requested in an AAR. Section 6227 provides that adjustments requested in an AAR that result in an imputed underpayment may be taken into account by the partnership and partners under rules similar to the rules of section 6226. In the case of an adjustment that does not result in an imputed underpayment, rules similar to the rules of section 6226 shall apply with appropriate adjustments. Rules under section 6226 pertaining to pass-through partners have been reserved under proposed § 301.6226–3(e). Accordingly, the proposed regulations under section 6227 also reserve on rules with respect to pass-through partners until the rules under section 6226 regarding such partners are established.

### 8. Definitions and Special Rules

#### A. Terms defining partnership years and types of partners

Proposed § 301.6241–1(a) contains definitions for purposes of subchapter C of chapter 63 and these proposed regulations. Proposed § 301.6241–1(a)(8) defines the term “reviewed year” to mean the partnership taxable year to which the

adjustments relate. Proposed § 301.6241-1(a)(9) defines the term “reviewed year partner” to mean any person who held an interest in a partnership at any time during the reviewed year. Proposed § 301.6241-1(a)(1) defines the term “adjustment year” to mean the partnership taxable year in which a decision of a court becomes final (if a petition is filed under section 6234), an AAR is made, or, in any other case, when an FPA is mailed (or if the partnership waives its right to an FPA, the year the waiver is executed by the IRS). Proposed § 301.6241-1(a)(2) defines an “adjustment year partner” to mean any person who held an interest in a partnership at any time during the adjustment year of the partnership.

Proposed § 301.6241-1(a)(5) defines the term “pass-through partner” to mean a pass-through entity that holds an interest in a partnership. A pass-through entity is a partnership (including a foreign entity that is classified as a partnership under § 301.7701-3(b)(2)(i)(A) or (c)), an S corporation, a trust, (other than a trust described in the next sentence), and a decedent’s estate. The term “pass-through partner” does not include disregarded entities described in § 301.7701-2(c)(2)(i) or a trust that is wholly owned by only one person, whether the grantor or another person, and the trust reports the owner’s information to payors under § 1.671-4(b)(2)(i)(A). In addition, the term “pass-through partner” does not include entities such as a registered investment company under section 851 or a real estate investment trust under section 856.

Proposed § 301.6241-1(a)(7) defines the term “partnership-partner” to mean a partnership that holds an interest in a partnership. A partnership-partner is a type of pass-through partner as defined in proposed § 301.6241-1(a)(5).

Proposed § 301.6241-1(a)(4) defines an “indirect partner” as any person who has an interest in the partnership through their interest in one or more pass-through partners. For example, a shareholder in an S corporation that is a partner in a partnership is an indirect partner of that partnership.

#### *B. Partnership adjustment, imputed underpayment, and tax attribute*

Under proposed § 301.6241-1(a)(6), the term “partnership adjustment” means

any adjustment to the amount of any item of income, gain, loss, deduction, or credit as defined in proposed § 301.6221(a)-1(b)(1), or any partner’s distributive share thereof, as described under proposed § 301.6221(a)-1(b)(2).

Proposed § 301.6241-1(a)(3) defines the term “imputed underpayment” as any amount determined in accordance with proposed § 301.6225-1.

For purposes of subchapter C of chapter 63, proposed § 301.6241-1(a)(10) defines the term “tax attribute”. Under this definition, a tax attribute is anything that can affect, with respect to a partnership or partner, the amount or timing of an item of income, gain, loss, deduction or credit as defined in proposed § 301.6221(a)-1(b)(1) or that can affect the amount of tax due in any taxable year. Examples of tax attributes include, but are not limited to, basis and holding period, as well as the character of items of income, gain, loss, deduction, or credit and carryovers and carrybacks of such items.

#### *C. Bankruptcy*

Under proposed § 301.6241-2(a)(1), if a partnership is a debtor in a Title 11 bankruptcy case, the running of any period of limitations under section 6235 for making a partnership adjustment, and under sections 6501 and 6502 for assessment or collection of any imputed underpayment, is suspended during the period the bankruptcy case prohibits the IRS from making the adjustment, assessment, or collection. The suspension runs until the prohibition ends, plus 60 days in the case of an adjustment or assessment, or six months in the case of collection.

While proposed § 301.6241-2(a)(1) follows the language in section 6241(6) to suspend the adjustment, assessment, and collection periods when those actions are prohibited by a bankruptcy case, the Bankruptcy Code does not prohibit two of those actions – adjustment or assessment. No provision of the automatic stay in section 362(a) of Title 11 prevents tax audits or the issuance of an FPA, the mechanism for adjustment, and the making of a tax assessment is expressly allowed under section 362(b)(9) of Title 11 notwithstanding the general stay against tax assessments in section 362(a)(6) of Title 11.

Proposed § 301.6241-2(a)(2) clarifies that the filing of a proof of claim or request for payment and the taking of other actions in the partnership’s bankruptcy case do not violate the restrictions in section 6232(b) prohibiting assessment or collection during the 90-day period to petition for judicial review under section 6234 and, if a petition is filed, before the court’s decision becomes final.

Under proposed § 301.6241-2(a)(3), the period to petition for judicial review is suspended while the bankruptcy case prevents the partnership from filing a petition under section 6234, and for 60 days thereafter.

Proposed § 301.6241-2(a)(4) clarifies that bankruptcy law does not prohibit audits, mailing of notices under section 6231, demands for unfiled returns, assessments or notice or demand for payment of assessments.

#### *D. Partnerships that cease to exist*

Proposed § 301.6241-3 follows section 6241(7) and provides that if the IRS determines that any partnership (including a partnership-partner) ceases to exist before a partnership adjustment under subchapter C of chapter 63 takes effect, the partnership adjustment is taken into account by the former partners of the partnership.

Under proposed § 301.6241-3(c), a partnership adjustment takes effect when all amounts due under subchapter C of chapter 63 resulting from the partnership adjustment are fully paid by the partnership. Therefore, if a partnership does not pay the amounts owed, the partnership adjustment resulting in the imputed underpayment or other amount due has not taken effect. As a result, former partners of a partnership may be required to take into account partnership adjustments if a partnership does not pay an imputed underpayment (and any applicable interest, penalties, additions to tax, or additional amounts) under section 6225 or section 6227. Additionally, former partners of a partnership-partner may be required to take into account partnership adjustments if a partnership-partner does not pay any amount due (including any applicable interest, penalties, additions to tax, or additional amounts) under section 6226 or section 6227 as a result of receiving a

statement from a partnership in which it is a partner under proposed § 301.6226-2 or proposed § 301.6227-2.

As provided in proposed § 301.6241-3(a)(3), the provisions of proposed § 301.6241-3 do not apply to partnerships that have a valid election in effect under section 6221(b) and the regulations thereunder. Accordingly, the former partners of a partnership that has elected out of the centralized partnership audit regime are not required to take partnership adjustments into account under proposed § 301.6241-3.

Under proposed § 301.6241-3(b)(1), the IRS may, in its discretion, determine that a partnership ceases to exist. Only the IRS may determine that a partnership has ceased to exist. No other person, including the partnership, the partnership representative, nor any partner, current or former, has the ability to make this determination for purposes of invoking the provisions of section 6241(7) and the proposed regulations. The IRS is not required to make a determination that a partnership ceases to exist even if the definition in proposed § 301.6241-3(b)(2) applies with respect to such partnership. If the IRS determines that any partnership has ceased to exist for purposes of these rules, the IRS will notify the partnership and the former partners, in writing, at their last known address, within 30 days of the determination. If the IRS determines that a partnership (or partnership-partner) has ceased to exist, the partnership is no longer liable for any remaining amounts owed resulting from a partnership adjustment that is required to be taken into account by a former partner. Proposed § 301.6241-3(a)(2).

Proposed § 301.6241-3(b)(2) defines the term “cease to exist” for purposes of section 6241(7). Under proposed § 301.6241-3(b)(2), a partnership ceases to exist if the partnership terminates within the meaning of section 708(b)(1)(A) or does not have the ability to pay, in full, any amount that the partnership owes under subchapter C of chapter 63. See JCS-1-16 at 80 (noting that a partnership ceases to exist if it terminates under section 708(b)(1)(A), as well as when the partnership “has no significant income, revenue, assets, or activities at the time the partnership adjustment takes effect”). A partnership does not have the ability to pay if the IRS determines that the account with

respect to the partnership is not collectible based on the information that the IRS has at the time of the determination. In making that determination, the IRS will rely on existing guidance regarding when a taxpayer account is not collectible and is not required to develop additional facts that are not known to the IRS at the time the decision is made.

Proposed § 301.6241(b)(2)(i) provides that the IRS will not determine that a partnership has ceased to exist solely because: (i) a partnership has technically terminated under section 708(b)(1)(B); (ii) the partnership had made a valid election under section 6226 and the regulations thereunder with respect to any imputed underpayment; or (iii) the partnership has not paid any amount the partnership is liable for under subchapter C of chapter 63. If a partnership terminates under section 708(b)(1)(A), the partnership ceases to exist on the last day of the partnership’s final taxable year. If a partnership does not have the ability to pay, the partnership ceases to exist on the date that the IRS makes a determination under proposed § 301.6241-3(b)(2)(i) that the partnership ceases to exist. Proposed § 301.6241-3(b)(2)(ii).

Proposed § 301.6241-3 only applies if the IRS has determined that a partnership has ceased to exist before a partnership adjustment determined in a partnership-level proceeding under the centralized partnership audit regime takes effect. As described in proposed § 301.6241-3(c), for purposes of this section, a partnership adjustment takes effect when all amounts due under subchapter C of chapter 63 resulting from the partnership adjustment are fully paid by the partnership. However, in no event may the IRS determine that a partnership ceases to exist with respect to a partnership adjustment after the expiration of the period of limitations on collection applicable to the amount due resulting from such adjustment. Proposed § 301.6241-3(b)(2)(iii). In the event that a partnership pays some, but not all, of any amount due resulting from a partnership adjustment before a partnership ceases to exist, the former partners of the partnership that has ceased to exist are not required to take into account the portion of the partnership adjustments with respect to which any amounts have been paid by

the partnership. Proposed § 301.6241-3(c)(2). In cases of partial payment, the notification that the IRS has determined that the partnership has ceased to exist will include information regarding the portion of the partnership adjustments that are attributable to any remaining balance owed by the partnership that must be taken into account by the former partners.

If the IRS determines that a partnership ceases to exist, the partnership adjustments are taken into account by the former partners of the partnership. Under proposed § 301.6241-3(d)(1)(i), the term “former partners” means the adjustment year partners of a partnership that has ceased to exist. If any adjustment year partner is a partnership-partner that the IRS has determined has ceased to exist, the partners of the partnership-partner for the partnership-partner’s taxable year that includes the end of the adjustment year of the partnership that has ceased to exist are the former partners for purposes of this section. Proposed § 301.6241-3(d)(1)(ii). If there are no adjustment year partners of a partnership, including where there are no partners of a partnership-partner, (for instance, because the partnership ceased to exist before the adjustment year), the term “former partners” means the partners of the partnership (or partnership-partner) during the last taxable year for which a partnership return was filed under section 6031(b). Proposed § 301.6241-3(d)(2).

Under proposed § 301.6241-3(e), the former partners of a partnership that has ceased to exist take the partnership adjustment into account as if the partnership had made an election under section 6226 and the regulations thereunder. A former partner must take into account the former partner’s share of a partnership adjustment reflected in the statement provided to the former partner in accordance with proposed § 301.6226-3.

If a partnership is notified by the IRS that it has ceased to exist, the partnership must furnish statements to its former partners reflecting the former partner’s share of the partnership adjustments required to be taken into account, and file the statements with the IRS, no later than 30 days after the date of the notice from the IRS in which the IRS determines that the partnership ceases to exist. Proposed § 301.6241-3(e)(2)(ii). The statements

must conform to the requirements under proposed § 301.6226–2 except that the adjustments are taken into account by the former partners rather than the reviewed year partners. Proposed § 301.6241–3(e)(2)(i). If the statements are not timely furnished to the former partners, the IRS may furnish statements to the former partners to inform those partners of their share of the adjustments. Proposed § 301.6241–3(e)(3). If the IRS furnishes the statements to the former partners, the IRS will notify the former partner in writing of such partner's share of the partnership adjustment based on the information reasonably available to the IRS at the time such notification is provided. A notification issued by the IRS is treated the same as a statement required to be furnished and filed under proposed § 301.6241–3(e)(2).

Proposed § 301.6241–3(f) provides examples that illustrate the provisions of this section.

#### E. Nondeductible payments

Proposed § 301.6241–4 provides generally that the payment of any amount under subchapter C of chapter 63 is nondeductible, and must be treated as an expenditure described in section 705(a)(2)(B) (that is, not deductible and not properly chargeable to a capital account). Accordingly, a payment by a partnership of any amount required to be paid under subchapter C of chapter 63, including any imputed underpayment, any amount under proposed § 301.6226–3 (regarding reviewed year partners taking into account partnership adjustments), and any interest, penalties, additions to tax, or additional amounts with respect to such amounts is treated as an expenditure described in section 705(a)(2)(B).

#### F. Extension to entities filing partnership returns

Proposed § 301.6241–5 extends the provisions of the centralized partnership audit regime to a taxable year for which any entity files a partnership return (Form 1065, *U.S. Return of Partnership Income*), even if it is determined that the entity filing the return is not a partnership (proposed § 301.6241–5(a)) or even that no

entity existed (proposed § 301.6241–5(b)). Under proposed § 301.6241–5(a), if an entity files a partnership return for a taxable year, the provisions of subchapter C of chapter 63 (and the regulations thereunder) apply to that entity, its items (and any partner's distributive share of those items), and any person holding an interest in that entity at any time during the taxable year for which the partnership return was filed.

Proposed § 301.6241–5(c) provides exceptions to the general rules in proposed § 301.6241–5(a). Under proposed § 301.6241–5(c)(1), the provisions of subchapter C of chapter 63 do not apply to taxable years for which a valid election under section 6221(b) to elect out of the centralized partnership audit regime is in effect. Under proposed § 301.6241–5(c)(2), the provisions of subchapter C of chapter 63 do not apply to taxable years for which a partnership return is filed solely to make an election described in section 761(a) (election out of subchapter K of chapter 1 for certain unincorporated organizations).

#### Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. However, pursuant to Executive Order 13789, the Treasury Department is currently reviewing the scope and implementation of the existing exemption for certain tax regulations from the review process set forth in Executive Order 12866. Because the proposed regulations would not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited

in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at [www.irs.gov](http://www.irs.gov).

#### Comments

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments submitted will be made available at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing has been scheduled for September 18, 2017, beginning at 10:00 AM in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by August 14, 2017. A period of 10 minutes will be allocated to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal authors of these proposed regulations are Jennifer M. Black, Joy E. Gerdy-Zogby, and Steven L. Karon

of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

### List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

### Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG-138326-07) that was published in the Federal Register on Friday, February 13, 2009 (74 FR 7205) is withdrawn.

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 301.6221(a)-1 is added to read as follows:

§ 301.6221(a)-1 *Scope of the partnership procedures under subchapter C of chapter 63 of the Internal Revenue Code.*

(a) *In general.* Any adjustment to items of income, gain, loss, deduction, or credit (as defined in paragraph (b)(1) of this section) of a partnership for a partnership taxable year and any partner's distributive share (as defined in paragraph (b)(2) of this section) thereof is determined, any tax attributable thereto is assessed and collected, and the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to any such item or share is determined at the partnership level under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63). See § 301.6222-1 for rules relating to assess-

ment and collection in a proceeding involving inconsistent reporting pursuant to section 6222. See § 301.6225-2 for rules with respect to an amended return in the case of modification under section 6225(c)(2). See § 301.6226-3 for rules in cases where an election under section 6226 is made.

(b) *Definitions.* Solely for purposes of paragraph (a) of this section the following terms have the meaning described in this paragraph (b).

(1) *Items of income, gain, loss, deduction, or credit*-(i) *In general.* The phrase *items of income, gain, loss, deduction, or credit* means all items and information required to be shown, or reflected, on a return of the partnership under section 6031, the regulations thereunder, and the forms and instructions prescribed by the Internal Revenue Service (IRS) for the partnership's taxable year, and any information in the partnership's books and records for the taxable year. This phrase includes-

(A) the character, timing, source, and amount of the partnership's income, gain, loss, deductions, and credits, including whether an item is deductible, tax-exempt, or a tax-preference item;

(B) the character, timing, and source of the partnership's activities, including whether the partnership's activities are passive or active;

(C) contributions to, and distributions from, the partnership, including the value, amount, and character of those contributions and distributions (for example, for purposes of sections 704(c), 721(b), 721(c), 737, and 751(b));

(D) the partnership's basis in its assets, the character and type of the assets, and the value (or revaluation such as under § 1.704-1(b)(2)(iv)(f) or (s) of this chapter) of the assets; including any effect the character or value of the partnership's assets has on the sale or exchange of an interest in the partnership (for example, for purposes of section 751(a));

(E) the amount and character of partnership liabilities, including whether a liability is recourse or nonrecourse and any changes to those liabilities from the preceding tax year;

(F) the separate category, timing, and amount of the partnership's creditable

foreign tax expenditures described in § 1.704-1(b)(4)(viii)(b) of this chapter;

(G) any elections made by the partnership and the consequences or effects of those elections, including a section 754 election, any election referenced in section 703(b), a section 761 election, and an election under sections 6221(b) or 6226(a);

(H) items related to transactions between a partnership and any person including disguised sales, guaranteed payments, section 704(c) allocations, and transactions to which section 707 applies;

(I) any item resulting from a partnership terminating under section 708(b)(1)(A), including as a result of a transaction under Rev. Rul. 99-6 (1999-1 C.B. 432) (see § 601.601(d)(2) of this chapter);

(J) items and any effects from a technical termination under section 708(b)(1)(B); and

(K) partner capital accounts, including the release of a partner from a deficit restoration obligation.

(ii) *Factors that affect the determination of items of income, gain, loss, deduction, or credit.* Any factors that must be taken into account to determine or allocate the tax treatment of items adjusted under subchapter C of chapter 63 (in accordance with paragraph (b)(1) of this section) are determined at the partnership level. Such factors include-

(A) the legal and factual determinations that underlie the determination of items of income, gain, loss, deduction, or credit;

(B) the partnership's accounting practices and methods;

(C) whether any person is a partner in the partnership;

(D) whether a partnership exists for tax purposes, including whether multiple partnerships should be treated as a single partnership;

(E) whether any items or transactions of the partnership, the adjustments to which are determined under subchapter C of chapter 63, lack economic substance or should otherwise be disregarded, collapsed, recharacterized, or attributed to other persons (for example, under the step transaction doctrine), including whether the partnership is a sham or should otherwise be disregarded for tax purposes (including under § 1.701-2 of

this chapter and any applicable judicial doctrines);

(F) the period of limitations on making adjustments under subchapter C of chapter 63;

(G) the period of limitations on the assessment of amounts attributable to adjustments determined under subchapter C of chapter 63, except for the period of limitations under section 6501 with regard to assessments of tax attributable to adjustments taken into account by partners as a result of an election under section 6226;

(H) partners' outside bases, but only to the extent the partners' outside bases relate to an adjustment determined under subchapter C of chapter 63; and

(I) any determinations necessary to calculate the imputed underpayment (as defined in § 301.6241-1(a)(3)) under section 6225, including whether items adjusted under subchapter C of chapter 63 are limited (or subject to limitations) under the Internal Revenue Code (or a treaty), and the facts and circumstances specific to any partner(s) that might affect the calculation of an imputed underpayment or modification requested by the partnership with respect to an imputed underpayment.

(2) *Partner's distributive share.* The phrase *partner's distributive share* includes—

(i) the partner's share of items adjusted under subchapter C of chapter 63, including the type of partnership interest(s) the partner holds and the percentage interest of a partner in the partnership;

(ii) the allocation of any item determined under subchapter C of chapter 63;

(iii) any special allocations applicable to any partner;

(iv) the character, source, and timing of any item or activity required to be taken into account by the partner which is related to any item adjusted under subchapter C of chapter 63; and

(v) any amount required to be taken into account by any person under section 6226.

(3) *Tax.* For purposes of section 6221(a), the term *tax* means tax imposed by chapter 1 of subtitle A of the Internal Revenue Code.

(c) *Penalty defenses*—(1) *In general.* Any defense to any penalty, addition to tax, or additional amount must be raised

by the partnership in a partnership-level proceeding under subchapter C of chapter 63, regardless of whether the defense relates to facts and circumstances relating to a person other than the partnership. After the adjustments determined in a partnership proceeding under subchapter C of chapter 63 become final, no defense to any penalty determined may be raised or taken into account in determining the applicable penalties, additions to tax, or additional amounts under subchapter C of chapter 63 with respect to any person.

(2) *Examples.* The following examples illustrate the rules of this paragraph (c).

*Example 1.* The IRS initiates an administrative proceeding with respect to Partnership's taxable year under subchapter C of chapter 63. During the proceeding, the IRS mails to Partnership a notice of proposed partnership adjustment under section 6231 that imposes a section 6662 accuracy-related penalty with respect to an imputed underpayment on the grounds that the imputed underpayment is attributable to negligence or disregard of rules or regulations. Partnership believes that the actions of A, a partner in the partnership for the taxable year subject to the administrative proceeding, demonstrate that A had reasonable cause and acted in good faith with respect to how A reported on A's Federal income tax return the items that were adjusted and gave rise to the imputed underpayment subject to the penalty. Partnership provides this information to the IRS during the administrative proceeding in response to the notice of proposed partnership adjustment. The IRS will take this penalty defense into account when determining whether the portion of the penalty that relates to the adjustments attributable to A applies at the partnership level.

*Example 2.* Same facts as in *Example 1* of this paragraph (c)(2), except Partnership does not provide A's information to the IRS during the administrative proceeding. The IRS mails Partnership a notice of final partnership adjustment (FPA) under section 6231. Partnership does not challenge the FPA in court. Partnership makes a timely election under section 6226 (regarding the alternative to payment of the imputed underpayment) and furnishes each reviewed year partner (as defined in § 301.6241-1(a)(9)) a statement including the reviewed year partner's share of the section 6662 accuracy-related penalty determined in the FPA. In taking the section 6662 accuracy-related penalty into account, A raises with the IRS a reasonable cause defense based on A's actions, asserting that A had reasonable cause and acted in good faith. Because all defenses against a penalty imposed under subchapter C of chapter 63 may only be raised by Partnership, A may not raise a defense to his share of the section 6662 penalty determined under section 6226. Therefore, the IRS will not take the penalty defense into account.

(d) *Coordination with other chapters of the Internal Revenue Code.* Nothing in subchapter C of chapter 63 and the regulations thereunder precludes the IRS from

making any adjustment to an item described in paragraph (b) of this section for purposes of determining taxes imposed by other provisions of the Internal Revenue Code (that is, taxes not imposed by chapter 1 of subtitle A).

(e) *Applicability date*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 3. Section 301.6221(b)-1 is added to read as follows:

*§ 301.6221(b)-1 Election out for certain partnerships with 100 or fewer partners.*

(a) *In general.* The provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) do not apply for any partnership taxable year for which an eligible partnership under paragraph (b) of this section makes a valid election in accordance with paragraph (c) of this section. For rules regarding deficiency procedures, see subchapter B of chapter 63 of the Internal Revenue Code and §§ 301.6211-1 through 301.6215-1.

(b) *Eligible partnership*—(1) *In general.* Only an eligible partnership may make an election under this section. A partnership is an eligible partnership for purposes of this section if—

(i) the partnership has 100 or fewer partners as determined in accordance with paragraph (b)(2) of this section, and

(ii) each statement the partnership is required to furnish under section 6031(b) for the partnership taxable year is furnished to a partner that was an eligible partner (as defined in paragraph (b)(3) of this section) for the partnership's entire taxable year.

(2) *100 or fewer partners*—(i) *In general.* Except as provided in paragraph (b)(2)(ii) of this section, a partnership has 100 or fewer partners if the partnership is required to furnish 100 or fewer statements under section 6031(b) for the taxable year.

(ii) *Special rule for S corporations.* For purposes of this paragraph (b)(2), a partnership with a partner that is an S corporation (as defined in section 1361(a)(1)) must take into account each statement required to be furnished by the S corporation to its shareholders under section 6037(b) for the taxable year of the S corporation ending with or within the partnership's taxable year.

(iii) *Examples.* The following examples illustrate the provisions of this paragraph (b)(2). For purposes of these examples, each partnership is required to file a return under section 6031(a):

*Example 1.* During its 2020 partnership taxable year, Partnership has four partners each owning an interest in Partnership. Two of the partners are Spouse 1 and Spouse 2 who are married to each other during all of 2020. Spouse 1 and Spouse 2 each own a separate interest in Partnership. The two other partners are unmarried individuals. Under section 6031(b), Partnership is required to furnish a separate statement (that is, Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*) to each individual partner, including separate statements to Spouse 1 and Spouse 2. Therefore, for purposes of paragraph (b)(2) of this section, Partnership has four partners during its 2020 taxable year.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (b)(2)(iii), except Spouse 2 does not separately own an interest in Partnership during 2020 and Spouse 1 and Spouse 2 live in a community property state. Spouse 1 and Spouse 2 have lived in the community property state for the entire taxable year and at all times since they were married. Spouse 1 acquired Spouse 1's interest in Partnership while married to Spouse 2. Because 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 Partnership is required to furnish under section 6031(b), Partnership is required to furnish a statement to Spouse 1, but not to Spouse 2. Therefore, for purposes of paragraph (b)(2) of this section, Partnership has three partners during its 2020 taxable year.

*Example 3.* At the beginning of 2020, Partnership, which has a taxable year ending December 31, 2020, has three partners - individuals A, B, and C. Each individual owns an interest in Partnership. On June 30, 2020, Individual A dies, and A's interest in Partnership becomes an asset of A's estate. A's estate owns the interest for the remainder of 2020. On September 1, 2020, B sells his interest in Partnership to Individual D, who holds the interest for the remainder of the year. Under section 6031(b), Partnership is required to furnish five statements for its 2020 taxable year - one each to Individual A, the estate of Individual A, Individual B, Individual D, and Individual C. Therefore, for purposes of paragraph (b)(2) of this section, Partnership has five partners during its 2020 taxable year.

*Example 4.* During its 2020 taxable year, Partnership has 51 partners - 50 partners who are individuals and S, an S corporation. S and Partnership

are both calendar year taxpayers. S has 50 shareholders during the 2020 taxable year. Under section 6031(b), Partnership is required to furnish 51 statements for the 2020 taxable year - one to S and one to each of Partnership's 50 partners who are individuals. Under section 6037(b), S is required to furnish a statement (that is, Schedule K-1 (Form 1120-S), *Shareholder's Share of Income, Deductions, Credits, etc.*) to each of its 50 shareholders. Under paragraph (b)(2)(ii) of this section, the number of statements required to be furnished by S under section 6037(b), which is 50, is taken into account to determine whether partnership has 100 or fewer partners. Accordingly, for purposes of paragraph (b)(2) of this section, Partnership has a total of 101 partners (51 statements furnished by Partnership to its partners plus 50 statements furnished by S to its shareholders) and is therefore not an eligible partnership under paragraph (b)(1) of this section. Because Partnership is not an eligible partnership, it cannot make the election under paragraph (a) of this section.

*Example 5.* During its 2020 taxable year, Partnership has two partners, A, an individual, and E, an estate of a deceased partner. E has 10 beneficiaries. Under section 6031(b), Partnership is required to furnish two statements, one to A and one to E. Any statements that E may be required to furnish to its beneficiaries are not taken into account for purposes of paragraph (b)(2) of this section. Therefore, Partnership has two partners under paragraph (b)(2) of this section.

(3) *Eligible Partners—(i) In general.* For purposes of paragraph (b)(1)(ii) of this section, the term *eligible partner* means a partner that is an individual, a C corporation (as defined by section 1361(a)(2)), an eligible foreign entity described in paragraph (b)(3)(iii) of this section, an S corporation, or an estate of a deceased partner. An S corporation is an eligible partner regardless of whether one or more shareholders of the S corporation are not an eligible partner.

(ii) *Partners that are not eligible partners.* A partner is not an eligible partner under paragraph (b)(3)(i) of this section if the partner is —

- (A) a partnership,
- (B) a trust,
- (C) a foreign entity that is not an eligible foreign entity described in paragraph (b)(3)(iii) of this section,
- (D) a disregarded entity described in § 301.7701-2(c)(2)(i),
- (E) a nominee or other similar person that holds an interest on behalf of another person, or
- (F) an estate of an individual other than a deceased partner.

(iii) *Eligible foreign entity.* For purposes of this paragraph (b)(3), a foreign entity is an eligible partner if the foreign

entity would be treated as a C corporation if it were a domestic entity. For purposes of the preceding sentence, a foreign entity would be treated as a C corporation if it were a domestic entity if the entity is classified as a per se corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8), is classified by default as an association taxable as a corporation under § 301.7701-3(b)(2)(i)(B), or is classified as an association taxable as a corporation in accordance with an election under the provisions of § 301.7701-3(c).

(iv) *Examples.* The following examples illustrate the rules of this paragraph (b)(3). For purposes of these examples, each partnership is required to file a return under section 6031(a):

*Example 1.* During the 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, D, is a partnership. Because D is a partnership, D is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1) of this section and, therefore, cannot make the election under paragraph (a) of this section for its 2020 taxable year.

*Example 2.* During its 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, S, is an S corporation. S has ten shareholders. One of S's shareholders is a disregarded entity and one is a qualified small business trust. S is an eligible partner under paragraph (b)(3)(i) of this section even though S's shareholders would not be considered eligible partners if those shareholders held direct interests in Partnership. See § 301.6221(b)-1(b)(3)(i). Accordingly, Partnership meets the requirements under paragraph (b)(3) of this section for its 2020 taxable year.

*Example 3.* During its 2020 taxable year, Partnership has two equal partners, A, an individual, and C, a disregarded entity, wholly owned by B, an individual. C is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1)(ii) of this section and, therefore, is ineligible to make the election under paragraph (a) of this section for its 2020 taxable year.

(c) *Election—(1) In general.* An election under this section must be made on the eligible partnership's timely filed return, including extensions, for the taxable year to which the election applies and include all information required by the Internal Revenue Service (IRS) in forms, instructions, or other guidance. An election is not valid unless the partnership discloses to the IRS all of the information required under paragraph (c)(2) of this section about all partners and, in the case



of a partner that is an S corporation, the shareholders of such S corporation. An election once made may not be revoked without the consent of the IRS.

(2) *Disclosure of partner information to the IRS.* A partnership making an election under this section must disclose to the IRS information about each person that was a partner at any time during the taxable year of the partnership to which the election applies, including each partner's name, correct U.S. taxpayer identification number (TIN), and Federal tax classification, an affirmative statement that the partner is an eligible partner under paragraph (b)(3) of this section, and any other information required by the IRS in forms, instructions, or other guidance. If a partner is an S corporation, the partnership must also disclose to the IRS the name, correct TIN, and Federal tax classification of each shareholder of the S corporation as well as any other information required by the IRS in forms, instructions, or other guidance.

(3) *Partner notification.* A partnership that makes an election under this section must notify each of its partners of the election within 30 days of making the election.

(d) *Election made by a partnership that is a partner—(1) In general.* The fact that a partnership has made an election under this section does not affect whether the provisions of subchapter C of chapter 63 apply to any other partnership, including a partnership in which the partnership making the election is a partner. Accordingly, the provisions of subchapter C of chapter 63 that apply to partners in a partnership that has not made an election under this section apply, to the extent provided in the regulations under subchapter C of chapter 63, to partners that are themselves partnerships that have made an election under this section in their capacity as partners in the other partnership.

(2) *Examples.* The following examples illustrate the rules of paragraph (d)(1) of this section. For purposes of these examples, each partnership is required to file a return under section 6031(a):

*Example 1.* During its 2020 taxable year, Partnership, a calendar year taxpayer, has two partners. One partner, A, is also a calendar year partnership. A files a valid election out of the centralized partnership audit regime with its timely filed partnership return for its 2020 taxable year. Notwithstanding A's valid election out of the centralized partnership audit

regime, A is subject to the same rules as any partner in a partnership subject to the rules under subchapter C of chapter 63, including the consistency requirements of section 6222 and the regulations thereunder.

*Example 2.* The IRS mails to Partnership, a calendar year taxpayer, a notice of final partnership adjustment under section 6231 with respect to Partnership's 2020 taxable year. Partnership timely elects the alternative to payment of imputed underpayment under section 6226 and the regulations thereunder. One of Partnership's partners is A, a calendar year partnership. A made a valid election out of the centralized partnership audit regime with its timely filed partnership return for its 2020 taxable year. Partnership must provide A with a statement under section 6226 containing A's share of the adjustments for Partnership's 2020 taxable year. A is subject to the same rules as any partner in a partnership subject to the rules under subchapter C of chapter 63.

(e) *Effect of an election—(1) In general.* An election made under this section is an action taken under subchapter C of chapter 63 by the partnership for purposes of section 6223. Accordingly, the partnership and all partners are bound by an election of the partnership under this section unless the IRS determines that the election is invalid. See § 301.6223-2 for the binding nature of actions taken by a partnership under subchapter C of chapter 63.

(2) *IRS determination that election is invalid.* If the IRS determines that an election under this section for a partnership taxable year is invalid, the IRS will notify the partnership in writing and the provisions of subchapter C of chapter 63 will apply to that partnership taxable year.

(f) *Applicability date.* These regulations are applicable to partnership taxable years beginning after December 31, 2017.

Par. 4. Section 301.6222-1 is added to read as follows:

**§ 301.6222-1 Partner's return must be consistent with partnership return.**

(a) *Consistent treatment of items—(1) In general.* The treatment on a partner's return of each item of income, gain, loss, deduction, or credit (as defined in § 301.6221(a)-1(b)(1)) attributable to a partnership must be consistent with the treatment of those items on the partnership return in all respects, including the amount, timing, and characterization of those items. A partner has not satisfied the requirement of this paragraph (a) if the treatment of the item on the partner's return is consistent with how the item was

treated on a schedule or other information furnished to the partner by the partnership but inconsistent with the treatment of the item on the partnership return actually filed. For rules relating to the election to be treated as having reported the inconsistency where the partner treats an item consistently with an incorrect schedule or other information furnished by the partnership, see paragraph (d) of this section.

(2) *Partner that is a partnership.* The rules of this section apply to a partnership-partner (as defined in § 301.6241-1(a)(7)) regardless of whether the partnership-partner has made an election under section 6221(b) to elect out of the provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63). Accordingly, unless the requirements of paragraph (c) of this section are satisfied, a partnership-partner must treat items attributable to a partnership in which it is a partner consistent with the treatment of such items on the partnership return filed by the partnership in which it is a partner.

(3) *Partnership does not file a return.* A partner's treatment of items attributable to a partnership that does not file a return is per se inconsistent, unless the partner files a notice of inconsistent treatment under paragraph (c) of this section.

(4) *Treatment of items on a partnership return.* For purposes of this section, the treatment of an item on a partnership return includes—

(i) the treatment of an item on the partnership's return of partnership income filed with the IRS under section 6031, and any amendment or supplement thereto, including an administrative adjustment request (AAR) filed pursuant to section 6227 and the regulations thereunder; and

(ii) the treatment of an item on any statement, schedule or list, and any amendment or supplement thereto, filed by the partnership with the Internal Revenue Service (IRS), including any statements filed pursuant to section 6226 and the regulations thereunder.

(5) *Examples.* The following examples illustrate the rules of this paragraph (a). For purposes of these examples, each partnership is subject to the provisions of subchapter C of chapter 63, and each partnership and its partners are calendar year taxpayers, unless otherwise stated.

*Example 1.* B is a partner in Partnership during 2018 and 2019. Both B and Partnership are calendar year taxpayers. In December 2018, Partnership receives an advance payment for services to be performed in 2019 and reports this amount as income on its partnership return for 2018. B includes its distributive share of income from the advance payment on B's income tax return for 2019 and not on B's income tax return for 2018. B did not file a notice of inconsistent treatment with respect to the advanced payment. B's treatment of the income attributable to Partnership is inconsistent with the treatment of that item by Partnership on its partnership return.

*Example 2.* C is a partner in Partnership during 2018. Partnership incurred start-up costs before it was actively engaged in its business. Partnership capitalized these costs on its 2018 partnership return. C deducted his distributive share of the start-up costs on C's 2018 income tax return. C's treatment of the start-up costs is inconsistent with the treatment of that item by Partnership on its partnership return.

*Example 3.* D is a partner in Partnership during 2018. Partnership reports a loss of \$100,000 on its partnership return for 2018. On the 2018 Schedule K-1 attached to the partnership return, Partnership reports \$5,000 as D's distributive share of that loss. On the 2018 Schedule K-1 furnished to D, however, Partnership reports \$15,000 as D's distributive share of the loss. D reports the \$15,000 loss on D's 2018 income tax return. D has not satisfied the requirements of paragraph (a) of this section because D reported D's distributive share of the loss in a manner that is inconsistent with how D's distributive share of the loss was reported on the 2018 partnership return actually filed. See, however, paragraph (d) of this section for the election to be treated as having reported the inconsistency where the partner treats an item consistently with an incorrect schedule.

*Example 4.* D was a partner in Partnership during 2018. Partnership reports a loss of \$100,000 on its partnership return for 2018. In 2020, Partnership files an AAR under section 6227 reporting that the amount of the loss on its 2018 partnership return is \$90,000, rather than \$100,000 as originally reported. Pursuant to section 6227 and the regulations thereunder, Partnership elects to have its partners take the adjustment into account, and furnishes D a statement showing D's share of the reduced loss for 2018. D fails to take his share of the reduced loss for 2018 into account in accordance with section 6227 and the regulations thereunder. D has not satisfied the requirements of paragraph (a) of this section because D has not taken into account his share of the loss in a manner consistent with how Partnership treated such items on the partnership return actually filed.

*Example 5.* E was a partner in Partnership during 2018. In 2021, Partnership receives a notice of final partnership adjustment in an administrative proceeding under subchapter C of chapter 63 with respect to Partnership's 2018 taxable year. Partnership properly elects the application of section 6226 and furnishes to E a statement of E's share of adjustments with respect to Partnership's 2018 taxable year. E fails to take his share of the adjustments into account in accordance with section 6226 and the regulations thereunder. E has not satisfied the requirements of paragraph (a) of this section because E has not taken

into account his share of adjustments with respect to Partnership's 2018 taxable year in a manner consistent with how Partnership treated such items on the partnership return actually filed.

*Example 6.* In 2018, E is a partner in Partnership. E is a partnership-partner with a 2018 taxable year that ends on the same day as Partnership's 2018 taxable year. E has filed a valid election under section 6221(b) in effect with respect to E's 2018 partnership taxable year. Notwithstanding E's election under section 6221(b) for its 2018 taxable year, E is subject to section 6222 for taxable year 2018. E must treat, on its 2018 partnership return, any items attributable to E's interest in Partnership in a manner that is consistent with the treatment of those items on the 2018 partnership return actually filed by Partnership.

(b) *Effect of inconsistent treatment—*  
(1) *Determination of underpayment of tax resulting from inconsistent treatment.* If a partner fails to satisfy the requirements of paragraph (a) of this section, unless the partner provides notice in accordance with paragraph (c) of this section, the IRS may adjust the inconsistently reported item on the partner's return to make it consistent with the treatment of such item on the partnership return and determine the underpayment of tax that results from that adjustment. For purposes of this section, the underpayment of tax is the amount by which the correct tax, as determined by making the partner's return consistent with the partnership return, exceeds the tax shown on the partner's return.

(2) *Assessment and collection of tax.* The IRS may assess and collect any underpayment of tax resulting from an adjustment described in paragraph (b)(1) of this section in the same manner as if the underpayment of tax was on account of a mathematical or clerical error appearing on the partner's return, except that the procedures under section 6213(b)(2) for requesting abatement of an assessment do not apply.

(3) *Effect when partner is a partnership.* If the partner is itself a partnership (a partnership-partner), any adjustment on account of such partnership-partner's failure to satisfy the requirements of paragraph (a) of this section will be treated as an adjustment on account of a mathematical or clerical error under section 6213(b), except that the procedures under section 6213(b)(2) for requesting abatement of an assessment do not apply. See section 6232(d)(1)(B).

(4) *Examples.* The following examples illustrate the rules of this paragraph (b).

*Example 1.* D, an individual, is a partner in Partnership. D and Partnership are both calendar year taxpayers and Partnership does not have an election under section 6221(b) in effect for its 2018 taxable year. On its partnership return for taxable year 2018, Partnership reports \$100,000 in ordinary income. On the Schedule K-1 attached to the partnership return, as well as on the Schedule K-1 furnished to D, Partnership reports \$15,000 as D's distributive share of the \$100,000 in ordinary income. D reports only \$5,000 of the \$15,000 of ordinary income on his 2018 income tax return. The IRS may determine the amount of tax that results from adjusting the ordinary income attributable to D's interest in Partnership reported on D's 2018 income tax return from \$5,000 to \$15,000 and assess that resulting underpayment in tax as if it was on account of a mathematical or clerical error appearing on D's return. D may not request an abatement of that assessment under section 6213(b).

*Example 2.* F was a partner in Partnership during 2018. In 2021, Partnership receives a notice of final partnership adjustment in an administrative proceeding under subchapter C of chapter 63 with respect to Partnership's 2018 taxable year. Partnership properly elects the application of section 6226 and files with the IRS a statement of F's share of adjustments with respect to Partnership's 2018 taxable year. F fails to report one adjustment, F's share of a decrease in the amount of losses for 2018, on F's return as required by section 6226 and the regulations thereunder. The IRS may determine the amount of tax that results from adjusting the decrease in the amount of losses on F's return to be consistent with the amount included on the section 6226 statement filed with the IRS and may assess the resulting underpayment in tax as if it was on account of a mathematical or clerical error appearing on F's return. F may not request an abatement of that assessment under section 6213(b).

(c) *Notification to the IRS when items attributable to a partnership are treated inconsistently—*(1) *In general.* Paragraphs (a) and (b) of this section (regarding the consistent treatment of items and the effect of inconsistent treatment) do not apply to items identified as inconsistent (or that may be inconsistent) in a statement that the partner provides to the IRS according to the forms, instructions, and other guidance prescribed by the IRS. Instead, the procedures in paragraph (c)(3) of this section apply. A statement does not identify an inconsistency for purposes of this paragraph (c) unless it is attached to the partner's return on which the item is treated inconsistently.

(2) *Coordination with section 6223.* Paragraph (c)(1) of this section is not applicable to an item the treatment of which is binding on the partner because of actions taken by the partnership under subchapter C of chapter 63 or because of a final decision in a proceeding with respect to the partnership under subchapter C of

chapter 63. Accordingly, the provisions of paragraph (c)(1) of this section do not apply with respect to the partner's treatment of an item reflected on an AAR under section 6227 or a statement under section 6226 filed by the partnership with the IRS to which the partner is bound under section 6223. Therefore, if the partner's treatment of the item reflected on an AAR or statement described in section 6226 is not consistent with the treatment of the partnership to which the partner is bound under section 6223, the provisions of section 6222(c) and paragraph (c)(1) of this section do not apply with respect to that item, and any resulting underpayment may be assessed and collected in accordance with paragraph (b)(2) of this section.

(3) *Partner protected only to extent of notification.* A partner who reports the inconsistent treatment of an item is not subject to paragraphs (a) and (b) of this section only with respect to those items identified in the statement described in paragraph (c)(1) of this section. Thus, if a partner notifying the IRS with respect to one item does not report the inconsistent treatment of another item, the IRS may determine the amount of tax that results from adjusting the unidentified, inconsistently reported item on the partner's return to make it consistent with the treatment of the item on the partnership return, and assess the resulting underpayment of tax in accordance with paragraph (b)(2) of this section.

(4) *Adjustment after notification—(i) In general.* If a partner notifies the IRS of the inconsistent treatment of an item in accordance with paragraph (c)(1) of this section, and the IRS disagrees with the inconsistent treatment, the IRS may adjust the identified, inconsistently reported item in a proceeding with respect to the partner. Nothing in this paragraph (c)(4)(i) precludes the IRS from also conducting a proceeding with respect to the partnership.

(ii) *Adjustments in partner proceeding.* In a proceeding with respect to a partner described in paragraph (c)(4)(i) of this section, the IRS may adjust any identified, inconsistently reported item to make the item consistent with the treatment of that item on the partnership return or determine that the correct treatment of such item differs from the treatment on the

partnership return and instead adjust the item to reflect the correct treatment, notwithstanding the treatment of that item on the partnership return. The IRS may also adjust any item on the partner's return, including items that are not attributable to the partnership. Any final decision with respect to an inconsistent position in a proceeding to which the partnership is not a party is not binding on the partnership.

(5) *Examples.* The following examples illustrate the rules of this paragraph (c). For purposes of these examples, each partnership is subject to the provisions of subchapter C of chapter 63, and each partnership and partner is a calendar year taxpayer, unless otherwise stated.

*Example 1.* B is a partner in Partnership during 2018. B treats a deduction and a capital gain attributable to Partnership on B's 2018 income tax return in a manner that is inconsistent with the treatment of those items by Partnership on its 2018 partnership return. B reports the inconsistent treatment of the deduction in accordance with paragraph (c)(1) of this section, but not the inconsistent treatment of the gain. Because B did not notify the IRS of the inconsistent treatment of the gain in accordance with paragraph (c)(1) of this section, the IRS may determine the amount of tax that results from adjusting the gain reported on B's 2018 income tax return in order to make the treatment of that gain consistent with how the gain was treated on Partnership's partnership return. Pursuant to paragraph (c)(3) of this section, the IRS may assess and collect the underpayment of tax resulting from the adjustment to the gain as if it was on account of a mathematical or clerical error appearing on B's return.

*Example 2.* On its 2018 partnership return, Partnership treats partner E's distributive share of ordinary loss attributable to Partnership as \$8,000. E, however, claims an ordinary loss of \$9,000 as attributable to Partnership on its 2018 income tax return and notifies the IRS of the inconsistent treatment in accordance with paragraph (c)(1) of this section. As a result of the notice of inconsistent treatment, the IRS conducts a separate proceeding under subchapter B of chapter 63 of the Internal Revenue Code with respect to E's 2018 income tax return, a proceeding to which Partnership is not a party. During the proceeding, the IRS determines that the proper amount of E's distributive share of the ordinary loss from Partnership is \$3,000. During the same proceeding, the IRS also determines that E overstated a charitable contribution deduction in the amount of \$2,500 on its 2018 income tax return. The determination of the adjustment of E's share of ordinary loss is not binding on Partnership. The charitable contribution deduction is not attributable to Partnership or to another partnership subject to the provisions of subchapter C of chapter 63. The IRS may determine the amount of tax that results from adjusting the \$9,000 ordinary loss deduction to \$3,000 and from adjusting the charitable contribution deduction. Pursuant to paragraph (c)(4)(ii) of this section, the IRS is not limited to only adjusting the ordinary loss of

\$9,000, as originally reported on E's partner return, to \$8,000, as originally reported by Partnership on its partnership return, nor is the IRS prohibited from adjusting the charitable contribution deduction in the proceeding with respect to E.

(d) *Partner receiving incorrect information—(1) In general.* A partner is treated as having complied with section 6222(c)(1)(B) and paragraph (c)(1) of this section with respect to an item attributable to a partnership if the partner –

(i) Demonstrates that the treatment of the item on the partner's return is consistent with the treatment of that item on the statement, schedule, or other form prescribed by the IRS and furnished to the partner by the partnership, and

(ii) The partner makes an election in accordance with paragraph (d)(2) of this section.

(2) *Time and manner of making election—(i) In general.* An election under paragraph (d) of this section must be filed in writing with the IRS office set forth in the notice that notified the partner of the inconsistency no later than 60 days after the date of such notice.

(ii) *Contents of election.* The election described in paragraph (d)(2)(i) of this section must be—

(A) Clearly identified as an election under section 6222(c)(2)(B);

(B) Signed by the partner making the election;

(C) Accompanied by a copy of the statement, schedule, or other form furnished to the partner by the partnership and a copy of the IRS notice that notified the partner of the inconsistency; and

(D) Include any other information required in forms, instructions, or other guidance prescribed by the IRS.

(iii) *Treatment of item is unclear.* Generally, the requirement described in paragraph (d)(2)(ii)(C) of this section will be satisfied by attaching a copy of the statement, schedule, or other form furnished to the partner by the partnership to the election (in addition to a copy of the IRS notice that notified the partner of the inconsistency). However, if it is not clear from the statement, schedule, or other form furnished by the partnership that the partner's treatment of such item on the partner's return is consistent, the election must also include an explanation of how the treatment of such item on the statement, schedule, or other form furnished

by the partnership is consistent with the treatment of the item on the partner's return, including with respect to the characterization, timing, and amount of such item.

(3) *Example.* The following example illustrates the rules of this paragraph (d). For purposes of this example, the partnership is subject to subchapter C of chapter 63 and the partnership and its partners are calendar year taxpayers.

*Example.* E is a partner in Partnership for 2018. On its 2018 partnership return, Partnership reports that E's distributive share of ordinary income attributable to Partnership is \$1,000. Partnership furnishes to E a Schedule K-1 for 2018 showing \$500 as E's distributive share of ordinary income. E reports \$500 of ordinary income attributable to Partnership on its 2018 income tax return consistent with the Schedule K-1 furnished to E. The IRS notifies E that E's treatment of the ordinary income attributable to Partnership on its 2018 income tax return is inconsistent with how Partnership treated the ordinary income allocated to E on its 2018 partnership return. Within 60 days of receiving the notice from the IRS of the inconsistency, E files an election with the IRS in accordance with paragraph (d)(2) of this section. Because E made a valid election under section 6222(c)(2)(B) and paragraph (d)(1) of this section, E is treated as having notified the IRS of the inconsistency with respect to the ordinary income attributable to Partnership under paragraph (c)(1) of this section.

(e) *Applicability date—(1) In general.* Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 5. Section 301.6223–1 is added to read as follows:

#### § 301.6223–1 Partnership representative.

(a) *Each partnership must have a partnership representative.* A partnership subject to subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) for a partnership taxable year must designate a partnership representative for the partnership taxable year in accordance with this section. There may be only one designated partnership representative for a partnership taxable year at any time. The designation of a partnership

representative for a partnership taxable year under this section remains in effect until the date on which the designation of the partnership representative is terminated by valid resignation (as described in paragraph (d) of this section), valid revocation (as described in paragraph (e) of this section), or a determination by the Internal Revenue Service (IRS) that the designation is not in effect (as described in paragraph (f) of this section). A designation of a partnership representative for a partnership taxable year under paragraphs (d), (e), or (f) of this section supersedes all prior designations of a partnership representative for that year. A partnership representative must update the partnership representative's contact information when such information changes as required by forms, instructions, or other guidance prescribed by the IRS. See § 301.6223–2(a) and (b) with regard to the binding effect of actions taken by the partnership representative. See § 301.6223–2(c) with regard to the sole authority of the partnership representative to act on behalf of the partnership. See paragraph (f) of this section for rules regarding designation of a partnership representative by the IRS.

(b) *Eligibility to serve as a partnership representative—(1) In general.* Any person (as defined in section 7701(a)(1)) that meets the requirements of paragraphs (b)(2) and (3) of this section, as applicable, is eligible to serve as a partnership representative. A partnership representative who no longer has the capacity to act (as described in paragraph (b)(4) of this section) is ineligible to serve as a partnership representative. A person designated under this section as partnership representative is deemed to be eligible to serve as the partnership representative unless and until the IRS determines that the person is ineligible.

(2) *Substantial presence in the United States.* A person must have substantial presence in the United States to be the partnership representative. A person has substantial presence in the United States for the purposes of this section if—

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

(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.

(3) *Eligibility of an entity to be a partnership representative—(i) In general.* A person who is not an individual may be a partnership representative only if an individual who meets the requirements of paragraphs (b)(2) and (4) of this section is appointed by the partnership as the sole individual through whom the partnership representative will act for all purposes under subchapter C of chapter 63. A partnership representative meeting the requirements of this paragraph (b)(3) is an *entity partnership representative* and the individual through whom such entity partnership representative acts is the *designated individual*. Designated individual status automatically terminates on the date that designation of the entity partnership representative for which the designated individual was appointed is no longer in effect.

(ii) *Appointment of a designated individual.* A designated individual is appointed at the time of the designation of the entity partnership representative in the manner prescribed by the IRS in forms, instructions, and other guidance. Accordingly, if the entity partnership representative is designated on the partnership return for the taxable year in accordance with paragraph (c)(2) of this section, the designated individual must be appointed at that time. Similarly, if the entity partnership representative is designated under paragraph (d) of this section (regarding resignation and successor designation of a partnership representative) or paragraph (e) of this section (regarding revocation and subsequent designation after revocation of a partnership representative), the designated individual must be appointed at that time. If the partnership fails to appoint a designated individual, the IRS may determine that the entity partnership representative designation is not in effect under paragraph (f) of this section.

(4) *Capacity to act.* For the purposes of this section, a person does not have the capacity to act, and is therefore ineligible to serve as a partnership representative or

designated individual, as applicable, under this paragraph (b), in the event of—

(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;

(v) Liquidation or dissolution under state law in the case of an entity partnership representative; or

(vi) Any similar situation where the IRS reasonably determines the person may no longer have the capacity to act.

(c) *Designation of partnership representative by the partnership*—(1) *In general.* The partnership must designate a partnership representative separately for each taxable year. The designation of a partnership representative for one taxable year is effective only for the taxable year for which it is made.

(2) *Designation.* Except in the case of designation of a partnership representative after an event described in paragraph (d) of this section (regarding resignation), paragraph (e) of this section (regarding revocation by the partnership), or paragraph (f) of this section (regarding designation made by the IRS), or as prescribed in forms, instructions, and other guidance, designation of a partnership representative must be made on the partnership return for the partnership taxable year to which the designation applies and must include all of the information required by forms, instructions, and other guidance, including information about the designated individual if the provisions of paragraph (b)(3) of this section apply. The designation of the partnership representative (and the appointment of the designated individual, if applicable) is effective on the date that the partnership return is filed.

(3) *Example.* The following example illustrates the rules of this paragraph (c).

*Example.* Partnership properly designates A as its partnership representative for taxable year 2018 on its 2018 partnership return. Partnership designates B as its partnership representative for taxable year 2021 on its 2021 partnership return. In 2022, the IRS mails Partnership a notice of administrative proceeding under section 6231 with respect to Partnership's 2018 taxable year. A is the partnership representative for the 2018 partnership taxable year, notwithstanding the designation of B as partnership representative for the 2021 partnership taxable year.

(d) *Resignation of the partnership representative*—(1) *In general.* A partnership representative may resign by notifying the partnership and the IRS in writing of the resignation. The notification to the IRS, submitted in accordance with applicable forms and instructions prescribed by the IRS, may include a designation of a successor partnership representative for the partnership taxable year for which designation of the resigning partnership representative was in effect. A resignation and designation of the successor partnership representative, if applicable, is effective 30 days from the date on which the IRS receives the written notification. If the resigning partnership representative designates a successor, the IRS will notify the partnership, the resigning partnership representative, and the newly designated partnership representative when the IRS receives the written notification. If the resigning partnership representative does not designate a successor, the IRS will determine there is no designation in effect in accordance with paragraph (f) of this section, and the partnership will have the opportunity to designate a successor partnership representative, or the IRS will designate a successor, as described in paragraph (f)(1) of this section. Failure to satisfy the requirements of this paragraph (d) is treated as if no resignation has occurred and the partnership representative designation remains in effect until the designation is terminated either by valid resignation (as described in this paragraph (d)), a valid revocation of the designation by the partnership (as described in paragraph (e) of this section), or a determination by the IRS that the designation is not in effect (as described in paragraph (f) of this section).

(2) *Time for resignation.* A partnership representative may resign simultaneously with the filing of a valid administrative adjustment request (AAR) in accordance with section 6227 and the regulations thereunder for a partnership taxable year, after receipt of a notice of administrative proceeding for the partnership taxable year, or at such other time as prescribed by the IRS in other guidance. If a partnership representative resigns in connection with the filing of an AAR, the partnership representative must designate a successor partnership representative. A partnership

may not use the form prescribed by the IRS for filing an AAR solely for the purposes of allowing the partnership representative to resign.

(3) *Special rule for resignation of designated individual.* A designated individual may resign by notifying the partnership, partnership representative, and the IRS in writing of the resignation subject to the time of resignation restrictions described in paragraph (b)(2) of this section as if the designated individual were a partnership representative. The notification to the IRS, submitted in accordance with applicable forms and instructions prescribed by the IRS, may, but is not required to, include an appointment of a successor designated individual for the partnership taxable year for which the designated individual was appointed. The resignation (and appointment of the successor designated individual, if applicable) is effective 30 days from the date on which the IRS receives the written notification. If the resigning designated individual appoints a successor, the IRS will notify the partnership, the partnership representative, the resigning designated individual, and any newly appointed designated individual when the IRS receives the written notification. If the resigning designated individual does not appoint a successor, the IRS will determine there is no designation in effect in accordance with paragraph (f) of this section, and the partnership will have the opportunity to designate a partnership representative, including the appointment of a designated individual, or the IRS will designate a partnership representative, as described in paragraph (f)(1) of this section.

(e) *Revocation of designation*—(1) *In general.* The partnership may revoke the designation of the partnership representative for a partnership taxable year by notifying the partnership representative and the IRS in writing. The notification to the IRS, submitted in accordance with applicable forms and instructions prescribed by the IRS, must satisfy the requirements of paragraph (e)(3)(iii) of this section and must include designation of a successor partnership representative for the partnership taxable year for which designation of the partnership representative was in effect. The revocation and designation of a new partnership representative is effective

30 days from the date on which the IRS receives the written notification. The IRS will notify the partnership and any partnership representative whose designation is being revoked when the IRS receives a revocation made in accordance with paragraph (e)(2) of this section. Failure to satisfy the requirements of this section is treated as if no revocation has occurred and the partnership representative designation remains in effect until the designation is terminated either by valid resignation (as described in paragraph (d) of this section), valid revocation of the designation by the partnership (as described in this paragraph (e)), or a determination by the IRS that the designation is not in effect (as described in paragraph (f) of this section).

(2) *Time for revocation*—(i) *Revocation during an administrative proceeding*. Except as provided in paragraph (e)(2)(ii) of this section or in other guidance prescribed by the IRS, a partnership may not revoke the designation of the partnership representative before the IRS mails a notice of administrative proceeding pursuant to section 6231 and the regulations thereunder. Upon receipt of a notice of administrative proceeding, the partnership may revoke the partnership representative designation.

(ii) *Revocation with an AAR*. The partnership may revoke a designation of a partnership representative for the taxable year when the partnership files a valid AAR in accordance with section 6227 and the regulations thereunder for a partnership taxable year. The revocation of the partnership representative and the designation of the new partnership representative is effective 30 days from the date the partnership files a valid AAR. A partnership may not use the form prescribed by the IRS for filing an AAR solely for the purpose of revoking the designation of a partnership representative.

(3) *Partners who may sign revocation*—(i) *General partner and certain partners in limited circumstances*. 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. A partner in the partnership during the taxable year who was not a general

partner eligible to sign the revocation 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 the capacity to act (as described under paragraphs (b)(4)(i) through (v) of this section as if the general partner was a partnership representative or designated individual). See paragraph (e)(3)(ii) of this section for the rules applicable to limited liability companies.

(ii) *Limited liability companies*—(A) *In general*. Solely for the purposes of applying this paragraph (e)(3) to a limited liability company (LLC) (as defined in paragraph (e)(3)(ii)(B)(1) of this section), a member-manager of an LLC is treated as a general partner, and a member of an LLC who is not a member-manager is treated as a partner other than a general partner.

(B) *Definitions*. For purposes of this paragraph (e)(3)(ii), the following terms have the following meaning:

(1) *LLC*. An LLC means an organization formed under a state or foreign law that allows the limitation of the liability of all members for the organization's debts and other obligations within the meaning of § 301.7701-3(b)(2)(ii) and that is classified as a partnership for Federal tax purposes.

(2) *Member*. A member means any person who owns an interest in an LLC.

(3) *Member-manager*. A member-manager means a member of an LLC who, alone or together with others, is vested with the continuing exclusive authority to make the management decisions necessary to conduct the business for which the organization was formed. Generally, an LLC statute may permit the LLC to choose management by one or more managers (whether or not members) or by all of the members. If there are no elected or designated member-managers of the LLC, each member will be treated as a member-manager for purposes of this paragraph (e)(3)(ii)(B)(3).

(iii) *Form of the revocation*. The notification of revocation described in paragraph (e)(1) of this section must include the items described in this paragraph (e)(3)(iii). A notification of revocation described in paragraph (e)(1) of this section

that does not include each of the following items is not a valid revocation:

(A) A certification under penalties of perjury that the person signing the form—

(1) Is a partner described in paragraph (e)(3)(i) of this section (or in the case of an LLC, a person described in paragraph (e)(3)(ii) of this section) authorized by the partnership to revoke the designation of the partnership representative; and

(2) Has provided a copy of the revocation to the partnership and to the partnership representative whose designation is being revoked;

(B) A statement that the person signing the form is revoking the designation of the partnership representative; and

(C) A subsequent designation of a partnership representative in accordance with forms and instructions prescribed by the IRS.

(4) *Partnership representative designated by the IRS*. If a partnership representative is designated by the IRS pursuant to paragraph (f)(5) of this section, the partnership may only revoke that designation with the permission of the IRS.

(5) *Multiple revocations*. If within a 90-day period the IRS receives more than one revocation of a designation of a partnership representative for the same partnership taxable year signed by different persons, the IRS may determine that a designation is not in effect under paragraph (f) of this section.

(6) *Examples*. The following example illustrates the rules of this paragraph (e).

*Example 1*. Partnership properly designates B as partnership representative for its 2018 taxable year on its 2018 partnership return. In 2020, Partnership mails written notification to the IRS to revoke designation of B as its partnership representative for Partnership's 2018 taxable year. The revocation is not made in connection with an AAR for Partnership's 2018 taxable year, and the IRS has not mailed Partnership a notice of administrative proceeding under section 6231 with respect to Partnership's 2018 taxable year. Because the revocation was not made during a time permitted under paragraph (e)(2) of this section, the revocation is not effective and B remains the partnership representative for Partnership's 2018 taxable year.

*Example 2*. During an administrative proceeding with respect to Partnership's 2018 taxable year, Partnership provides IRS with written notification to revoke its designation of B as its partnership representative for the 2018 taxable year. The written notification does not include a designation of a new partnership representative for Partnership's 2018 taxable year. Because the revocation does not include a designation of a new partnership representa-

tive as required under paragraph (e)(1) of this section, the revocation is not effective and B remains the partnership representative for Partnership's 2018 taxable year.

(f) *Designation of the partnership representative by the IRS—(1) In general.* If the IRS determines that a designation of a partnership representative is not in effect for a partnership taxable year in accordance with paragraph (f)(2) of this section, the IRS will notify the partnership and the most recent partnership representative for that partnership taxable year that a partnership designation is not in effect and provide the partnership with the opportunity to designate a successor partnership representative that is eligible under paragraph (b) of this section. The determination that a designation is not in effect is effective on the date the IRS mails the notification. Except as described in paragraph (f)(4) of this section, the partnership may designate a successor partnership representative within 30 days of the date of notification. If the partnership does not designate a successor within 30 days from the date of notification, the IRS will designate a partnership representative in accordance with paragraph (f)(5) of this section. A partnership representative designation made in accordance with paragraphs (c), (d), (e), or (f) of this section remains in effect until the IRS determines the designation is not in effect.

(2) *IRS determination that partnership representative designation not in effect.* The IRS may determine that the partnership representative designation is not in effect in the case of multiple revocations as described in paragraph (e)(5) of this section or if the IRS determines that –

(i) the partnership failed to make a valid designation under paragraph (c) of this section;

(ii) the partnership representative or the designated individual does not have substantial presence (as described in paragraph (b)(2) of this section, as applicable) or does not have capacity to act (as described in paragraph (b)(4) of this section);

(iii) the partnership failed to appoint a designated individual (as described in paragraph (b)(3) of this section, as applicable); or

(iv) no successor designation or appointment was made in the case of a resignation without a designation or appoint-

ment of a successor as described in paragraphs (d)(1) and (3) of this section.

(3) *Form of successor partnership representative designation.* The partnership must designate the successor partnership representative in accordance with applicable forms and instructions prescribed by the IRS. If the partnership fails to provide all information required under the forms and instructions, the partnership will have failed to designate a successor partnership representative.

(4) *No opportunity for designation by the partnership in the case of multiple revocations.* In the event that the IRS determines a partnership representative designation is not in effect due to multiple revocations as described in paragraph (e)(5) of this section, the partnership will not be given an opportunity to designate the successor partnership representative prior to the designation by the IRS as described in paragraph (f)(5) of this section.

(5) *Designation by the IRS—(i) In general.* The IRS designates a partnership representative by notifying the partnership of the name, address, and telephone number of the new partnership representative. The designation of a partnership representative by the IRS is effective on the date on which the IRS mails the notice of the designation to the partnership. The IRS will also mail a copy of the notice to the new partnership representative.

(ii) *Factors considered when partnership representative designated by the IRS.* The IRS may designate any person to be the partnership representative. In addition to other relevant factors, the IRS will consider whether there is a suitable partner of the partnership, either from the reviewed year (as defined in § 301.6241-1(a)(8)) or at the time the partnership representative designation is made. The IRS may consider the following factors when designating a person as the partnership representative:

(A) The views of the partners having a majority interest in the partnership regarding the designation;

(B) The general knowledge of the person in tax matters and the administrative operation of the partnership;

(C) The person's access to the books and records of the partnership;

(D) Whether the person is a United States person (within the meaning of section 7701(a)(30)).

(6) *Examples.* The following examples illustrate the rules of this paragraph (f).

*Example 1.* The IRS determines that Partnership has designated a partnership representative that does not have substantial presence in the United States as defined in paragraph (b)(2) of this section. The IRS may determine that the designation is not in effect and designate a new partnership representative after following the procedures in paragraph (f) of this section.

*Example 2.* Partnership designates as its partnership representative a corporation but fails to appoint a designated individual to act on behalf of the corporation as required under paragraph (b)(3) of this section. The IRS may determine that the partnership representative designation is not in effect and may designate a new partnership representative after following the procedures in paragraph (f) of this section.

*Example 3.* The partnership representative resigns pursuant to paragraph (d) of this section without designating a new partnership representative. The IRS mails Partnership a notification informing Partnership that no designation is in effect and that the IRS plans to designate a new partnership representative. Partnership fails to respond within 30 days of the IRS's notification. The IRS will designate a partnership representative pursuant to paragraph (f) of this section.

*Example 4.* Partnership designated on its partnership return a partnership representative, PR1. After Partnership received a notice of administrative proceeding, general partner, GP1, signs and submits to the IRS the form described in paragraph (e)(3) of this section requesting the revocation of the current partnership representative PR1 and the designation of a successor partnership representative, PR2. Sixty days later, general partner, GP2, signs and submits a form described in paragraph (e)(3) of this section requesting the revocation of the newly appointed PR2 and the designation of PR3 as the new partnership representative. The IRS may accept GP2's revocation and subsequent designation of PR3 or, because GP2's revocation was within 90 days of GP1's revocation, the IRS may determine, pursuant to paragraphs (e)(5) and (f)(2) of this section that there is no designation in effect due to multiple revocations. The IRS may then designate a new partnership representative pursuant to paragraph (f) of this section without allowing the partnership an opportunity for additional, possibly conflicting, designations.

(g) *Reliance on forms required by this section.* The IRS may rely on any form or other document filed or submitted under this section as evidence of the designation, resignation, or revocation on such form and as evidence of the date on which such form was filed or submitted relating to a designation, resignation, or revocation.

(h) *Effective date—(1) In general.* Except as provided in paragraph (h)(2) of this section, this section applies to part-

nership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable years beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 6. Section 301.6223–2 is added to read as follows:

*§ 301.6223–2 Binding effect of actions of the partnership and partnership representative.*

(a) *Binding nature of actions by partnership and final decision in a partnership proceeding.* The actions of the partnership and the partnership representative taken under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) and any final decision in a proceeding brought under subchapter C of chapter 63 with respect to the partnership bind the partnership, all partners of the partnership (including partnership-partners as defined in § 301.6241–1(a)(7) that have a valid election under section 6221(b) in effect for any taxable year that overlaps with the taxable year of the partnership), and any other person whose tax liability is determined in whole or in part by taking into account directly or indirectly adjustments determined under subchapter C of chapter 63 (for example, indirect partners as defined in § 301.6241–1(a)(4)). For instance, a settlement agreement entered into by the partnership representative on behalf of the partnership, a notice of final partnership adjustment with respect to the partnership that is not contested by the partnership or the partnership representative, or the final decision of the court with respect to the partnership if the notice of final partnership adjustment is contested, binds all persons described in the preceding sentence.

(b) *Actions by the partnership representative before termination of designation.* The termination of the designation of the partnership representative under § 301.6223–1 does not affect the validity of any action taken by that partnership representative during the period prior to termination when the designation was in effect. For example, if a partnership representative properly designated under

§ 301.6223–1 consented to an extension of the period for adjustments under section 6235(b), that extension remains valid even after termination of the designation of that partnership representative.

(c) *Partnership representative has the sole authority to act on behalf of the partnership—(1) In general.* The partnership representative has the sole authority to act on behalf of the partnership for all purposes under subchapter C of chapter 63. In the case of an entity partnership representative, the designated individual has the sole authority to act on behalf of the partnership representative and the partnership. Except for a partner that is the partnership representative or the designated individual, no partner, or any other person, may participate in an examination or other proceeding involving the partnership under subchapter C of chapter 63 without the permission of the IRS. No 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.

(2) *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 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 for all purposes under subchapter C of chapter 63.

(d) *Examples.* The following examples illustrate the rules of this section.

*Example 1.* Partnership designates a partnership representative, PR, on its partnership return for 2020. PR is a partner in Partnership. The partnership agreement for Partnership includes a clause that requires PR to consult with an identified management group of partners in Partnership before taking any action with respect to an administrative proceeding before the IRS. The IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year. During the course of the administrative proceeding, PR consents to an extension of the period for adjustments under section 6235(b) allowing additional time for the IRS to mail a final notice of partnership adjustment. PR failed to consult with the manage-

ment group of partners prior to agreeing to this extension of time. PR's consent provided to the IRS to extend the time period is valid and binding on Partnership because, pursuant to section 6223, PR, as the designated partnership representative, has authority to bind Partnership and all its partners.

*Example 2.* Partnership designates a partnership representative, PR, on its partnership return for 2020. PR is not a partner in Partnership. During an administrative proceeding with respect to Partnership's 2020 taxable year, PR agrees to certain IRS adjustments and within 45 days after the issuance of the notice of final partnership adjustment (FPA), elects the alternative to payment of the imputed underpayment under section 6226 and the regulations thereunder. Certain partners in Partnership challenge the actions taken by PR during the administrative proceeding and the validity of the section 6226 statements furnished to those partners, alleging that PR was never authorized to act on behalf of Partnership under state law or the partnership agreement. Because PR was designated by Partnership as the partnership representative, under section 6223 and this section, PR was authorized to act on behalf of Partnership for all purposes under subchapter C of chapter 63, and the IRS may rely on that designation as conclusive evidence of PR's authority to act on behalf of Partnership.

*Example 3.* Partnership designates an entity partnership representative, EPR, and appoints an individual A, as the designated individual, on its partnership return for 2020. EPR is a C corporation. A is unaffiliated with EPR and is not an officer, director, or employee of EPR. During an administrative proceeding with respect to Partnership's 2020 taxable year, A, acting for EPR, agrees to an extension of the period for adjustments under section 6235(b). The IRS mails an FPA within the extended period for adjustments as agreed to by EPR, but after the expiration of the period had no agreement been entered into. Partnership challenges the FPA as untimely, alleging that A was not authorized under state law to act on behalf of EPR and thus the extension agreement was invalid. Because A was appointed by the partnership as the designated individual to act on behalf of EPR, A was authorized to act on behalf of EPR for all purposes under subchapter C of chapter 63, and the IRS may rely on that identification as conclusive evidence of A's authority to act on behalf of EPR and Partnership.

*Example 4.* The partnership representative, PR, consents to an extension of the period for adjustment under section 6235(b) for Partnership for the partnership taxable year. After signing the consent, PR resigns as partnership representative in accordance with § 301.6223–1. The extension of the period under section 6235(b) remains valid even after PR resigns.

*Example 5.* Partnership designates a partnership representative who is unable to meet with the IRS in person in the United States as required by § 301.6223–1(b). Although the partnership representative does not have substantial presence in the United States within the meaning of § 301.6223–1(b)(2), until a termination occurs under § 301.6223–1(d) or (e) or the IRS determines the partnership representative is ineligible under § 301.6223–1(b) and terminates the designation under § 301.6223–1(f), the partnership representative desig-



nation remains in effect, and Partnership and all its partners are bound by the actions of the partnership representative.

(e) *Applicability date*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable years beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 7. Section 301.6225-1 is added to read as follows:

*§ 301.6225-1 Partnership Adjustment by the Internal Revenue Service.*

(a) *Imputed underpayment paid by partnership in adjustment year*—(1) *In general.* Any imputed underpayment (as determined in accordance with paragraph (c) of this section) with respect to any partnership adjustment (as defined in § 301.6241-1(a)(6)) for any partnership taxable year must be paid by the partnership in the same manner as if it were a tax imposed for the adjustment year (as defined in § 301.6241-1(a)(1)). The notice of final partnership adjustment under section 6231 will include the amount of any imputed underpayment, as modified under § 301.6225-2 if applicable, unless the partnership waives its right to such notice under section 6232(d)(2). For the alternative to payment of the imputed underpayment by the partnership, see § 301.6226-1. For assessment, collection, and payment of an imputed underpayment, see section 6232 and the regulations thereunder. If a partnership pays an imputed underpayment (as determined in accordance with paragraph (c) of this section), the partnership's expenditure for the imputed underpayment and the adjustments that result in the imputed underpayment are taken into account by the partnership in accordance with § 301.6241-4. For interest and penalties with respect to an imputed underpayment, see section 6233.

(2) *All preferences, limitations, restrictions, and conventions apply.* For purposes of determining the imputed underpayment, adjustments, netting of adjustments, and calculations or determinations of any amounts under this section, unless the Internal Revenue Service (IRS) in its discretion deter-

mines otherwise, all applicable preferences, restrictions, limitations, and conventions will be taken into account to disallow netting of adjustments, where applicable, or to disallow or limit, as applicable, any adjustment that potentially results in an increase of loss, deduction or credit, or decrease of income or gain, and 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 partners. For instance, if the adjustment is a reduction of qualified research expenses, the amount of the imputed underpayment is determined as if all partners claimed a credit with respect to their allocable portion of such expenses under section 41, rather than a deduction under section 174. See § 301.6225-2 for modifications of the imputed underpayment that may be requested by the partnership.

(3) *Imputed underpayment set forth in notice of proposed partnership adjustment.* An imputed underpayment set forth in a notice of proposed partnership adjustment (NOPPA) under section 6231 is determined under paragraph (c)(1) of this section without regard to any modification under § 301.6225-2. Modifications under § 301.6225-2, if allowed by the IRS, may reduce the imputed underpayment determined under paragraph (c)(1) of this section. Only the partnership adjustments set forth in a NOPPA are taken into account for purposes determining the imputed underpayment under this section and any modification under § 301.6225-2.

(b) *Treatment of an adjustment that does not result in an imputed underpayment.* Any adjustment that does not result in an imputed underpayment (as described in paragraph (c)(2) of this section) is taken into account by the partnership in the adjustment year in accordance with § 301.6225-3.

(c) *Calculation of an imputed underpayment*—(1) *In general.* In the case of any partnership adjustment by the IRS, the imputed underpayment required to be paid by the partnership under paragraph (a) of this section is calculated by—

(i) Multiplying the total netted partnership adjustment (as determined under paragraph (c)(3) of this section) by the highest rate of Federal income tax in effect for the reviewed year (as defined in § 301.6241-1(a)(8)) under section 1 or 11, and

(ii) Increasing or decreasing the product in paragraph (c)(1)(i) of this section by the net increase or net decrease in credits resulting from partnership adjustments (as determined under paragraph (d) of this section).

(2) *Partnership adjustments that do not result in an imputed underpayment.* A partnership adjustment does not result in an imputed underpayment if—

(i) The adjustment relates to a distributive share reallocation that is disregarded under paragraph (d)(2)(ii) of this section;

(ii) After grouping and netting the adjustments as described in paragraph (d) of this section, the result of netting any grouping or subgrouping is a net non-positive adjustment (as described in paragraph (d)(3) of this section); or

(iii) The calculation under paragraph (c)(1) of this section results in an amount that is zero or less than zero.

(3) *Calculation of the total netted partnership adjustment.* For purposes of determining whether there is an imputed underpayment under paragraph (c)(1) of this section, the *total netted partnership adjustment* is—

(i) The sum of all net positive adjustments in the residual grouping as determined in accordance with paragraph (d)(2)(v) of this section, plus

(ii) The sum of all net positive adjustments in the reallocation grouping as determined in accordance with paragraph (d)(2)(ii) of this section.

(4) *No netting of adjustments between taxable years.* Each imputed underpayment is calculated based on adjustments solely with respect to a single taxable year. Adjustments from one taxable year may not be netted against adjustments from another taxable year.

(d) *Grouping and netting of partnership adjustments*—(1) *In general.* For purposes of calculating an imputed underpayment under paragraph (c) of this section, partnership adjustments are grouped according to paragraph (d)(2) of this section and the partnership adjustments comprising each grouping are netted in accordance with paragraph (d)(3) of this section. Within each grouping, partnership adjustments are further grouped 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.

(2) *Groupings*—(i) *In general*. To calculate an imputed underpayment under paragraph (c) of this section, partnership adjustments are grouped into categories in the following order –

(A) First, each partnership adjustment that reallocates the distributive share of an item forms its own grouping which is taken into account in accordance with paragraph (d)(2)(ii) of this section (reallocation grouping);

(B) Second, adjustments to credits are taken into account in a grouping under paragraph (d)(2)(iii) of this section (credit grouping);

(C) Third, adjustments to creditable expenditures are taken into account in a grouping under paragraph (d)(2)(iv) of this section (creditable expenditure grouping); and

(D) Fourth, the remaining adjustments are taken into account in the residual grouping under paragraph (d)(2)(v) of this section (residual grouping).

(ii) *Reallocation grouping*. A partnership adjustment that reallocates the distributive share of an item from one or more partners to one or more other partners, or a partnership adjustment that allocates an item to a particular partner or partners, is taken into account in calculating the imputed underpayment under paragraph (c) of this section by disregarding net decreases to items of income or gain and net increases to items of deduction, loss, or credit. Each adjustment to an item or to a distributive share of an item that allocates to or reallocates to and from a particular partner or partners is a separate subgrouping for purposes of the netting rules in paragraph (d)(3) of this section. For instance, if the reallocation adjustment reallocates an item of deduction from one partner to another partner, the decrease in the deduction with respect to the first partner is in a separate subgrouping from the increase in deduction with respect to the second partner. If a particular partner or group of partners has more than one adjustment allocable to it within the reallocation grouping, such adjustments may be combined or further divided into additional subgroupings according to the principles of paragraphs (d)(1) and (d)(2)(v) of this section and

netted according to paragraph (d)(3) of this section. After subgroupings are netted under paragraph (d)(3) of this section, any net non-positive adjustments (as defined in paragraph (d)(3)(ii)(C) of this section) are disregarded. Net non-positive adjustments disregarded under this paragraph (d)(2)(ii) are adjustments that do not result in an imputed underpayment under paragraph (c)(2) of this section. Net positive adjustments are included in the calculation of the total netted partnership adjustment under paragraph (c)(3) of this section if the net positive adjustments would otherwise be a part of the residual grouping described in paragraph (d)(2)(v) of this section. Net positive adjustments to credits are included in the credit grouping described in paragraph (d)(2)(iii) of this section.

(iii) *Credit grouping*. The credit grouping includes all adjustments to items that are claimed or could be claimed by a partnership as a credit on the partnership's return.

(iv) *Creditable expenditure grouping*.—[Reserved]

(v) *Residual grouping*. Any partnership adjustment not described in paragraph (d)(2)(ii), (d)(2)(iii), or (d)(2)(iv) of this section is included in the residual grouping described in this paragraph (d)(2)(v) and is further divided into subgroupings according to any limitations or restrictions imposed on the items to which the adjustment relates under the Code. Each subgrouping in the residual grouping is created to account for limitations or restrictions such as character or holding period.

(3) *Netting adjustments within each grouping or subgrouping*—(i) *In general*. The partnership adjustments in a grouping or subgrouping described in paragraph (d)(2) of this section are netted together within each grouping or subgrouping to determine whether there is a net positive adjustment or a net non-positive adjustment (as defined in paragraph (d)(3)(ii)(B) and (C) of this section) for that grouping or subgrouping. Adjustments in one grouping or subgrouping are not netted against adjustments in any other grouping or subgrouping. For instance, under paragraph (d)(2) of this section, adjustments to ordinary income and loss items are grouped together separately from capital

gain and loss items. Therefore under this paragraph (d)(3)(i), the items in the ordinary grouping are not netted against the items in the capital grouping.

(ii) *Only net positive adjustments taken into account in calculating the total netted partnership adjustment*—(A) *In general*. Only adjustments to items resulting in a net positive adjustment (as defined in paragraph (d)(3)(ii)(B) of this section) for a grouping or subgrouping are taken into account in calculating the total netted partnership adjustment under paragraph (c)(3) of this section. A net non-positive adjustment (as defined in paragraph (d)(3)(ii)(C) of this section) for a grouping or subgrouping is disregarded for purposes of calculating the total netted partnership adjustment under paragraph (c)(3) of this section. The adjustments underlying a net non-positive adjustment that are disregarded under this paragraph (d)(3)(ii)(A) are adjustments that do not result in an imputed underpayment (as described in paragraph (c)(2) of this section).

(B) *Net positive adjustment*. A net positive adjustment results if the net amount of adjustments within a grouping or subgrouping under paragraph (d)(2) of this section (except with respect to the credit grouping described in paragraph (d)(2)(iii) of this section) is greater than zero.

(C) *Net non-positive adjustment*. A net non-positive adjustment is any net amount within a grouping or subgrouping described in paragraph (d)(2) of this section (except for the credit grouping under paragraph (d)(2)(iii) of this section) that is not a net positive adjustment (as defined in paragraph (d)(3)(ii)(B) of this section).

(iii) *Treatment of adjustments when netting*. For purposes of netting adjustments within a grouping —

(A) An increase in gain is treated as an increase in income;

(B) A decrease in gain is treated as a decrease in income;

(C) An increase in loss is treated as a decrease in income; and

(D) A decrease in a loss is treated as an increase in income.

(e) *Multiple imputed underpayments in a single administrative proceeding*—(1) *In general*. The IRS, in its discretion, may determine that partnership adjustments for the same partnership taxable year result in

more than one imputed underpayment. The determination of whether there is more than one imputed underpayment for any partnership taxable year, and if so, which partnership adjustments are taken into account to calculate any particular imputed underpayment is based on the nature of the partnership adjustments. See § 301.6225-2(d)(6) for modification of the number and composition of imputed underpayments.

(2) *Types of imputed underpayments*—

(i) *In general.* There are two types of imputed underpayments, a general imputed underpayment (defined in paragraph (e)(2)(ii) of this section) and a specific imputed underpayment (defined in paragraph (e)(2)(iii) of this section). Each type of imputed underpayment is separately calculated in accordance with the rules described in paragraphs (c) and (d) of this section.

(ii) *General imputed underpayment.* The general imputed underpayment is calculated based on all adjustments (other than adjustments that do not result in an imputed underpayment under paragraph (c)(2) of this section) that are not taken into account to determine a specific imputed underpayment under paragraph (e)(2)(iii) of this section. There is only one general imputed underpayment in any administrative proceeding. If there is one imputed underpayment in an administrative proceeding, it is a general imputed underpayment and may take into account adjustments described in paragraph (e)(2)(iii) of this section, if any.

(iii) *Specific imputed underpayment.* A specific imputed underpayment is an imputed underpayment with respect to adjustments to an item or items that were allocated to one partner or a group of partners that had the same or similar characteristics or that participated in the same or similar transaction. The IRS may designate more than one specific imputed underpayment with respect to any partnership taxable year. For instance, in a single partnership taxable year there may be a specific imputed underpayment with respect to adjustments related to a transaction affecting some, but not all, partners of the partnership (such as adjustments that are specially allocated to certain partners) and a second specific imputed underpayment with respect to adjustments resulting from a reallocation of a distributive share of income from one partner to another

partner. The IRS may, in its discretion, determine that partnership adjustments that could be taken into account to calculate one or more specific imputed underpayments under this paragraph (e)(2)(iii) for a partnership taxable year are more appropriately taken into account in determining the general imputed underpayment for such taxable year. For instance, the IRS may determine that it is more appropriate to calculate only the general imputed underpayment if when calculating the specific imputed underpayment requested by the partnership, there is an increase in the number of the partnership adjustments that after netting result in net non-positive adjustments and are disregarded in calculating the specific imputed underpayment.

(f) *Examples.* The following examples illustrate the rules of this section. For purposes of these examples, each partnership is subject to the provisions of subchapter C of chapter 63 of the Code, each partnership and its partners are calendar year taxpayers, all partners are U.S. persons (unless otherwise stated), the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods, and no partnership requests modification under § 301.6225-2.

*Example 1.* Partnership reports on its 2019 partnership return \$100 of ordinary income and an ordinary deduction of <\$70>. The IRS initiates an administrative proceeding with respect to Partnership's 2019 taxable year and determines that ordinary income was \$105 instead of \$100 (\$5 adjustment) and that the ordinary deduction was <\$80> instead of <\$70> (<\$10> adjustment). Neither item is subject to special restrictions or limitations. Pursuant to paragraph (d) of this section, the adjustments are both in the residual grouping. The <\$10> adjustment to the ordinary deduction is netted with the \$5 adjustment to ordinary income because they are both ordinary in character and neither is subject to restrictions or limitations. After netting these adjustments, the total netted partnership adjustment is <\$5>, which does not result in an imputed underpayment and therefore, the underlying adjustments (that is, the <\$10> adjustment to the ordinary deduction and the \$5 adjustment to ordinary income) are taken into account by Partnership in the adjustment year in accordance with § 301.6225-3.

*Example 2.* Partnership reports on its 2019 partnership return ordinary income of \$300, long-term capital gain of \$125, long-term capital loss of <\$75>, a depreciation deduction of <\$100>, and a tax credit that can be claimed by the partnership of \$5. In an administrative proceeding with respect to the partnership's 2019 taxable year, the IRS determines ordinary income of \$500 (\$200 adjustment), long-term capital gain of \$200 (\$75 adjustment),

long-term capital loss of <\$25> (\$50 adjustment), a depreciation deduction of <\$70> (\$30 adjustment), and a tax credit of \$3 (\$2 adjustment). Pursuant to paragraph (d) of this section, the tax credit is in the credit grouping under paragraph (d)(2)(iii) of this section. The remaining adjustments are part of the residual grouping under paragraph (d)(2)(v) of this section. The adjustment to ordinary income and the depreciation deduction are grouped together in an ordinary subgrouping within the residual grouping and netted with each other because they are both ordinary in character and neither is subject to differing restrictions or limitations. Pursuant to paragraph (d)(3)(iii) of this section, for purposes of netting, the decrease in the depreciation deduction is treated as an increase in income of \$30. Thus, \$200 (adjustment to ordinary income) plus \$30 (depreciation adjustment treated as increase in income) yields \$230 of additional income in the ordinary subgrouping within the residual grouping. For similar reasons, the adjustments to long-term capital gain and long-term capital loss are grouped together in a long-term capital subgrouping within the residual grouping and netted with each other. For purposes of netting, the decrease in capital loss is treated as an increase in income of \$50. Thus, \$75 (long-term capital gain adjustment) plus \$50 (long-term capital loss adjustment) yields \$125 of additional income in the long-term capital subgrouping within the residual grouping. With respect to the ordinary subgrouping, the \$230 adjustment to ordinary income is a net positive adjustment for that subgrouping and is added to the \$125 of additional income in the long-term capital subgrouping, for a total netted partnership adjustment of \$355. Under paragraph (c)(1)(i) of this section, the total netted partnership adjustment is multiplied by 40 percent (highest tax rate in effect), which results in \$142. Under paragraph (c)(1)(ii) of this section, the \$142 is increased by the \$2 credit adjustment, resulting in an imputed underpayment of \$144.

*Example 3.* Partnership reported on its 2019 partnership return long-term capital gain of \$125 and long-term capital loss of <\$75>. In an administrative proceeding with respect to Partnership's 2019 taxable year, the IRS determines the long-term capital gain should have been reported as ordinary income of \$125, resulting in an increase in ordinary income of \$125 (\$125 adjustment) as well as a decrease of long-term capital gain of \$125 (<\$125> adjustment). Under paragraph (d)(2) of this section, these adjustments are part of the residual grouping, but are in a separate subgrouping because of their different character, that is, the increase in ordinary income is part of an ordinary subgrouping and the decrease in long-term capital gain is part of a long-term capital subgrouping, both within the residual grouping. There are no other adjustments for the 2019 taxable year. The \$125 decrease in long-term capital gain is a net non-positive adjustment in the long-term capital subgrouping and as a result is an adjustment that does not result in an imputed underpayment. The \$125 increase in ordinary income results in a net positive adjustment. Because the ordinary subgrouping is the only subgrouping resulting in a net positive adjustment, \$125 is the total netted partnership adjustment. Under paragraph (c)(1)(i) of this section, \$125 is multiplied by 40 percent resulting in an imputed underpayment of \$50.

*Example 4.* Partnership reported a \$100 deduction for certain expenses on its 2019 partnership return and a \$100 deduction with respect to the same expenses on its 2020 partnership return. The IRS initiates an administrative proceeding with respect to Partnership's 2019 and 2020 taxable years and determines that Partnership improperly accelerated accrual of a portion of the expenses with respect to the deduction in 2019 that should have been taken into account in 2020. Therefore, for taxable year 2019, the IRS determines that Partnership should have reported a deduction of \$75 with respect to the expenses (\$25 adjustment) in 2019. However, for 2020, the IRS determines that Partnership should have reported a deduction of \$125 with respect to these expenses (<\$25> adjustment). There are no other adjustments for the 2019 and 2020 partnership taxable years. Pursuant to paragraph (c)(4) of this section, the adjustments for 2019 and 2020 are not netted with each other. The 2019 adjustment of \$25 is multiplied by 40 percent resulting in an imputed underpayment of \$10 for Partnership's 2019 taxable year. The \$25 increase in the deduction for 2020 is an adjustment that does not result in an imputed underpayment. Therefore, there is no imputed underpayment for 2020.

*Example 5.* On its partnership return for the 2020 taxable year, Partnership reported ordinary income of \$100 million and a capital gain of \$50 million. Partnership had four equal partners during the 2020 tax year, all of whom were individuals. On its partnership return for the 2020 tax year, the capital gain was allocated to partner E and the ordinary income was allocated to all partners based on their interests in Partnership. In an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS determines that for 2020 the capital gain allocated to E should have been \$75 million instead of \$50 million and that Partnership should have recognized an additional \$10 million in ordinary income. In the NOPPA mailed by the IRS, the IRS may determine pursuant to paragraph (e) of this section that there is a general imputed underpayment with respect to the increase in ordinary income and a specific imputed underpayment with respect to the increase in capital gain specially allocated to E.

(g) *Applicability date*—(1) *In general.* Except as provided in paragraph (g)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 8. Section 301.6225–2 is added to read as follows:

#### § 301.6225–2 *Modification of Imputed Underpayment.*

(a) *Partnership may request modification of an imputed underpayment.* A part-

nership that has received a notice of proposed partnership adjustment (NOPPA) under section 6231 from the Internal Revenue Service (IRS) may request modification of a proposed imputed underpayment set forth in the NOPPA in accordance with this section and any forms, instructions, and other guidance prescribed by the IRS. The effect of modification on a proposed imputed underpayment is described in paragraph (b) of this section. Unless otherwise described in paragraph (d) of this section, a partnership may request any type of modification of an imputed underpayment described in paragraph (d) of this section in the time and manner described set forth in paragraph (c) of this section. A request for modification with respect to a partnership adjustment (as defined in § 301.6241–1(a)(6)) that does not result in an imputed underpayment (as described in § 301.6225–1(c)(2)(i) or (c)(2)(ii)) is only available if the partnership has a proposed imputed underpayment set forth in the NOPPA. Only the partnership representative may request modification of an imputed underpayment. See section 6223 and § 301.6223–2 for rules regarding the binding authority of the partnership representative.

(b) *Effect of modification*—(1) *In general.* A modification of an imputed underpayment under this section that is approved by the IRS may result in an increase or decrease in the amount of an imputed underpayment set forth in the NOPPA under section 6231. A modification may increase or decrease an imputed underpayment by affecting the extent to which adjustments factor into the calculation of the imputed underpayment (as described in paragraph (b)(2) of this section), by affecting the tax rate that is applied in calculating the imputed underpayment (as described in paragraph (b)(3) of this section), and to the extent provided in forms, instructions, or other guidance prescribed by the IRS (see paragraph (b)(4) of this section). If a partnership requests more than one modification, modifications that affect the extent to which an adjustment factors into the calculation of the imputed underpayment under paragraph (b)(2) of this section are taken into account before rate modifications under paragraph (b)(3) of this section are taken into account. A modifi-

cation under this section has no effect on the amount of any partnership adjustment determined under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63).

(2) *Modifications that affect partnership adjustments for purposes of calculating the imputed underpayment.* Once approved by the IRS, a modification under paragraph (d)(2) of this section (amended returns), paragraph (d)(3) of this section (tax exempt status), paragraph (d)(5) of this section (specified passive activity losses), paragraph (d)(7) of this section (qualified investment entities), paragraph (d)(8) of this section (closing agreements), or, if applicable, paragraph (d)(9) of this section (other modifications) affects the extent to which a partnership adjustment factors into the calculation of an imputed underpayment. Any partnership adjustment or portion of a partnership adjustment that is taken into account through one of the types of modification described in this paragraph (b)(2) is excluded from the calculation of the total netted partnership adjustment (as described in § 301.6225–1(c)(3)) if the adjustment or portion of the adjustment is part of the reallocation grouping (as described in § 301.6225–1(d)(2)(ii)) or the residual grouping (as described in § 301.6225–1(d)(2)(v)). Similarly, any partnership adjustment or portion of a partnership adjustment that is taken into account through one of the types of modification described in this paragraph (b)(2) is excluded from the credit grouping (as described in § 301.6225–1(d)(2)(iii)) if the adjustment or portion thereof is part of the credit grouping.

(3) *Modifications that affect the tax rate*—(i) *In general.* Once approved by the IRS, a modification under paragraph (d)(4) of this section (rate modification) reduces the tax rate applied in calculating the total netted partnership adjustment (as determined under § 301.6225–1(c)(3)) with respect to an imputed underpayment. Rate modification does not affect the extent to which partnership adjustments factor into the calculation of the imputed underpayment. A modification under paragraph (d)(9) of this section (other modifications) is treated as a rate modification under paragraph (b)(3) of this section if such modification affects the rate applied with respect to any partnership adjustment or portion of a partnership adjustment that makes up the

total netted partnership adjustment with respect to an imputed underpayment.

(ii) *Determination of the imputed underpayment in the case of rate modification.* Except as described in paragraph (b)(3)(iv) of this section, the imputed underpayment in the case of rate modification under paragraph (d)(4) of this section is the sum of partnership adjustments not subject to rate reduction under paragraph (d)(4) of this section (as described in this paragraph (b)(3)(ii)), plus the *rate-modified netted partnership adjustment* determined under paragraph (b)(3)(iii) of this section, reduced or increased by any adjustments to credits (taking into account any modifications under this section). To determine the partnership adjustments not subject to rate reduction under paragraph (d)(4) of this section, multiply the partnership adjustments in the total netted partnership adjustment that are not subject to rate modification under paragraph (d)(4) of this section (including the portion of any partnership adjustment that remains after applying paragraph (b)(3)(iii) of this section) by the highest tax rate (as described in § 301.6225-1(c)(1)(i)).

(iii) *Calculation of rate-modified netted partnership adjustment in the case of a rate modification.* The *rate-modified netted partnership adjustment* is determined as follows—

(A) For each partnership adjustment in the total netted partnership adjustment that is subject to an approved rate modification under paragraph (d)(4) of this section, determine each reviewed year partner's (as defined in § 301.6241-1(a)(9)) or indirect partner's (as defined in § 301.6241-1(a)(4)) distributive share of the partnership adjustment subject to modification based on how each adjustment subject to rate modification would be properly allocated to such partner in the reviewed year (as defined in § 301.6241-1(a)(8)).

(B) Multiply the portion of each partnership adjustment determined under paragraph (b)(3)(iii)(A) of this section by the tax rate applicable to such portion under paragraph (d)(4) of this section.

(C) Add all of the amounts calculated under paragraph (b)(3)(iii)(B) of this section with respect to each partnership adjustment subject to an approved rate modification under paragraph (d)(4).

(iv) *Rate modification with respect to special allocations.* If an imputed under-

payment results from adjustments with respect to more than one item and any reviewed year partner (or indirect partner) for whom modification is approved under paragraph (d)(4) of this section has a distributive share of such items that is not the same with respect to all such items, the imputed underpayment as modified under paragraph (d)(4) of this section is determined as described in paragraphs (b)(3)(ii) and (b)(3)(iii) of this section except that each partner's distributive share is determined based on the amount of net gain or loss to the partner that would have resulted if the partnership had sold all of its assets at their fair market value as of the close of the reviewed year appropriately adjusted to reflect any modification with respect to any partner (or indirect partner) that is approved under paragraphs (d)(2), (d)(3), (d)(5), (d)(6), (d)(7), (d)(8), and (d)(9) of this section. Upon request by the IRS, the partnership may be required to provide the partners' capital account calculation through the end of the reviewed year, a calculation of asset liquidation gain or loss, and any other information necessary to determine whether rate modification is appropriate, consistent with the rules of paragraph (c)(2) of this section.

(4) *Other modifications.* The effect of other modifications described in paragraph (d)(9) of this section may be described in forms, instructions, or other guidance prescribed by the IRS.

(c) *Time, form, and manner for requesting modification—(1) In general.* In addition to the requirements described in paragraph (d) of this section, a request for modification under this section must be submitted in accordance with the forms, instructions, and other guidance prescribed by the IRS and contain the information described in paragraph (c)(2) of this section. The partnership representative must submit any request for modification and all relevant information (as described in paragraph (c)(2) of this section) to the IRS within the time described in paragraph (c)(3) of this section. A request for modification, including a request by the IRS for information related to a request for modification, and the determination by the IRS to approve or not approve all or a portion of a request for modification, is part of the administrative

proceeding with respect to the partnership under subchapter C of chapter 63 and does not constitute an examination, inspection, or other administrative proceeding with respect to any other person for purposes of section 7605(b).

(2) *Partnership must substantiate facts supporting a request for modification—(i) In general.* A partnership requesting modification under this section must substantiate the facts supporting such a request to the satisfaction of the IRS. The documents and other information necessary to substantiate a particular request for modification is based on the facts and circumstances of each request, as well as the type of modification requested under paragraph (d) of this section, and may include tax returns, partnership operating documents, certifications in the form and manner required with respect to the particular modification, and any other information necessary to support the requested modification. The IRS may, in forms, instructions, or other guidance, set forth procedures with respect to information and documents supporting the modification, including procedures to require particular documents or other information to substantiate a particular type of modification, the manner for submitting documents and other information to the IRS, and recordkeeping requirements. The IRS will deny a request for modification if a partnership fails timely to provide information the IRS determines is necessary to substantiate a request for modification.

(ii) *Information to be furnished for any modification request.* In the case of any modification request, the partnership representative must furnish to the IRS a detailed description of the structure, allocations, ownership, and ownership changes, its partners, and, if relevant, any indirect partners for each taxable year relevant to the request for modification, as well as the partnership agreement as defined in § 1.704-1(b)(2)(ii)(h) of this chapter for each taxable year relevant to the modification request. In the case of any modification request with respect to an indirect partner, the partnership representative must provide to the IRS any information that the IRS may require relevant to any pass-through partner(s) (as defined in § 301.6241-1(a)(5)) through which the indirect partner holds its interest in the partnership. For instance, if the partnership

requests modification with respect to an amended return filed by an indirect partner pursuant to paragraph (d)(2) of this section, the partnership representative may be required to provide to the IRS information that would have been required to have been filed by pass-through partners through which the indirect partner holds its interest in the partnership as if those pass-through partners had also filed their own amended returns.

(3) *Time for submitting modification request and information*—(i) *Modification request*. Unless an extension of time is granted by the IRS, all information required under this section with respect to a request for modification must be submitted to the IRS in the form and manner prescribed by the IRS on or before 270 days after the date the NOPPA is mailed.

(ii) *Extension of the 270-day period*. A partnership may request an extension, subject to consent by the IRS, of the 270-day period described in paragraph (c)(3)(i) of this section.

(iii) *Expiration of the 270-day period by agreement*. The 270-day period described in paragraph (c)(3)(ii) of this section expires as of the date the partnership representative and the IRS agree, in writing, to waive the 270-day period after the mailing of the NOPPA and before the IRS may issue a notice of final partnership adjustment. See section 6231(a) (flush language).

(4) *Approval of modification by the IRS*. After the IRS makes a determination as to whether a requested modification is accurate and appropriate, the IRS will notify the partnership representative in writing of the approval or denial, in whole or in part, of any request for modification. Notification of approval will be provided to the partnership representative only after receipt of all relevant information (including any supplemental information required by the IRS) and all necessary payments with respect to the particular modification requested.

(d) *Types of modification*—(1) *In general*. Except as otherwise described in this section, a partnership may request one type of modification or more than one type of modification described in paragraph (d) of this section.

(2) *Amended returns by partners*—(i) *In general*. A partnership may request a

modification of an imputed underpayment based on an amended return filed by a reviewed year partner (or indirect partner) in accordance with paragraph (d)(2) of this section that takes into account all of the partnership adjustments properly allocable to such partner (or indirect partner). The partnership may not request an additional modification of any imputed underpayment for a partnership taxable year under this section with respect to any partner (or indirect partner) that files an amended return under paragraph (d)(2) of this section or with respect to any partnership adjustment allocated to such partner.

(ii) *Modification request based on amended return will not be approved without full payment*. A modification request under paragraph (d)(2) of this section will not be approved unless the partner (or indirect partner) filing the amended return has paid all tax, penalties, additions to tax, and interest due as a result of taking into account the adjustments in the first affected year (as defined in § 301.6226–(b)(2)) and all modification years (as described in paragraph (d)(2)(iv) of this section) before the expiration of the 270-day period described in paragraph (c)(3) of this section.

(iii) *Form and manner for filing amended returns*. A reviewed year partner (or indirect partner) must file all amended returns required for modification under paragraph (d)(2) of this section with the IRS. The IRS will not approve modification under paragraph (d)(2) of this section unless prior to the expiration of the 270-day period described in paragraph (c)(3) of this section, the partnership representative provides to the IRS in the form and manner prescribed by the IRS an affidavit from the partner (or indirect partner) signed under penalties of perjury by such partner that each amended return required to be filed under paragraph (d)(2) of this section has been filed (including the date on which such amended returns were filed) and that the full amount of tax, penalties, additions to tax, additional amounts, and interest was paid (including the date on which such amounts were paid).

(iv) *Modification approved only if amended returns for all taxable years are filed*. Modification under paragraph (d)(2) of this section will not be approved by the

IRS unless a partner (or indirect partner) files an amended return for the first affected year and any modification year. A *modification year* is any taxable year with respect to which any tax attribute (as defined in § 301.6241–1(a)(10)) is affected by reason of taking the partner's allocable share of all partnership adjustments into account in the first affected year. A modification year may be a taxable year before or after the first affected year, depending on the effect on tax attributes of taking the partner's (or indirect partner's) share of the partnership adjustments into account in the first affected year.

(v) *Period of limitations must be open*—(A) *In general*. Except as described in paragraph (d)(2)(v)(B) of this section, the IRS will not accept modification under paragraph (d)(2) of this section with respect to any amended return if the period of limitations on assessment under section 6501 with respect to the partner's taxable year for which the amended return is being filed has expired. For modification with respect to years for which a partner's period of limitations on assessment under section 6501 has expired, see § 301.6225–2(d)(8) (regarding closing agreements).

(B) *Amended return claiming a refund*. An amended return filed under paragraph (d)(2) of this section claiming a refund may be filed after the expiration of period of limitations under section 6511, provided all partnership adjustments allocated to the partner (or indirect partner) filing the amended return are taken into account on such amended return, the only items reported on the amended return are items attributable to such partnership adjustments, and the partner files all required amended returns described in paragraph (d)(2)(iv) of this section.

(vi) *Amended returns for partnership adjustments that reallocate distributive shares*. Except as described in this paragraph (d)(2)(vi), in the case of a partnership adjustment that reallocates the distributive share of any item from one partner to another, a modification under paragraph (d)(2) of this section will be approved only if all partners affected by such adjustment (affected partners) file amended returns in accordance with paragraph (d)(2) of this section. The IRS may determine that the requirements of this

paragraph (d)(2)(vi) are satisfied if one or more affected partners take into account their allocable share of the adjustment through other modifications approved by the IRS. For instance, if, in the case where an adjustment reallocates a loss from one partner to another, one affected partner files an amended return taking into account the adjustment, and the other affected partner signs a closing agreement taking into account the adjustment, the IRS may determine that the requirements of this paragraph (d)(2)(vi) have been satisfied.

(vii) *Amended returns in the case of pass-through partners*—(A) *Pass-through partners may file amended returns*. A pass-through partner (or indirect partner that is a pass-through partner), including a partnership-partner (as defined in § 301.6241-1(a)(7)) (or indirect partner that is a partnership-partner) that has a valid election under section 6221(b) in effect for a partnership taxable year, may elect, solely for purposes of modification under paragraph (d)(2) of this section, to take into account its share of the partnership adjustments and determine and pay an amount calculated in the same manner as the safe harbor amount under § 301.6226-2(g) (except as described in paragraph (d)(2)(vii)(B) of this section).

(B) *Tax rate*. For purposes of calculating the payment amount for a pass-through partner under paragraph (d)(2)(vii)(A) of this section, instead of using the tax rate under section 6225(b)(1)(A), the tax rate 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)).

(C) *Restrictions on upper-tier amended returns*. If modification is approved with respect to a pass-through partner (or indirect partner that is a pass-through partner) that takes its share of the partnership adjustments into account and pays any amount due under paragraph (d)(2)(vii)(A) of this section, the partnership may not request modification based on amended returns of direct and indirect partners of the pass-through partner (or indirect partner that is a pass-through partner).

(vii) *Limitations on amended returns*—(A) *In general*. A partner (or indirect part-

ner) may not file an amended return with respect to any items related to partnership adjustments or an imputed underpayment except as described in paragraph (d)(2) of this section.

(B) *Further amended returns restricted*. If a partner files an amended return under paragraph (d)(2) of this section, such partner may not file a subsequent amended return without the permission of the IRS.

(3) *Tax-exempt partners*—(i) *In general*. A partnership may request modification of an imputed underpayment with respect to partnership adjustments that the partnership demonstrates to the satisfaction of the IRS are allocable to a reviewed year partner (or indirect partner) that would not owe tax by reason of its status as a tax-exempt entity (as defined in paragraph (d)(3)(ii) of this section) in the reviewed year (tax-exempt partner).

(ii) *Definition of tax-exempt entity*. For the purposes of paragraph (d)(3) of this section, the term *tax-exempt entity* means a person or entity defined in section 168(h)(2)(A), (C), or (D).

(iii) *Modification limited to portion of partnership adjustments for which tax-exempt partner not subject to tax*. Only the portion of the partnership adjustments properly allocated to a tax-exempt partner with respect to which the partner would not be subject to tax for the reviewed year (tax-exempt portion) may form the basis of a modification of the imputed underpayment under paragraph (d)(3) of this section. A modification under paragraph (d)(3) of this section will not be approved by the IRS unless the partnership provides documentation in accordance with paragraph (c)(2) of this section to support the tax-exempt partner's status and the tax-exempt portion of the partnership adjustment allocable to the tax-exempt partner.

(4) *Modification based on a rate of tax lower than the highest applicable tax rate*. A partnership may request modification based on a lower rate of tax with respect to adjustments that are attributable to a reviewed year partner (or indirect partner) that is a C corporation and adjustments with respect to capital gains or qualified dividends that are attributable to a reviewed year partner (or indirect partner) who is an individual. In no event may the lower rate determined under the preceding

sentence be less than the highest rate in effect with respect to the type of income and taxpayer. For instance, with respect to adjustments that are attributable to a C corporation, the highest rate in effect for the reviewed year with respect to all C corporations would apply to that adjustment, regardless of the rate that would apply to the C corporation based on the amount of that C corporation's taxable income. For the purposes of this paragraph (d)(4), an S corporation is treated as an individual.

(5) *Certain passive losses of publicly traded partnerships*—(i) *In general*. In the case of a publicly traded partnership (as defined in section 469(k)(2)), the imputed underpayment is determined without regard to the portion thereof that the partnership demonstrates is attributable to a net decrease in a specified passive activity loss (as defined in paragraph (d)(5)(ii) of this section) which is allocable to a specified partner (as defined in paragraph (d)(5)(iii) of this section). The modification described in this paragraph (d)(5)(i) applies equally with respect to a publicly traded partnership that is subject to a proceeding under subchapter C of chapter 63 and where a portion of the imputed underpayment is attributable to a publicly traded partnership that is a partnership-partner (or indirect partner that is a partnership-partner).

(ii) *Specified passive activity loss*. A specified passive activity loss carryover amount for any specified partner of a publicly traded partnership is the lesser of the section 469(k) passive activity loss of that partner which is separately determined with respect to such partnership at the end of the partner's taxable year in which or with which the reviewed year of the partnership ends (reviewed year loss) or at the end of the partner's taxable year in which or with which the adjustment year (as defined in § 301.6241-1(a)(1)) of the partnership ends, reduced to the extent any such partner has utilized any portion of its reviewed year loss to offset income or gain relating to the ownership or disposition of its interest in such publicly traded partnership during either the adjustment year or any intervening year (as defined in § 301.6226-3(b)(3)).

(iii) *Specified partner*. A specified partner is a person that for each taxable year

beginning with the partner's taxable year in which or with which the partnership reviewed year ends through the partner's taxable year in which or with which the partnership adjustment year ends satisfies the following three requirements—

(A) The person is a partner of a publicly traded partnership;

(B) The person is an individual, estate, trust, closely held C corporation, or personal service corporation; and

(C) The person has a specified passive activity loss with respect to the publicly traded partnership.

(iv) *Partner notification requirement to reduce passive losses.* If the IRS approves a modification request under paragraph (d)(5) of this section, the partnership must report, in accordance with forms, instructions, or other guidance prescribed by the IRS, to each specified partner the amount of that specified partner's reduction of its suspended passive loss carryovers at the end of the adjustment year to take into account the amount of any passive losses applied in connection with such modification request. The reduction in suspended passive loss carryovers as reported to a specified partner under this paragraph (d)(5)(iv) is a determination of the partnership under subchapter C of chapter 63 and is binding on the specified partners under section 6223 and the regulations thereunder.

(6) *Modification of the number and composition of imputed underpayments.* A partnership may request that the IRS include one or more partnership adjustments in one or more particular groupings or subgroupings (as described in § 301.6225-1(d)(2)) and may request that the IRS determine one or more specific imputed underpayments based on such groupings. For example, a partnership may request under this paragraph (d)(6) that one or more partnership adjustments taken into account to calculate an imputed underpayment be taken into account to calculate a different imputed underpayment.

(7) *Partnerships with partners that are "qualified investment entities" described in section 860-(i) In general.* A partnership may request a modification of an imputed underpayment based on the partnership adjustments allocated to a reviewed year partner (or indirect partner)

where the modification is based on deficiency dividends distributed as described in section 860(f), by a partner that is a qualified investment entity (QIE) under section 860(b), which includes both a regulated investment company (RIC) and a real estate investment trust (REIT). Modification is available only to the extent that the deficiency dividends take into account adjustments described in § 301.6225-1 that are also adjustments within the meaning of section 860(d)(1) or (d)(2) (whichever applies).

(ii) *Documentation of deficiency dividend.* The partnership must provide documentation in accordance with paragraph (c) of this section of the "determination" described in section 860(e). Under section 860(e)(2), § 1.860-2(b)(1)(i) of this chapter, and paragraph (d)(8) of this section, a closing agreement entered into by the QIE partner pursuant to section 7121 and paragraph (d)(8) of this section is a determination described in section 860(e), and the date of the determination is the date in which the closing agreement is approved by the IRS. In addition, under section 860(e)(4), a determination also includes a Form 8927, *Determination Under Section 860(e)(4) by a Qualified Investment Entity*, properly completed and filed by the RIC or REIT pursuant to section 860(e)(4). To establish the date of the determination under section 860(e)(4) and the amount of deficiency dividends actually paid, the partnership must provide a copy of Form 976, *Claim for Deficiency Dividends Deductions by a Personal Holding Company, Regulated Investment Company, or Real Estate Investment Trust* (Form 976), properly completed by or on behalf of the QIE pursuant to section 860(g), together with a copy of each of the required attachments for Form 976.

(8) *Partner closing agreements.* A partnership may request modification based on a closing agreement entered into by the IRS and any partner (or indirect partner) pursuant to section 7121, and, if approved by the IRS, the IRS will allow modification with respect to a partnership adjustment that is fully taken into account by such partner (or indirect partner) under a closing agreement and for which the required payment under the closing agreement is made. Generally, the IRS will not

approve any additional modification under this section with respect to a partner (or indirect partner) to which a modification under this paragraph (d)(8) has been approved.

(9) *Other modifications.* A partnership may request a modification not described in paragraph (d) of this section and the IRS will determine whether such modification is accurate and appropriate in accordance with paragraph (c)(4) of this section. Additional types of modifications and the documentation necessary to substantiate such modifications may be set forth in forms, instructions, or other guidance prescribed by the IRS.

(e) *Examples.* The following examples illustrate the rules of this section. For purposes of these examples, each partnership is subject to the provisions of subchapter C of chapter 63, each partnership and its partners are calendar year taxpayers, all partners are U.S. persons (unless otherwise stated), the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods, and no partnership requests modification under this section except as provided in the example.

*Example 1.* The IRS mails a NOPPA to Partnership for the 2019 partnership taxable year proposing a single partnership adjustment increasing ordinary income by \$100, resulting in a \$40 imputed underpayment (\$100 multiplied by the 40 percent tax rate). Partner, A, held a 20 percent interest in Partnership during 2019. Partnership requests modification under paragraph (d)(2) of this section based on A filing an amended return for the 2019 taxable year taking into account \$20 of the partnership adjustment and paying the tax and interest due attributable to A's share of the increased income and based on A's effective tax rate for 2019. No tax attribute in any other taxable year of A is affected by A taking into account A's share of the partnership adjustment for 2019. IRS approves the modification and the \$20 increase in ordinary income allocable to A is therefore not included in the calculation of the total netted partnership adjustment (determined in accordance with § 301.6225-1). Partnership's total netted partnership adjustment is reduced to \$80 (\$100 adjustment less \$20 taken into account by A), and the imputed underpayment is reduced to \$32 (total netted partnership adjustment of \$80 after modification multiplied by 40 percent).

*Example 2.* The IRS initiates an administrative proceeding with respect to Partnership's 2019 taxable year. Partnership has two equal partners during its 2019 taxable year: an individual, A, and a partnership-partner, B. For 2019, B has two equal partners: a tax-exempt entity, C, and an individual, D. The IRS mails a NOPPA to Partnership for its 2019 taxable year showing a single partnership adjustment increasing Partnership's ordinary income by \$100, resulting in a \$40 imputed underpayment



(\$100 total netted partnership adjustment multiplied by 40 percent). Partnership requests modification under paragraph (d)(3) of this section with respect to B's partner, C, a tax-exempt entity. Partnership's partnership representative provides the IRS with documentation demonstrating to the IRS's satisfaction that C holds a 25 percent indirect interest in Partnership through its interest in B and that C is a tax-exempt entity defined in paragraph (d)(3)(ii) of this section that is not subject to tax with respect to its share of the partnership adjustment allocated to B which is \$25 (50 percent x 50 percent x \$100). IRS approves the modification and the \$25 increase in ordinary income allocable to C is not included in the calculation of the total netted partnership adjustment (determined in accordance with § 301.6225-1). Partnership's total netted partnership adjustment is reduced to \$75 (\$100 adjustment less C's share of the adjustment, \$25), and the imputed underpayment is reduced to \$30 (total netted partnership adjustment of \$75, after modification, multiplied by 40 percent).

*Example 3.* The facts are the same as in *Example 2* of this paragraph (e), except 30 percent of the \$25 of the adjustment allocated to C is unrelated business taxable income (UBTI) as defined in section 512 with respect to which C would be subject to tax if taken into account by C. As a result, the modification under paragraph (d)(3) of this section with respect to C relates only to 70 percent of the \$25 of ordinary income allocated to C that is not UBTI. Therefore, only a modification of \$17.50 (70 percent multiplied by \$25) of the total \$100 partnership adjustment may be approved by the IRS and excluded when calculating the imputed underpayment for Partnership's 2019 taxable year. The total netted partnership adjustment (determined in accordance with § 301.6225-1) is reduced to \$82.50 (\$100 less \$17.50), and the imputed underpayment is reduced to \$33 (total netted partnership adjustment of \$82.50, after modification, multiplied by 40 percent).

*Example 4.* The facts are the same as in *Example 2* of this paragraph (e), but assume that B filed an amended return taking its share of the partnership adjustments into account. B reports 50 percent of the partnership adjustments (\$50) on its amended return, and B makes a payment pursuant to paragraph (d)(2)(ii) of this section. Partnership's total netted partnership adjustment is reduced by \$50 (the amount taken into account by B). Partnership's total netted partnership adjustment (determined in accordance with § 301.6225-1) is \$50, and the imputed underpayment, after modification, is \$20.

*Example 5.* The facts are the same as in *Example 2* of this paragraph (e), except that in addition to the modification with respect to tax-exempt entity C which reduced the imputed underpayment by excluding from the calculation of the imputed underpayment \$25 of the \$100 partnership adjustment reflected in the NOPPA, individual D files an amended return for D's 2019 taxable year taking into account D's share of the partnership adjustment (50 percent of B's 50 percent interest in Partnership, or \$25) and paying the additional tax and interest due in accordance with paragraph (d)(2) of this section. No tax attribute in any other taxable year of D is affected by D taking into account D's share of the partnership adjustment for 2019. IRS approves the modification and the \$25 increase in ordinary income allocable to

D is not included in the calculation of the total netted partnership adjustment (determined in accordance with § 301.6225-1). As a result, Partnership's total netted partnership adjustment is \$50 (\$100, less \$25 allocable to C, less \$25 taken into account by D), and the imputed underpayment, after modification, is \$20.

*Example 6.* The IRS mails a NOPPA to Partnership for the 2019 taxable year proposing two partnership adjustments based on an IRS determination that two assets, asset X and asset Y, owned by Partnership were overvalued. The partnership adjustment with respect to asset X results in increased ordinary income of \$75 and the partnership adjustment with respect to asset Y results in an increase in depreciation of \$25, which under § 301.6225-1(d)(3)(iii) is treated as a \$25 decrease in income. The total netted partnership adjustment (determined in accordance with § 301.6225-1) is \$50 (\$75 - \$25), resulting in an imputed underpayment of \$20 (\$50 multiplied by 40 percent). Under the partnership agreement in effect for Partnership's 2019 taxable year, the adjustments attributable to both of these assets are allocated to the partners consistent with their ownership percentages in Partnership. Partnership requests a modification under paragraph (d)(6) of this section to calculate two imputed underpayments with respect to the partnership adjustments for 2019: a general imputed underpayment with respect to \$50 of the increase in income related to the adjustment of the value of asset X and a specific imputed underpayment with respect to \$25 of the increase in income related to the adjustment of the value of asset X and the \$25 decrease in income related to the adjustment of the value of asset Y. If approved by the IRS, the general imputed underpayment, as modified, is \$20 (\$50 multiplied by 40 percent) and the specific imputed underpayment would result in zero (increase in income of \$25 attributable to asset X offset by the decrease in income of \$25 attributable to asset Y), causing those two adjustments to be disregarded and taken into account by the partnership in the adjustment year as adjustments that do not result in an imputed underpayment. The IRS may determine that the creation of the specific imputed underpayment is not appropriate in this circumstance and deny the partnership's modification request because the adjustments are not related to allocations to particular partners and also because the proposed modification results in an increase in net non-positive adjustments. See § 301.6225-1(e)(2)(iii).

(f) *Applicability date*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 9. Section 301.6225-3 is added to read as follows:

§ 301.6225-3 *Treatment of partnership adjustments that do not result in an imputed underpayment.*

(a) *In general.* Partnership adjustments (as defined in § 301.6241-1(a)(6)) that do not result in an imputed underpayment (as described in § 301.6225-1(c)(2)) are taken into account by a partnership in the adjustment year (as defined in § 301.6241-1(a)(1)) in accordance with paragraph (b) of this section.

(b) *Treatment of adjustments by the partnership*—(1) *In general.* Except as described in paragraphs (b)(2) through (b)(5) of this section, a partnership adjustment that does not result in an imputed underpayment is taken into account as a reduction in non-separately stated income or as an increase in non-separately stated loss for the adjustment year depending on whether the adjustment is to an item of income or loss.

(2) *Separately stated items.* In the case of a partnership adjustment to an item that is required to be separately stated under section 702, the adjustment is taken into account by the partnership in the adjustment year as a reduction in such separately stated item or as an increase in such separately stated item depending on whether the adjustment is a reduction or an increase to the separately stated item.

(3) *Credits.* In the case of a partnership adjustment to a credit shown on the partnership return for the reviewed year (as defined in § 301.6241-1(a)(8)), the adjustment is taken into account by the partnership in the adjustment year as a separately stated item.

(4) *Reallocation adjustments.* A partnership adjustment that does not result in an imputed underpayment pursuant to § 301.6225-1(c)(2)(i) is taken into account by the partnership in the adjustment year as a separately stated item or a non-separately stated item, as required by section 702. The portion of an adjustment allocated under this paragraph (b)(4) is allocated to adjustment year partners (as defined in § 301.6241-1(a)(2)) who are also reviewed year partners (as defined in § 301.6241-1(a)(9)) with respect to whom the amount was reallocated. If any reviewed year partner with respect to whom an amount was reallocated is not also an adjustment year partner, the portion of the adjustment that would otherwise be allo-

cated to such reviewed year partner is allocated instead to the adjustment year partner or partners who are the successor or successors to the reviewed year partner. If the partnership cannot identify an adjustment year partner that is a successor to the reviewed year partner described in the previous sentence or if a successor does not exist, the portion of the adjustment that would otherwise be allocated to that reviewed year partner is allocated among the adjustment year partners according to the adjustment year partners' distributive shares.

(5) *Adjustments taken into account by partners as part of the modification process.* If, as part of modification under § 301.6225-2, a reviewed year partner (or an indirect partner (as defined in § 301.6241-1(a)(4)) that holds its interest in the partnership through its interest in the reviewed year partner) takes into account an adjustment that would otherwise not result in an imputed underpayment, and the IRS approves the modification, such adjustment is not taken into account by the partnership in the adjustment year.

(6) *Effect of election under section 6226.* If a partnership makes a valid election under § 301.6226-1 with respect to an imputed underpayment, a partnership adjustment that does not result in an imputed underpayment and that is described in § 301.6225-1(c)(2)(i) or (c)(2)(ii) is taken into account by the reviewed year partners in accordance with § 301.6226-3 and is not taken into account under this section.

(c) *Treatment of adjustment year partners.* The rules under subchapter K of chapter 1 of subtitle A of the Internal Revenue Code with respect to the treatment of partners apply in the case of adjustments taken into account by the partnership under this section.

(d) *Applicability date—(1) In general.* Except as provided in paragraph (d)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 10. Section 301.6225-4 is added to read as follows:

§ 301.6225-4 *Adjustments to partners' outside bases and capital accounts and a partnership's basis and book value in property.*—[Reserved]

Par. 11. Section 301.6226-1 is added to read as follows:

§ 301.6226-1 *Election for an alternative to the payment of the imputed underpayment.*

(a) *In general.* A partnership may elect under this section an alternative to the payment by the partnership of an imputed underpayment determined under section 6225 and the regulations thereunder. In addition, a partnership making a valid election under paragraph (b) of section is no longer liable for the imputed underpayment (as defined in § 301.6241(a)(3)) to which the election applies. If a notice of final partnership adjustment (FPA) mailed under section 6231 includes more than one imputed underpayment in accordance with § 301.6225-1(e), a partnership may make an election under this section with respect to one or more imputed underpayments identified in the FPA. See § 301.6226-2(f) regarding the determination of each reviewed year partner's share of the partnership adjustments (as defined in § 301.6241-1(a)(6)) and related penalties, additions to tax, and additional amounts that must be taken into account.

(b) *Effect of election—(1) Reviewed year partners.* If a partnership makes a valid election under this section with respect to any imputed underpayment, the reviewed year partners (as defined in § 301.6241-1(a)(9)) must take into account their share of the partnership adjustments that relate to that imputed underpayment and are liable for any tax, penalties, additions to tax, additional amounts, and interest as described in § 301.6226-3. A modification approved by the IRS under § 301.6225-2 is taken into account by the reviewed year partners in accordance with § 301.6226-2(f)(2).

(2) *Partnership.* A partnership making a valid election under this section is not liable for the imputed underpayment to which the election applies on the date

such election is made. In addition, adjustments that do not result in an imputed underpayment described in § 301.6225-1(c)(2)(i) and (ii) are not taken into account by the partnership in the adjustment year (as defined in § 301.6241-1(a)(1)) and instead are included in the reviewed year partners' share of the partnership adjustments reported to the reviewed year partners of the partnership.

(c) *Time, form, and manner for making the election—(1) In general.* An election under this section is valid only if all of the provisions of this section and § 301.6226-2 (regarding statements furnished to reviewed year partners and filed with the Internal Revenue Service (IRS)) are satisfied. An election under this section may only be revoked with the consent of the IRS.

(2) *Invalid election.* If an election under this section is determined by the IRS to be invalid, the IRS will notify the partnership and the partnership representative within 30 days of the determination that the election is invalid and the reason for the determination that the election is invalid. If the IRS makes a final determination that an election under this section is invalid, section 6225 applies with respect to the imputed underpayment as if the election was never made and the partnership must pay the imputed underpayment under section 6225 and any penalties and interest under section 6233. An election under this section is valid until the IRS determines that the election is invalid.

(3) *Time for making the election.* An election under this section must be filed within 45 days of the date the FPA is mailed by the IRS. The time for filing such an election may not be extended.

(4) *Form and manner of the election—(i) In general.* An election under this section must be signed by the partnership representative and filed in accordance with forms, instructions, and other guidance and include the information specified in paragraph (c)(4)(ii) of this section.

(ii) *Contents of the election.* An election under this section must include—

(A) The name, address, and correct taxpayer identification number (TIN) of the partnership,

(B) The taxable year to which the election relates,

(C) A copy of the FPA to which the election relates,

(D) In the case of an FPA that includes more than one imputed underpayment, identification of the imputed underpayment(s) to which the election applies,

(E) Each reviewed year partner's name, address, and correct TIN, and

(F) Any other information prescribed by the IRS in forms, instructions, and other guidance.

(d) *Binding nature of statements.* The election under this section, which includes filing and furnishing statements described in § 301.6226-2, are actions of the partnership under section 6223 and the regulations thereunder and, unless determined otherwise by the IRS, the partner's share of the adjustments, the safe harbor amount and interest safe harbor amount (as described in § 301.6226-2(g)), and any penalties, additions to tax, and additional amounts as set forth in the statement are binding on the partner pursuant to section 6223. Accordingly, a partner may not treat items reflected on a statement described in § 301.6226-2 on the partner's return inconsistently with how those items are treated on the statement that is filed with the IRS. See § 301.6222-1(c)(2) (regarding items the treatment of which a partner is bound to under section 6223).

(e) *Coordination with section 6234 regarding judicial review.* Nothing in this section affects the rules regarding judicial review of a partnership adjustment. Accordingly, a partnership that makes an election under this section is not precluded from filing a petition under section 6234(a). See § 301.6226-2(b)(3), *Example 3*.

(f) *Applicability date—(1) In general.* Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 12. Section 301.6226-2 is added to read as follows:

*§ 301.6226-2 Statements furnished to partners and filed with the IRS.*

(a) *In general.* A partnership that makes an election under § 301.6226-1

must furnish to each reviewed year partner (as defined in § 301.6241-1(a)(9)) and file with the Internal Revenue Service (IRS) a statement that includes the items required by paragraphs (e) and (f) of this section with respect to each reviewed year partner's share of partnership adjustments (as defined in § 301.6241-1(a)(6)) with respect to the imputed underpayment for which an election under § 301.6226-1 is made. The statements furnished to the reviewed year partners under this section are in addition to, and must be filed and furnished separate from, any other statements required to be filed with the IRS and furnished to partners, including any statements under section 6031(b). A separate statement under this section must be furnished with respect to each reviewed year (as defined in § 301.6241-1(a)(8)) subject to an election under § 301.6226-1.

(b) *Time and manner for furnishing the statements to partners—(1) In general.* The statements described in paragraph (a) of this section must be furnished to the reviewed year partners no later than 60 days after the date all of the partnership adjustments to which the statement relates are finally determined. The partnership adjustments are finally determined upon the later of:

(i) The expiration of the time to file a petition under section 6234, or

(ii) If a petition under section 6234 is filed, the date when the court's decision becomes final.

(2) *Address used for reviewed year partners.* The partnership must furnish the statement described in paragraph (a) of this section to each reviewed year partner in accordance with the forms, instructions, and other guidance prescribed by the IRS. If the partnership mails the statement, it must mail the statement to the current or last address of the reviewed year partner that is known to the partnership. If a statement is returned to the partnership as undeliverable, the partnership must undertake reasonable diligence to identify a correct address for the reviewed year partner to which the statement relates.

(3) *Examples.* The following examples illustrate the rules of paragraph (b) of this section.

*Example 1.* During Partnership's 2020 taxable year, A, an individual, was a partner in Partnership and had an address at 123 Main St. On February 1, 2021, A sold his interest in Partnership and informed

Partnership that A moved to 456 Broad St. On March 15, 2021, Partnership mails A's statement under section 6031(b) for the 2020 taxable year to 456 Broad St. On June 1, 2023, A moves again but does not inform Partnership of A's new address. In 2023, the IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year and mails a notice of final partnership adjustment (FPA) to Partnership for that year. Partnership makes a timely election under section 6226 in accordance with § 301.6226-1 and on May 31, 2024, timely mails a statement described in paragraph (a) of this section to A at 456 Broad St. Although the statement was mailed to the last address for A that was known to Partnership, it is returned to Partnership as undeliverable because unknown to Partnership, A had moved. After undertaking reasonable diligence as to the correct address of A, Partnership is unable to ascertain the correct address. Therefore, pursuant to paragraph (b)(2) of this section, Partnership has properly furnished the statement to A.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (b)(3), except that A lives at 789 Forest Ave during all of 2024 and reasonable diligence would have revealed that 789 Forest Ave is the correct address for A, but Partnership did not undertake such diligence. Therefore, Partnership failed to properly furnish the statement with respect to A pursuant to paragraph (b)(2) of this section.

*Example 3.* Partnership is a calendar year taxpayer. The IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year. On January 1, 2024, the IRS mails an FPA with respect to the 2020 taxable year to Partnership. Partnership makes a timely election under section 6226 in accordance with § 301.6226-1. Partnership timely files a petition for readjustment under section 6234 with the Tax Court. The IRS prevails, and the Tax Court sustains all of the adjustments in the FPA with respect to the 2020 taxable year. The time to appeal the Tax Court decision expires, and the Tax Court decision becomes final on April 10, 2025. Under paragraph (b)(1)(ii) of this section, the adjustments in the FPA are finally determined on April 10, 2025, and Partnership must furnish the statements described in paragraph (a) of this section to its reviewed year partners and electronically file the statements with the IRS no later than June 9, 2025. See paragraph (c) of this section for the rules regarding filing the statements with the IRS.

(c) *Time and manner for filing the statements with the IRS.* No later than 60 days after the date the partnership adjustments are finally determined (as described in paragraph (b)(1) of this section), the partnership must electronically file with the IRS the statements that the partnership furnishes to each reviewed year partner under this section, along with a transmittal that includes a summary of the statements filed and such other information required in forms, instructions, and other guidance.

(d) *Correction of statements—(1) In general.* A partnership corrects an error in a statement furnished under paragraph (b)

of this section or filed under paragraph (c) of this section by filing the corrected statement with the IRS in the manner prescribed in paragraph (c) of this section and furnishing a copy of the corrected statement to the reviewed year partner to whom the statement relates in accordance with the forms, instructions, and other guidance prescribed by the IRS.

(2) *Error discovered by partnership*—(i) *Discovery within 60 days of statement due date.* If a partnership discovers an error in a statement within 60 days of the due date for furnishing the statements to partners and filing the statements with the IRS as described in paragraphs (b) and (c) of this section, the partnership must correct the error in accordance with paragraph (d)(1) of this section and does not have to seek consent of the IRS prior to doing so.

(ii) *Error discovered more than 60 days after statement due date.* If a partnership discovers an error more than 60 days after the due date for furnishing the statements to partners and filing the statements with the IRS as described in paragraphs (b) and (c) of this section, the partnership may only correct the error after receiving consent of the IRS in accordance with the forms, instructions, and other guidance prescribed by the IRS.

(3) *Error discovered by the IRS.* If the IRS discovers an error in the statements furnished or filed under paragraphs (b) and (c) of this section, the IRS may require the partnership to correct such errors in accordance with paragraph (d)(1) of this section. Failure by the partnership to correct an error when required by the IRS may be treated by the IRS as a failure to properly furnish statements to partners and file the statements with the IRS as described in paragraphs (b) and (c) of this section.

(4) *Adjustments in the corrected statements taken into account by the reviewed year partners.* The adjustments included on a corrected statement are taken into account by a reviewed year partner in accordance with § 301.6226–3 for the reporting year (as defined in § 301.6226–3(a)).

(e) *Content of the statements.* Each statement described in paragraph (a) of this section must include the following information:

(1) the name and correct TIN of the reviewed year partner to whom the statement is being furnished;

(2) the current or last address of the reviewed year partner that is known to the partnership;

(3) the reviewed year partner's share of items as originally reported for the reviewed year to the partner on statements furnished to the partner under section 6031(b) and, if applicable, section 6227;

(4) the reviewed year partner's share of partnership adjustments determined under paragraph (f)(1) of this section;

(5) modifications with respect to the reviewed year partner determined under paragraph (f)(2) of this section;

(6) the reviewed year partner's share of any amounts attributable to adjustments to the partnership's tax attributes (as defined in § 301.6241–1(a)(10)) for any intervening year (as defined in § 301.6226–3(b)(3)) resulting from the partnership adjustments in the reviewed year;

(7) the reviewed year partner's share of any penalties, additions to tax, or additional amounts determined under paragraph (f)(3) of this section;

(8) the reviewed year partner's safe harbor amount and, if applicable, interest safe harbor amount, as described under paragraph (g) of this section;

(9) the date the statement is furnished to the reviewed year partner;

(10) the partnership taxable year to which the adjustments relate; and

(11) any other information required by forms, instructions, and other guidance prescribed by the IRS.

(f) *Determination of each partner's share of adjustments, penalties, additions to tax, and additional amounts*—(i) *In general.* Except as described in paragraph (f)(1)(ii), (f)(1)(iii), or (f)(2) of this section, the adjustments set forth in the statement described in paragraph (a) of this section and any amounts attributable to adjustments to the partnership's tax attributes are reported to the reviewed year partner in the same manner as each adjusted item was originally allocated to the reviewed year partner on the partnership return for the reviewed year or intervening year, as applicable.

(ii) *Adjusted item not reported on the partnership's return for the reviewed*

*year.* Except as described in paragraph (f)(1)(iii) of this section, if the adjusted item was not reported on the partnership return for the reviewed year or intervening year, as applicable, each reviewed year partner's share of the adjustments must be determined in accordance with how such items would have been allocated under rules that apply with respect to partnership allocations, including under the partnership agreement.

(iii) *Adjustments that specifically allocate items.* If an adjustment involves an allocation of an item to a specific partner or in a specific manner, including a reallocation of an item, the reviewed year partner's share of the adjustment set forth in the statement is determined in accordance with the adjustment as finally determined (as described in paragraph (b)(1) of this section).

(2) *Treatment of modifications disregarded.* If the reviewed year partner filed an amended return pursuant to § 301.6225–3(c)(2) or entered into a closing agreement pursuant to § 301.6225–3(c)(6) and the imputed underpayment under section 6225 was determined without regard to the adjusted items taken into account on the amended return or in the closing agreement, such adjustments are disregarded for purposes of determining each reviewed year partner's share of the adjustments under paragraph (f)(1) of this section. However, these modifications are listed separately on the statements described in paragraph (a) of this section.

(3) *Penalties, additions to tax, or additional amounts.* Penalties, additions to tax, and additional amounts must be reported to each reviewed year partner in the same proportion as the reviewed year partner's share of the adjustment to which the penalty, addition to tax, or additional amount relates as determined in paragraph (f)(1) of this section. If a penalty, addition to tax, or additional amount does not relate to a specific adjustment, each reviewed year partner's share of the penalty, addition to tax, or additional amount is determined in accordance with how such items would have been allocated under rules that apply with respect to partnership allocations, including under the partnership agreement, unless it is allocated to a specific partner in a specific manner in a final determination of the adjustments, in

which case it is allocated in accordance with that final determination. See paragraph (b)(1) of this section regarding when adjustments are finally determined.

(g) *Safe harbor amount*—(1) *In general.* The partnership must calculate a safe harbor amount, which cannot be less than zero, for each reviewed year partner in accordance with paragraph (g)(2) of this section and an interest safe harbor amount for each reviewed year partner that is an individual in accordance with paragraph (g)(2). Except as provided in paragraph (g)(2)(ii) of this section, the rules of paragraph (f) of this section apply for purposes of paragraph (g) of this section.

(2) *Calculating the safe harbor amount*—(i) *In general.* The safe harbor amount for each reviewed year partner is calculated in the same manner as the imputed underpayment under § 301.6225-1 except that each reviewed year partner's share of the partnership adjustments on the statement described in paragraph (a) of this section (including any amounts attributable to adjustments to partnership tax attributes) are substituted as the partnership adjustments taken into account for purposes of determining the imputed underpayment under § 301.6225-1.

(ii) *Effect of modification on safe harbor amount*—(A) *In general.* Except as described in paragraph (g)(2)(ii)(B) of this section, any modification of the imputed underpayment approved by the IRS, including modification under § 301.6225-2(d)(4) (regarding rate modification), has no effect on the determination of the safe harbor amount for any partner.

(B) *Amended return and closing agreement.* Notwithstanding paragraph (g)(2)(ii)(A) of this section, if the reviewed year partner filed an amended return pursuant to § 301.6225-3(d)(2), or entered into a closing agreement pursuant to § 301-6225-3(d)(6), and the imputed underpayment under section 6225 to which an election under § 301.6226-1 applies is determined without regard to the adjustments taken into account on the amended return or in the closing agreement, such adjustments are disregarded in determining that partner's safe harbor amount.

(iii) *Calculating the interest safe harbor amount.* For partners who are individuals and who have calendar year taxable years, the partnership must also calculate

an interest safe harbor amount. The interest safe harbor amount is calculated at the rate set forth in § 301.6226-3(d)(4) from the due date (without extension) of the individual reviewed year partner's return for the first affected year (as defined in paragraph § 301.6226-3(b)(2)) until the due date (without extension) of the individual reviewed year partner's return for the reporting year.

(h) *Coordination with other provisions under subtitle A of the Internal Revenue Code*—(1) *Statements furnished to qualified investment entities described in section 860.* If a reviewed year partner is a qualified investment entity within the meaning of section 860(b) and the partner receives a statement described in paragraph (a) of this section, the partner may be able to avail itself of the deficiency dividend procedure described in § 301.6226-3(b)(4).

(2) *Liability for tax under section 7704(g)(3).* An election under this section has no effect on a partnership's liability for any tax under section 7704(g)(3) (regarding the exception for electing 1987 partnerships from the general rule that certain publicly traded partnerships are treated as corporations).

(3) *Adjustments subject to chapters 3 and 4 of subtitle A of the Internal Revenue Code.*—[Reserved]

(i) *Applicability date*—(1) *In general.* Except as provided in paragraph (i)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 13. Section 301.6226-3 is added to read as follows:

#### § 301.6226-3 Adjustments Taken Into Account by Partners.

(a) *Tax imposed by chapter 1 increased by additional reporting year tax.* The tax imposed by chapter 1 of subtitle A of the Internal Revenue Code (chapter 1 tax) for each reviewed year partner (as defined in § 301.6241-1(a)(9)) for the taxable year that includes the date a statement was furnished in accordance with § 301.6226-2 (the *re-*

*porting year*) is increased by the *additional reporting year tax*. The *additional reporting year tax* is either the aggregate of the adjustment amounts (determined in accordance with paragraph (b) of this section) or, if an election is made under paragraph (c) of this section, the safe harbor amount (determined in accordance with § 301.6226-2(g)). In addition to being liable for the additional reporting year tax, a reviewed year partner must also pay for the reporting year the partner's share of any penalties, additions to tax, and additional amounts as reflected in the statement described in § 301.6226-2 and any interest (as determined under paragraph (d) of this section).

(b) *Determining the aggregate of the adjustment amounts*—(1) *In general.* For purposes of paragraph (a) of this section, the aggregate of the adjustment amounts is the aggregate of the correction amounts described in paragraphs (b)(2) and (b)(3) of this section. A correction amount cannot be less than zero, and any amount below zero after applying the rules in this paragraph (b) does not reduce any other correction amount or tax due.

(2) *Correction amount for the first affected year.* The correction amount for the taxable year of the partner that includes the end of the reviewed year (the first affected year) is the amount by which the reviewed year partner's chapter 1 tax would increase for the first affected year if the partner's taxable income for such year was recomputed by taking into account the reviewed year partner's share of the partnership adjustments (as defined in § 301.6241-1(a)(6)) reflected on the statement described in § 301.6226-2 with respect to the partner. The correction amount is the amount by which the chapter 1 tax that would have been imposed for the first affected year if the items as adjusted in the statement described in § 301.6226-2 had been reported as such on the return for the first affected year exceeds the excess of –

(i) The sum of –

(A) The amount of chapter 1 tax shown by the partner on the return for the first affected year (which includes amounts shown on an amended return for such year, including an amended return filed under section 6225(c)(2) by the reviewed year partner or an indirect partner (as defined in § 301.6241-1(a)(4)) that holds its

interest in the partnership through its interest in the reviewed year partner with respect to the first affected year of the indirect partner), plus

(B) Amounts not so shown previously assessed (or collected without assessment) (as defined in § 1.6664-2(d) of this chapter), less

(ii) The amount of rebates made (as defined in § 1.6664-2(e) of this chapter). The definition of correction amount also may be expressed as –

$Correction\ amount = A - (B + C - D)$ , where A = the amount of chapter 1 tax that would have been imposed had the items as adjusted been properly reported on the return for the first affected year; B = the amount shown as chapter 1 tax on the return for the first affected year (taking into account amended returns); C = amounts not so shown previously assessed (or collected without assessment); and D = the amount of rebates made.

(3) *Correction amount for the intervening years.* The correction amount for all taxable years after the first affected year and before the reporting year (the intervening years) is the aggregate of the correction amounts determined for each intervening year. Determining the correction amount for each intervening year is a year-by-year determination. The correction amount for each intervening year is the amount by which the reviewed year partner's chapter 1 tax for such year would increase if the partner's taxable income for such year was recomputed by taking into account any adjustments to tax attributes (as defined in § 301.6241-1(a)(10)) under this paragraph (b)(3). Accordingly, the correction amount for each intervening year is the amount by which the chapter 1 tax that would have been imposed for the intervening year if any tax attribute for the intervening year had been adjusted after taking into account the reviewed year partner's share of the adjustments for the first affected year as described in paragraph (b)(2) of this section and if any tax attribute for the intervening year had been adjusted after taking into account any adjustments to tax attributes in any prior intervening year(s) exceeds the excess of –

(i) The sum of –

(A) The amount of chapter 1 tax shown by the partner on the return for the intervening year (which includes amounts shown on an amended return for such

year, including an amended return filed under section 6225(c)(2) by a reviewed year partner or an indirect partner that holds its interest in the partnership through its interest in the reviewed year partner), plus

(B) Amounts not so shown previously assessed (or collected without assessment) (as defined in § 1.6664-2(d) of this chapter), over

(ii) The amount of rebates made (as defined in § 1.6664-2(e) of this chapter). The definition of correction amount also may be expressed as –

$Correction\ amount = A - (B + C - D)$ , where A = the amount of chapter 1 tax that would have been imposed for the intervening year; B = the amount shown as chapter 1 tax on the return for the intervening year (taking into account amended returns); C = amounts not so shown previously assessed (or collected without assessment); and D = the amount of rebates made.

(4) *Coordination of sections 860 and 6226.* If a qualified investment entity (QIE) within the meaning of section 860(b) receives a statement described in § 301.6226-2(a) and correctly makes a determination within the meaning of section 860(e)(4) that one or more of the adjustments reflected in the statement is an adjustment within the meaning of section 860(d) with respect to that QIE for a taxable year, the QIE may distribute deficiency dividends within the meaning of section 860(f) for that taxable year and avail itself of the deficiency dividend procedures set forth in section 860. If the QIE utilizes the deficiency dividend procedures with respect to adjustments in a statement described in § 301.6226-2(a), the QIE may claim a deduction for deficiency dividends against the adjustments furnished to the QIE in the statement in calculating any correction amounts under paragraphs (b)(2) and (b)(3) of this section, and interest on that correction amount under paragraph (d) of this section, to the extent that the QIE makes deficiency dividend distributions under section 860(f) and complies with all requirements of section 860 and the regulations thereunder. A deficiency dividends deduction under this paragraph (b)(4) and section 860(a) has no effect on a QIE's

liability for any penalties reflected in a statement described in § 301.6226-2(a).

(c) *Election to pay safe harbor amount.* A reviewed year partner receiving a statement described in § 301.6226-2 may elect under this paragraph (c) to pay the safe harbor amount shown on the statement in lieu of the additional reporting year tax determined under paragraph (b) of this section. The election under this paragraph (c) is made on the reviewed year partner's return for the reporting year (as defined in paragraph (a) of this section) in accordance with forms and instructions. If a reviewed year partner making an election under this paragraph (c) fails to report the safe harbor amount on the partner's timely-filed return (determined without regard to extension) for the reporting year, the additional reporting year tax for the reviewed year partner is determined under paragraph (b) of this section.

(d) *Interest—(1) Interest on the correction amounts.* Interest on the correction amounts determined under paragraph (b) of this section is the aggregate of all interest calculated for each applicable taxable year at the rate set forth in paragraph (d)(4) of this section. For each applicable taxable year, interest on the correction amount is calculated from the due date (without extension) of the reviewed year partner's return for such applicable taxable year until the amount is paid. For purposes of this paragraph (d)(1), the term *applicable taxable year* means the reviewed year partner's taxable year affected by taking into account adjustments as described in paragraph (b) of this section (for instance, the first affected year and any intervening year in which there is a correction amount).

(2) *Interest on the safe harbor amount—(i) In general.* Except as described in paragraph (d)(2)(ii) of this section, in the case of an election under paragraph (c) of this section, interest on the safe harbor amount is calculated at the rate set forth in paragraph (d)(4) of this section from the due date (without extension) of the reviewed year partner's return for the first affected year (as defined in paragraph (b)(2) of this section) until the amount is paid.

(ii) *Election to pay interest safe harbor amount.* In the case of an election under

paragraph (c) of this section, a reviewed year partner who is an individual and who has a calendar year taxable year may elect to pay the interest safe harbor amount in lieu of calculating the interest on the safe harbor amount as described in paragraph (d)(2)(i) of this section. The election under this paragraph (d)(2)(ii) is made on the reviewed year partner's return for the reporting year (as defined in paragraph (a) of this section) in accordance with forms and instructions. If a reviewed year partner making an election under this paragraph (d)(2)(ii) fails to pay the interest safe harbor amount in full on or before the due date (without extension) for the return on which the election is made, interest on the safe harbor amount is determined under paragraph (d)(2)(i) of this section.

(3) *Interest on penalties.* Interest on any penalties, additions to tax, or additional amounts allocated to a reviewed year partner in a statement described in § 301.6226-2 is calculated at the rate set forth in paragraph (d)(4) of this section from the due date (without extension) of the reviewed year partner's return for the first affected year (as defined in paragraph (b)(2) of this section) until the amount is paid.

(4) *Rate of interest.* For purposes of paragraph (d) of this section, interest is calculated using the underpayment rate under section 6621(a)(2) by substituting "5 percentage points" for "3 percentage points" in section 6621(a)(2)(B).

(e) *Pass-through partners.*—[Reserved]

(f) *Partners that are foreign entities.*—[Reserved]

(g) *Examples.* The following examples illustrate the rules of this section. For purposes of these examples, each partnership and partner has a calendar year taxable year (unless otherwise stated), no modifications are requested by any partnership under § 301.6225-2 (unless otherwise stated), and the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods.

*Example 1.* On its partnership return for the 2020 tax year, Partnership reported ordinary income of \$1,000 and charitable contributions of \$400. On June 1, 2023, the IRS mails a notice of final partnership adjustment (FPA) to Partnership for Partnership's 2020 year disallowing the charitable contribution in its entirety and asserting an imputed underpayment plus a penalty of \$32 (a 20 percent accuracy-related penalty under section 6662(b)). Partnership makes a timely election under section 6226 in accordance

with § 301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments. The Tax Court determines that Partnership is not entitled to any of the claimed \$400 in charitable contributions and upholds the penalty of \$32. The decision regarding Partnership's 2020 tax year becomes final on December 15, 2025. Pursuant to § 301.6225-2(b)(1), the partnership adjustments are finally determined on December 15, 2025. On February 1, 2026, Partnership files the statements described under § 301.6226-2 with the IRS and furnishes to partner A, an individual who was a partner in Partnership during 2020, a statement described in § 301.6226-2. A had a 25 percent interest in Partnership during all of 2020 and was allocated 25 percent of all items from Partnership for that year. The statement shows A's share of ordinary income reported on Partnership's return for the reviewed year of \$250 and A's share of the charitable contribution reported on Partnership's return for the reviewed year of \$100. The statement also shows no adjustment to A's share of ordinary income, but does show an adjustment to A's share of the charitable contribution, a reduction of \$100 resulting in \$0 charitable contribution allocated to A from Partnership for 2020. In addition, the statement reports \$8 as A's share of the penalty (25 percent of \$32) related to the imputed underpayment resulting from the denial of the charitable contribution. The statement also shows A's safe harbor amount and interest safe harbor amount, as determined under § 301.6226-2(g). A does not elect to pay the safe harbor amount and therefore must pay the additional reporting year tax as determined in accordance with paragraph (b) of this section, in addition to A's share of the penalty and interest. A computes his additional reporting year tax as follows. First, A determines the correction amount for the first affected year (the 2020 taxable year) by taking into account A's share of the partnership adjustment (<100> reduction in charitable contribution) for the 2020 taxable year. A determines the amount by which his chapter 1 tax for 2020 would have increased if the \$100 adjustment to the charitable contribution from Partnership were taken into account for that year. There is no adjustment to tax attributes in A's intervening years as a result of the adjustment to the charitable contribution for 2020. Therefore, A's aggregate of the adjustment amounts is the correction amount for 2020. A's first affected year. In addition to the aggregate of the adjustment amount being added to the chapter 1 tax that A owes for 2026, the reporting year, A's tax liability for 2026 includes the \$8 penalty and any interest on the correction amount for the first affected year and the penalty determined in accordance with paragraph (d) of this section. Interest on the correction amount for the first affected tax year runs from April 15, 2021, the due date of A's 2020 return (the first affected tax year) until A pays this amount. In addition, interest runs on the \$8 penalty from April 15, 2021, the due date of A's 2020 return for the first affected year until A pays this amount. On his 2026 income tax return, A must report the additional reporting year tax determined in accordance

with section (b) of this section, which is the correction amount for 2020, plus A's share of the accuracy-related penalty determined at the partnership level (\$8), and interest determined in accordance with paragraph (d) of this section on the correction amount for 2020 and the penalty.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (g), except that A makes the elections under paragraphs (c) and (d)(ii) of this section to pay the safe harbor amount and interest safe harbor amount. In addition to the safe harbor amount and the interest safe harbor amount, A must also pay the \$8 penalty allocated to A on the statement. Therefore, on his 2026 income tax return, A must report the additional reporting year tax (in this case, the safe harbor amount), the penalty of \$8, and the interest safe harbor amount.

*Example 3.* On its partnership return for the 2020 tax year, Partnership reported an ordinary loss of \$500 million. On June 1, 2023, the IRS mails an FPA to Partnership for the 2020 taxable year determining that \$300 million of the \$500 million in ordinary loss should be recharacterized as a long-term capital loss. Partnership has no long-term capital gain for its 2020 tax year. The FPA for Partnership's 2020 tax year reflects an adjustment of an increase in ordinary income of \$300 million (as a result of the disallowance of the recharacterization of \$300 million from ordinary loss to long-term capital loss) and an imputed underpayment related to that adjustment, as well as an adjustment of an additional \$300 million in long-term capital loss for 2020 which does not result in an imputed underpayment pursuant to under § 301.6225-1(c)(2)(ii). Partnership makes a timely election under section 6226 in accordance with § 301.6226-1 with respect to the imputed underpayment in the FPA and does not file a petition for readjustment under section 6234. Accordingly, under § 301.6226-1(b)(2) and § 301.6225-3(b)(6), the adjustment year partners (as defined in § 301.6241-1(a)(2)) do not take into account the \$300 million long-term capital loss that does not result in an imputed underpayment. Rather, the reviewed year partners will take into account the \$300 million long-term capital loss. The time to file a petition expires on August 30, 2023. Pursuant to § 301.6225-2(b), the partnership adjustments become finally determined on August 30, 2023. On September 30, 2023, Partnership files with the IRS statements described in § 301.6226-2 and furnishes statements to all of its reviewed year partners in accordance with § 301.6226-2. One partner of Partnership in 2020, B (an individual), had a 25 percent interest in Partnership during all of 2020 and was allocated 25 percent of all items from Partnership for that year. The statement filed with the IRS and furnished to B shows B's allocable share of the ordinary loss reported on Partnership's return for the 2020 taxable year as \$125 million. The statement also shows an adjustment to B's allocable share of the ordinary loss in the amount of <\$75 million>, resulting in a corrected ordinary loss allocated to B of \$50 million for taxable year 2020 (\$125 million originally allocated to B less \$75 million which is B's share of the adjustment to the ordinary loss). In addition, the statement shows an increase to B's share of long-term capital loss in the amount of \$75 million (B's share of the adjustment that did not result in the

imputed underpayment with respect to Partnership). The statement also shows B's safe harbor amount and interest safe harbor amount, as determined under § 301.6226-2(g). B does not elect to pay the safe harbor amount and therefore must pay the additional reporting year tax as determined in accordance with paragraph (b) of this section. B computes his additional reporting year tax as follows. First, B determines the correction amount for the first affected year (the 2020 taxable year) by taking into account B's share of the partnership adjustments (a \$75 million reduction in ordinary loss and an increase of \$75 million in capital loss) for the 2020 taxable year. B determines the amount by which his chapter 1 tax for 2020 would have increased if the \$75 adjustment to ordinary loss and the \$75 million adjustment to capital loss from Partnership were taken into account for that year. Second, B determines if there is any increase in chapter 1 tax for any intervening year as a result of the adjustment to the ordinary and capital losses for 2020. B's aggregate of the adjustment amounts is the correction amount for 2020, B's first affected year plus any correction amounts for any intervening years. B is also liable for any interest on the correction amount for the first affected year and for any intervening year as determined in accordance with paragraph (d) of this section.

*Example 4.* On its partnership return for the 2020 tax year, Partnership reported ordinary income of \$100 million and a capital gain of \$40 million. Partnership had four equal partners during the 2020 tax year: E, F, G, and H, all of whom were individuals. On its partnership return for the 2020 tax year, the entire capital gain was allocated to partner E and the ordinary income was allocated to all partners based on their equal (25 percent) interest in Partnership. The IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year and determines that the capital gain should have been allocated equally to all four partners and that Partnership should have recognized an additional \$10 million in ordinary income. No modifications were approved by the IRS and no penalties are imposed. On June 1, 2023, the IRS mails an FPA to Partnership reflecting the reallocation of the \$40 million capital gain so that F, G, and H each have \$10 million increase in capital gain and E has a \$30 million reduction in capital gain for 2020. In addition, the FPA reflects the partnership adjustment increasing ordinary income by \$10 million. The FPA reflects a general imputed underpayment with respect to the increase in ordinary income and a specific imputed underpayment with respect to the increase in capital gain allocated to F, G, and H. In addition, the FPA reflects a \$30 million partnership adjustment that does not result in an imputed underpayment, that is, the reduction of \$30 million in capital gain with respect to E. Partnership makes a timely election under section 6226 in accordance with § 301.6226-1 with respect to the specific imputed underpayment relating to the reallocation of capital gain. Partnership does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to § 301.6225-2(b), the partnership adjustments become finally determined on August 30, 2023. Partnership timely pays and reports the general imputed underpayment relating to the partnership adjustment

to ordinary income. On September 30, 2023, Partnership files with the IRS statements described in § 301.6226-2 and furnishes statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA that relate to the specific imputed underpayment, that is, the reallocation of capital gain. The statements for F, G, and H each reflect a partnership adjustment of an additional \$10 million of capital gain for 2020. The statements also show that each partner's safe harbor amount and interest safe harbor amount, determined under § 301.6226-2(g). F, G, and H elect to pay the safe harbor amount and interest safe harbor amount. The statement for E reflects a partnership adjustment of a reduction of \$10 million of capital gain for 2020. The statement also reflects that E's safe harbor amount, as determined under § 301.6226-2(g), is \$0 (<\$10 million> multiplied by 40 percent but not less than zero). F elects to pay the safe harbor amount, which is zero.

*Example 5.* On its partnership return for the 2020 taxable year, Partnership reported a capital loss of \$5 million. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS mails a notice of proposed partnership adjustment (NOPPA) in which it proposes to disallow \$2 million of the reported \$5 million capital loss. No penalties are imposed with respect to the \$2 million adjustment. F, a C corporation partner with a 50 percent interest in Partnership, received 50 percent of all capital losses for 2020. As part of the modification process described in § 301.6225-2(d)(2) F files an amended return for 2020 taking into account F's share of the partnership adjustment (\$1 million reduction in capital loss) and pays the tax owed for 2020, including interest. Also as part of the modification process, F also files amended returns for 2021 and 2022 and paid additional tax (and interest) for these years because the reduction in capital loss for 2020 affected the tax due from F for 2021 and 2022. See § 301.6225-2(d)(2)(iv). The reduction of the capital loss in 2020 did not affect any other taxable year of F. The IRS approves the modification with respect to F and on June 1, 2023, mails an FPA to Partnership for Partnership's 2020 year reflecting the partnership adjustment reducing the capital loss in the amount of \$2 million. The FPA also reflects the modification to the imputed underpayment based on the amended returns filed by F taking into account F's share of the reduction in the capital loss. Partnership makes a timely election under section 6226 in accordance with § 301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments. The Tax Court upholds the determinations in the FPA and the decision regarding Partnership's 2020 tax year becomes final on December 15, 2025. Pursuant to § 301.6225-2(b)(1), the partnership adjustments are finally determined on December 15, 2025. On February 1, 2026, Partnership files the statements described under § 301.6226-2 with the IRS and furnishes to its partners statements reflecting their shares of the partnership adjustment. The statement issued to F reflects F's share of the partnership adjustment for Partnership's 2020 taxable year as finally determined by the Tax Court. The statement shows F's share of the capital loss reported on Part-

nership's return for the reviewed year of \$1 million and the \$1 million reduction in capital losses taken into account by F as part of the amended return modification. The statement shows that F's safe harbor amount, as determined under § 301.6226-2(g), is \$0 ([ \$1 million adjustment less the \$1 million taken into account in the amended return] multiplied by 40 percent). F elects to pay the safe harbor amount, which is zero.

(h) *Applicability date*—(1) *In general.* Except as provided in paragraph (h)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 14. Section 301.6226-4 is added to read as follows:

*§ 301.6226-4 Adjustments to partners' outside bases and capital accounts and a partnership's basis and book value in property.*—[Reserved]

Par. 15. Section 301.6227-1 is added to read as follows:

*§ 301.6227-1 Administrative adjustment request by partnership.*

(a) *In general.* 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 (as defined in § 301.6221(a)-1(b)(1)) and any partner's distributive share thereof (as described in § 301.6221(a)-1(b)(2)) for any partnership taxable year. When filing an administrative adjustment request (AAR), the partnership must determine whether the adjustments requested in the AAR result in an imputed underpayment (as defined in § 301.6241-1(a)(3)) in accordance with § 301.6227-2(a) for the reviewed year (as defined in § 301.6241-1(a)(8)). If the adjustments requested in the AAR result in an imputed underpayment, the partnership must take the adjustments into account under the rules described in § 301.6227-2(b) unless the partnership makes an election under § 301.6227-2(c), in which case each reviewed year partner (as defined in § 301.6241-1(a)(9)) must take the adjustments into account in accordance with § 301.6227-3. If the adjustments re-



requested in the AAR do not result in an imputed underpayment (as determined under § 301.6227-2(a)), such adjustments must be taken into account by the reviewed year partners (as defined in § 301.6241-1(a)(9)) in accordance with § 301.6227-3. A partner may not file an AAR except if the partner is doing so on behalf of the partnership in the partner's capacity as the partnership representative designated under section 6223 or if the partner is a partnership-partner (as defined in § 301.6241-1(a)(7)) filing an AAR under § 301.6227-3(c). In addition, a partnership may not file an AAR solely for the purpose of allowing the partnership to change the designation of a partnership representative. See § 301.6223-1 (regarding designation of the partnership representative).

(b) *Time for filing an AAR.* An AAR may only be filed by a partnership with respect to a partnership taxable year after a partnership return for that taxable year has been filed with the Internal Revenue Service (IRS). A partnership may not file an AAR with respect to a partnership taxable year more than three years after the later of the date the partnership return for such partnership taxable year was filed or the last day for filing such partnership return (determined without regard to extensions). In no event may an AAR be filed for a partnership taxable year after a notice of administrative proceeding with respect to such taxable year has been mailed by the IRS under section 6231.

(c) *Form and manner for filing an AAR—(1) In general.* An AAR, including any required statements, forms, and schedules as described in this section, must be filed with the IRS in accordance with the forms, instructions, and other guidance prescribed by the IRS, and must be signed under penalties of perjury by the partnership representative (as defined in section 6223(a) and the regulations thereunder).

(2) *Contents of AAR filed with the IRS.* A valid AAR filed with the IRS must include —

(i) The adjustments requested,

(ii) If a reviewed year partner is required to take into account the adjustments requested under § 301.6227-3, statements described in paragraph (e) of this section, including any transmittal with respect to such statements required

by forms, instructions, and other guidance, and

(iii) Other information prescribed by the IRS in forms, instructions, or other guidance.

(d) *Copy of statement furnished to reviewed year partners in certain cases.* If a reviewed year partner is required to take into account adjustments requested in an AAR under § 301.6227-3, the partnership must furnish a copy of the statement described in paragraph (e) of this section to the reviewed year partner to whom the statement relates in accordance with the forms, instructions and other guidance prescribed by the IRS. If the partnership mails the statement, it must mail the statement to the current or last address of the reviewed year partner that is known to the partnership. The statement must be furnished to the reviewed year partner on the date the AAR is filed with the IRS.

(e) *Statements—(1) Contents.* Each statement described in this paragraph (e) must include the following information:

(i) the name and correct TIN of the reviewed year partner to whom the statement is being furnished;

(ii) the current or last address of the partner that is known to the partnership;

(iii) the reviewed year partner's share of items as originally reported on statements furnished to the partner under section 6031(b) and, if applicable, section 6227;

(iv) the reviewed year partner's share of the adjustments as described under paragraph (c)(2) of this section;

(v) the date the statement is furnished to the partner;

(vi) the partnership taxable year to which the adjustments relate; and

(vii) any other information required by forms, instructions, and other guidance prescribed by the IRS.

(2) *Determination of each partner's share of adjustments—(i) In general.* Except as provided in paragraphs (e)(2)(ii) and (iii) of this section, each reviewed year partner's share of the adjustments requested in the AAR is determined in the same manner as each adjusted item was originally allocated to the reviewed year partner on the partnership return for the reviewed year.

(ii) *Adjusted item not reported on the partnership's return for the reviewed*

*year.* Except as provided in paragraph (e)(2)(iii) of this section, if the adjusted item was not reported on the partnership return for the reviewed year, each reviewed year partner's share of the adjustments must be determined in accordance with how such items would have been allocated under rules that apply with respect to partnership allocations, including under the partnership agreement.

(iii) *Allocation adjustments.* If an adjustment involves allocation of an item to a specific partner or in a specific manner, including a reallocation of an item, the reviewed year partner's share of the adjustment requested in the AAR is determined in accordance with the AAR.

(f) *Binding nature of AAR.* Filing an AAR as described in paragraph (c) of this section and furnishing statements as described in paragraph (d) of this section are actions of the partnership under section 6223 and the regulations thereunder. Accordingly, unless determined otherwise by the IRS, each partner's share of the adjustments set forth in a statement described in paragraph (e) of this section are binding on the partner pursuant to section 6223. A partner may not treat items on the partner's return inconsistently with how those items are treated on the statement that is filed with the IRS under paragraph (c) of this section. See § 301.6222-1(c)(2) (regarding items the treatment of which a partner is bound to under section 6223).

(g) *Administrative proceeding for a taxable year for which an AAR is filed.* Within the period described in section 6235, the IRS may initiate an administrative proceeding with respect to the partnership for any partnership taxable year regardless of whether the partnership filed an AAR with respect to such taxable year and may adjust any item subject to adjustment under subchapter C of chapter 63 of the Internal Revenue Code, including any item adjusted in an AAR filed by the partnership. The amount of an imputed underpayment determined by the partnership under § 301.6227-2(a)(1), including any modifications determined by the partnership under § 301.6227-2(a)(2), may be re-determined by the IRS.

(h) Notice of change to the amount of creditable foreign tax expenditures. [Reserved]

(i) *Applicability date*—(1) *In general.* Except as provided in paragraph (h)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 16. Section 301.6227–2 is added to read as follows:

§ 301.6227–2 *Determining and accounting for adjustments requested in an administrative adjustment request by the partnership.*

(a) *Determining whether adjustments result in an imputed underpayment*—(1) *Determination of the imputed underpayment.* The determination of whether adjustments requested in an administrative adjustment request (AAR) result in an imputed underpayment (as defined in § 301.6241–1(a)(3)) in the reviewed year (as defined in § 301.6241–1(a)(8)) and the determination of the amount of the imputed underpayment, if any, is made in accordance with the rules under § 301.6225–1.

(2) *Modification of imputed underpayment for purposes of this section.* A partnership may request modification of the amount of the imputed underpayment determined under paragraph (a)(1) of this section using only the provisions under § 301.6225–2(d)(3) (regarding tax-exempt partners), § 301.6225–2(d)(4) (regarding modification of applicable tax rate), § 301.6225–2(d)(5) (regarding specified passive activity losses), § 301.6225–2(d)(7) (regarding certain qualified investment entities), or as provided in forms, instructions, or other guidance prescribed by the IRS with respect to AARs. The partnership may not modify an imputed underpayment resulting from adjustments requested in an AAR except as described in this paragraph (a)(2). When requesting modification of the amount of an imputed underpayment under this paragraph (a)(2):

(i) The partnership is not required to seek the approval from the Internal Revenue Service (IRS) prior to modifying the amount of any imputed underpayment un-

der paragraph (a)(1) of this section as reported on the AAR; and

(ii) As part of the AAR filed with the IRS in accordance with forms, instructions, and other guidance, the partnership must –

(A) Notify the IRS of any modification,

(B) Describe the effect of the modification on the imputed underpayment,

(C) Provide an explanation of the basis for such modification, and

(D) Provide documentation to support the partnership’s eligibility for the modification.

(b) *Adjustments resulting in an imputed underpayment taken into account by the partnership*—(1) *In general.* Except in the case of an election under paragraph (c) of this section, a partnership must pay any imputed underpayment (as determined and modified under paragraph (a) of this section) resulting from the adjustments requested in an AAR on the date the partnership files the AAR. For the rules applicable to the partnership’s expenditure for the imputed underpayment, as well as any penalties and interest paid by the partnership with respect to the imputed underpayment, see § 301.6241–4.

(2) *Penalties and interest.* The IRS may impose a penalty, addition to tax, and additional amount with respect to an imputed underpayment determined under this section in accordance with section 6233(a)(3) (penalties determined from the reviewed year). In addition, the IRS may impose a penalty, addition to tax, and additional amount with respect to a failure to pay an imputed underpayment on the date an AAR is filed in accordance with section 6233(b)(3) (penalties with respect to the adjustment year return). Interest on the imputed underpayment is determined under chapter 67 for the period beginning on the date after the due date of the partnership return for the reviewed year (as defined in § 301.6241–1(a)(8)) (determined without regard to extension) and ending on the earlier of the date payment of the imputed underpayment is made, or the due date of the partnership return for the adjustment year (as defined in § 301.6241–1(a)(1)). See section 6233(a)(2). In the case of any failure to pay an imputed underpayment before the due date of the partnership return for the adjustment year, interest is determined in accordance with section 6233(b)(2).

(c) *Election to have adjustments resulting in an imputed underpayment taken into account by reviewed year partners.* In lieu of paying the imputed underpayment under paragraph (b) of this section, the partnership may elect to have each reviewed year partner (as defined in § 301.6241–1(a)(9)) take into account the adjustments requested in the AAR in accordance with § 301.6227–3. A partnership makes an election under this paragraph (c) at the time the AAR is filed in accordance with the forms, instructions, and other guidance prescribed by the IRS. If the partnership makes a valid election in accordance with this paragraph (c), the partnership is not required to pay the imputed underpayment resulting from the adjustments requested in the AAR. Rather, each reviewed year partner must take into account their share of the adjustments requested in the AAR in accordance with § 301.6227–3. If an election is made under this paragraph (c), modifications requested under paragraph (a)(2) of this section are disregarded and all adjustments requested in the AAR must be taken into account by each reviewed year partner in accordance with § 301.6227–3.

(d) *Adjustments not resulting in an imputed underpayment.* If the adjustments requested in an AAR do not result in an imputed underpayment (as determined under paragraph (a) of this section), the partnership must furnish statements to each reviewed year partner and file such statements with the IRS in accordance with § 301.6227–1. Each reviewed year partner must take into account its share of the adjustments requested in the AAR in accordance with § 301.6227–3.

(e) *Applicability date*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 17. Section 301.6227–3 is added to read as follows:

§ 301.6227–3 *Adjustments requested in an administrative adjustment request taken into account by reviewed year partners.*

(a) *In general.* Each reviewed year partner (as defined in § 301.6241–1(a)(9)) is required to take into account its share of adjustments requested in an administrative adjustment request (AAR) if the partnership makes an election under § 301.6227–2(c) with respect to such AAR. In addition, each reviewed year partner must take into account its share of adjustments requested in an AAR that do not result in an imputed underpayment (as defined in § 301.6241–1(a)(3)) as determined under § 301.6227–2(a). Each reviewed year partner receiving a statement furnished in accordance with § 301.6227–1(b) must take into account adjustments reflected in the statement in the taxable year that includes the date the statement is furnished (reporting year) in accordance with paragraph (b) of this section.

(b) *Adjustments taken into account by the reviewed year partner in the reporting year—*(1) *In general.* A reviewed year partner that is furnished a statement described in paragraph (a) of this section must treat the statement as if it were issued under section 6226(a)(2) and, on or before the due date for the reporting year must pay the additional reporting year tax (as defined in § 301.6226–3(a)), if any, determined after taking into account that partner’s share of the adjustments requested in the AAR in accordance with § 301.6226–3. For purposes of this paragraph (b), the rules under § 301.6226–3(c) (regarding the election to pay the safe harbor amount), § 301.6226–3(d)(2) (regarding interest on the safe harbor amount), and § 301.6226–3(d)(4) (regarding the increased rate of interest) do not apply, and the last sentence in § 301.6226–3(b)(1) (regarding the prohibition on correction amounts being less than zero) is disregarded. Nothing in this section entitles any partner to a refund of tax imposed by chapter 1 of subtitle A of the Internal Revenue Code (chapter 1 tax) to which such partner is not entitled. For instance, a partnership-partner (as defined in § 301.6241–1(a)(7)) may not claim a refund with respect to its share of any adjustment.

(2) *No additional reporting year tax due.* A reviewed year partner may reduce chapter 1 tax for the reporting year by the

amount determined under paragraph (b)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of this paragraph (b).

*Example 1.* In 2022, partner A, an individual, received a statement described in paragraph (a) of this section from Partnership with respect to Partnership’s 2020 taxable year. Both A and Partnership are calendar taxpayers and A is not claiming any refundable tax credit in 2020. The only adjustment shown on the statement is an increase in ordinary losses. Taking into account the adjustment, A determines that his additional reporting year tax for 2022 (the reporting year) is <\$100> (that is, a reduction of \$100.) A’s chapter 1 tax for 2022 (without regard to any additional reporting year tax) is \$150. Applying the rules in paragraph (b)(2) of this section, A’s chapter 1 tax for 2022 is reduced to \$50 (\$150 chapter 1 tax without regard to the additional reporting year tax plus <\$100> additional reporting year tax).

*Example 2.* The facts are the same as in *Example 1* of this paragraph (b)(3), except A’s chapter 1 tax for 2022 (without regard to any additional reporting year tax) is \$75. Applying the rules in paragraph (b)(2) of this section, A’s chapter 1 tax for 2022 is reduced by the <\$100> of additional reporting year tax. Accordingly, A’s chapter 1 tax for 2022 is \$0 (\$75 chapter 1 tax without regard to any additional reporting year tax plus <\$100> of additional reporting year tax). A owes no chapter 1 tax for 2022, and A may make a claim for refund with respect to the overpayment of \$25.

(c) *Reviewed year partners that are pass-through partners.*—[RESERVED]

(d) *Applicability date—*(1) *In general.* Except as provided in paragraph (d)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 18. Section 301.6241–1 is added to read as follows:

#### § 301.6241–1 *Definitions.*

(a) *Definitions.* For purposes of subchapter C of chapter 63 of the Internal Revenue Code –

(1) *Adjustment year.* The term *adjustment year* means the partnership taxable year in which –

(i) In the case of an adjustment pursuant to the decision of a court in a proceeding brought under section 6234, such decision becomes final;

(ii) In the case of an administrative adjustment request (AAR) under section 6227, such AAR is made; or

(iii) In any other case, a notice of final partnership adjustment is mailed under section 6231 or, if the partnership waives the restrictions under section 6232(b) (regarding limitations on assessment), the date the waiver is executed by the IRS.

(2) *Adjustment year partner.* The term *adjustment year partner* means any person who held an interest in a partnership at any time during the adjustment year.

(3) *Imputed underpayment.* The term *imputed underpayment* means the amount determined in accordance with § 301.6225–1.

(4) *Indirect partner.* The term *indirect partner* means any person who has an interest in a partnership through their interest in one or more pass-through partners (as defined in paragraph (a)(5) of this section).

(5) *Pass-through partner.* The term *pass-through partner* means a pass-through entity that holds an interest in a partnership. A pass-through entity is a partnership as described in § 301.7701–2(c)(1) (including a foreign entity that is classified as a partnership under § 301.7701–3(b)(2)(i)(A) or (c)), an S corporation, a trust (other than a trust described in the next sentence), and a decedent’s estate. For purposes of this paragraph (a)(5), a pass-through entity is not a disregarded entity described in § 301.7701–2(c)(2)(i) or a trust that is wholly owned by only one person, whether the grantor or another person, and the trust reports the owner’s information to payors under § 1.671–4(b)(2)(i)(A).

(6) *Partnership adjustment.* The term *partnership adjustment* means any adjustment to any item of income, gain, loss, deduction, or credit of a partnership (as defined in § 301.6221(a)–1(b)(1)), or any partner’s distributive share thereof (as described in § 301.6221(a)–1(b)(2)).

(7) *Partnership-partner.* The term *partnership-partner* means a partnership that holds an interest in another partnership.

(8) *Reviewed year.* The term *reviewed year* means the partnership taxable year to which a partnership adjustment relates.

(9) *Reviewed year partner.* The term *reviewed year partner* means any person

who held an interest in a partnership at any time during the reviewed year.

(10) *Tax attribute.* A tax attribute is anything that can affect, with respect to a partnership or a partner, the amount or timing of an item of income, gain, loss, deduction, or credit (as defined in § 301.6221(a)–1(b)(1)) or that can affect the amount of tax due in any taxable year. Examples of tax attributes include, but are not limited to, basis and holding period, as well as the character of items of income, gain, loss, deduction, or credit and carryovers and carrybacks of such items.

(b) *Applicability date*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 19. Section 301.6241–2 is added to read as follows:

#### § 301.6241–2 *Bankruptcy of the Partnership.*

(a) *Coordination between Title 11 and proceedings under subchapter C of chapter 63*—(1) *In general.* If a partnership is a debtor in a case under Title 11 of the United States Code (Title 11 case), the running of any period of limitations under section 6235 with respect to the time for making a partnership adjustment (as defined in § 301.6241–1(a)(6)) and under sections 6501 and 6502 with respect to the assessment or collection of any imputed underpayment (as defined in § 301.6241–1(a)(3)) determined under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) is suspended during the period the Internal Revenue Service (IRS) is prohibited by reason of the Title 11 case from making the adjustment, assessment, or collection until –

(i) 60 days after the suspension ends, for adjustments or assessments, and

(ii) 6 months after the suspension ends, for collection.

(2) *Interaction with section 6232(b).* The filing of a proof of claim or request for payment (or the taking of any other

action) in a Title 11 case is not treated as an action prohibited by section 6232(b) (regarding limitations on assessment).

(3) *Suspension of the time for judicial review.* In a Title 11 case, the running of the period specified in section 6234 (regarding judicial review of partnership adjustments) is suspended during the period during which the partnership is prohibited by reason of the Title 11 case from filing a petition under section 6234, and for 60 days thereafter.

(4) *Actions not prohibited.* The filing of a petition under Title 11 does not prohibit the following actions:

(i) an administrative proceeding with respect to a partnership under subchapter C of chapter 63;

(ii) the mailing of any notice with respect to a proceeding with respect to a partnership under subchapter C of chapter 63, including:

(A) a notice of administrative proceeding,

(B) a notice of proposed partnership adjustment, and

(C) a notice of final partnership adjustment;

(iii) a demand for tax returns;

(iv) the assessment of any tax, including the assessment of any imputed underpayment with respect to a partnership; and

(v) the issuance of notice and demand for payment of an assessment under subchapter C of chapter 63 (but see section 362(b)(9)(D) of Title 11 of the United States Code regarding the timing of when a tax lien takes effect by reason of such assessment).

(b) *Applicability date*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22T is in effect.

Par. 20. Section 301.6241–3 is added to read as follows:

#### § 301.6241–3 *Treatment where a Partnership Ceases to Exist.*

(a) *Former partners take adjustments into account*—(1) *In general.* Except as

described in paragraphs (a)(2) and (a)(3) of this section, if the Internal Revenue Service (IRS) determines that any partnership (including a partnership-partner as defined in § 301.6241–1(a)(7)) ceases to exist (as defined in paragraph (b)(2) of this section) before any partnership adjustment (as defined in § 301.6241–1(a)(6)) under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) takes effect (as described in paragraph (c) of this section), the partnership adjustment is taken into account by the former partners (as described in paragraph (d) of this section) of the partnership in accordance with paragraph (e) of this section.

(2) *Partnership no longer liable for any amounts resulting from a partnership adjustment.* A partnership that ceases to exist is no longer liable for any amounts resulting from a partnership adjustment required to be taken into account by a former partner under this section.

(3) *Partnerships making an election under section 6221(b).* The former partners of a partnership that ceases to exist are not required to take a partnership adjustment into account under this section if the partnership has an election under section 6221(b) in effect for the partnership taxable year that includes the end of the reviewed year of the partnership subject to a proceeding to which such adjustment relates.

(b) *Determination that partnership ceases to exist*—(1) *In general.* For purposes of this section, the IRS may, in its sole discretion, make a determination that a partnership ceases to exist for purposes of this section, but the IRS is not required to do so even if the definition in paragraph (b)(2) of this section applies with respect to such partnership. If the IRS determines that a partnership ceases to exist, the IRS will notify the partnership and the former partners (as defined in paragraph (d) of this section), in writing, within 30 days of such determination using the last known address of the partnership and the former partners.

(2) *Cease to exist defined*—(i) *In general.* The IRS may determine that a partnership ceases to exist if the partnership terminates within the meaning of section 708(b)(1)(A), or does not have the ability to pay, in full, any amount due under the

provisions of subchapter C of chapter 63 for which the partnership is or becomes liable. For purposes of this section, a partnership does not have the ability to pay if the IRS determines that the account with respect to the partnership is not collectible based on the information the IRS has at the time of such determination. For purposes of this section, a partnership does not cease to exist solely because –

(A) The partnership has a technical termination under section 708(b)(1)(B);

(B) A valid election under section 6226 and the regulations thereunder is in effect with respect to any imputed underpayment (as defined in § 301.6241-1(a)(3)); or

(C) The partnership has not paid any amount required to be paid under subchapter C of chapter 63.

(ii) *Year in which a partnership ceases to exist.* If a partnership terminates under section 708(b)(1)(A), the partnership ceases to exist on the last day of the partnership's final taxable year. If a partnership does not have the ability to pay, the partnership ceases to exist on the date that the IRS makes a determination under paragraph (b)(2)(i) of this section that the partnership ceases to exist.

(iii) *Limitation on IRS determination that partnership ceases to exist.* In no event may the IRS determine that a partnership ceases to exist with respect to a partnership adjustment after the expiration of the period of limitations on collection applicable to the amount due resulting from such adjustment.

(c) *Partnership adjustment takes effect—(1) Full payment of amounts resulting from a partnership adjustment.* For purposes of this section, a partnership adjustment under subchapter C of chapter 63 takes effect when there is full payment of amounts resulting from a partnership adjustment. For purposes of this section, *full payment of amounts resulting from a partnership adjustment* means all amounts due under subchapter C of chapter 63 resulting from the partnership adjustment are fully paid by the partnership.

(2) *Partial payment of amount due by the partnership.* If a partnership pays part, but not all, of any amount due resulting from a partnership adjustment before the partnership ceases to exist, the former partners of the partnership

that has ceased to exist are not required to take into account any partnership adjustment to the extent amounts have been paid by the partnership with respect to such adjustment. The notification that the IRS has determined that the partnership has ceased to exist will include information regarding the portion of the partnership adjustments with respect to which appropriate amounts have not already been paid by the partnership and therefore must be taken into account by the former partners (described in paragraph (d) of this section) in accordance with paragraph (e) of this section.

(d) *Former partners—(1) Adjustment year partners—(i) In general.* Except as described in paragraphs (d)(1)(ii) and (d)(2) of this section, the term *former partners* means the adjustment year partners (as defined in § 301.6241-1(a)(2)) of a partnership that ceases to exist for the partnership taxable year to which the partnership adjustment relates.

(ii) *Partnership-partner ceases to exist.* If the adjustment year partner is a partnership-partner that the IRS has determined ceased to exist, the partners of such partnership-partner during the partnership-partner's taxable year that includes the end of the adjustment year (as defined in § 301.6241-1(a)(1)) of the partnership that is subject to a proceeding under subchapter C of chapter 63 are the former partners for purposes of this section. If the partnership-partner ceased to exist before the partnership-partner's taxable year that includes the end of the adjustment year of the partnership that is subject to a proceeding under subchapter C of chapter 63, the former partners for purposes of this section are the partners of such partnership-partner during the partnership taxable year for which the final partnership return of the partnership-partner under section 6031 is filed.

(2) *No adjustment year partners.* If there are no adjustment year partners of a partnership that ceases to exist, the term *former partners* means the partners of the partnership during the last taxable year for which a partnership return under section 6031 was filed with respect to such partnership. For instance, if a partnership terminates under section 708(b)(1)(A) (and

therefore ceases to exist under paragraph (b)(2)(i) of this section) before the adjustment year and files a final partnership return for the partnership taxable year of such partnership, the former partners for purposes of this section are the partners of the partnership during the partnership taxable year for which a final partnership return is filed.

(e) *Taking adjustments into account—(1) In general.* For purposes of paragraph (a) of this section, a former partner of a partnership that ceases to exist takes a partnership adjustment into account as if the partnership had made an election under section 6226 and the regulations thereunder (regarding the alternative to payment of the imputed underpayment). A former partner must take into account the former partner's share of a partnership adjustment as set forth in the statement described in paragraph (e)(2) of this section in accordance with § 301.6226-3.

(2) *Statements furnished to former partners.* If a partnership is notified by the IRS that the partnership has ceased to exist as described in paragraph (b)(1) of this section, the partnership must furnish to each former partner a statement reflecting such former partner's share of the partnership adjustment required to be taken into account under this section and file a copy of such statement with the IRS in accordance with the rules under § 301.6226-2, except that –

(i) the adjustments are taken into account by the applicable former partner (as described in paragraph (d) of this section), rather than the reviewed year partners (as defined in § 301.6241-1(a)(9)), and

(ii) the partnership must furnish statements to the former partners and file the statements with the IRS no later than 30 days after the date of the notification to the partnership that the IRS has determined that the partnership has ceased to exist.

(3) *Authority to issue statements.* If any statements required by paragraph (e) of this section are not timely furnished to a former partner and filed with the IRS in accordance with paragraph (e)(2)(ii) of this section, the IRS may notify the former partner in writing of such partner's share of the partnership adjustments based on the information reasonably available to

the IRS at the time such notification is provided. For purposes of paragraph (e) of this section, a notification to a former partner under this paragraph (e)(3) is treated the same as a statement required to be furnished and filed under paragraph (e)(2) of this section.

(f) *Examples.* The following examples illustrate the provisions of this section. For purposes of the examples, all partnerships and partners are calendar year taxpayers and no partnership has an election under section 6221(b) in effect with respect to any taxable year.

*Example 1.* The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of Partnership. During 2023, in accordance with section 6235(b), Partnership extends the period of limitations on adjustments under section 6235(a) until December 31, 2025. On February 1, 2025, the IRS mails Partnership a notice of final partnership adjustment (FPA) that determines partnership adjustments that result in a single imputed underpayment. Partnership does not timely file a petition under section 6234 and does not make a valid election under section 6226. On May 1, 2026, the IRS mails Partnership notice and demand for payment of the amount due resulting from the adjustments determined in the FPA. Partnership fails to make a payment. On September 1, 2029, IRS determines Partnership ceases to exist for purposes of this section because the IRS has determined that Partnership does not have the ability to pay under paragraph (b)(2)(i) of this section. Under § 301.6241-1(a)(1), the adjustment year is 2025 and A and B, both individuals, are the only adjustment year partners of Partnership during 2025. Accordingly, under paragraph (d)(1) of this section, A and B are former partners. Therefore, A and B are required to take their share of the partnership adjustments determined in the FPA into account under paragraph (e) of this section.

*Example 2.* The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of Partnership. G, a partnership, is a partner of Partnership during 2020. On February 3, 2025, the IRS mails Partnership an FPA that determines partnership adjustments that result in a single imputed underpayment. Partnership does not timely file a petition under section 6234, but does make a timely election under section 6226. On May 31, 2025, Partnership timely files and furnishes a statement to G as required by section 6226 and the regulations thereunder. G terminated under section 708(b)(1)(A) on December 31, 2024. On June 1, 2026, the IRS determines that G ceased to exist in 2024 for purposes of this section in accordance with paragraph (b)(2)(i) of this section. J and K, individuals, were the only partners of G during 2024. Therefore, under paragraph (d)(1)(ii) of this section, J and K, the partners of G during G's 2024 partnership taxable year, are the former partners of G for purposes of this section. Therefore, J and K are required to take into account their share of the adjustments contained in the statement furnished by Partnership to G in accordance with paragraph (e) of this section.

(g) *Applicability date—(1) In general.* Except as provided in paragraph (g)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 21. Section 301.6241-4 is added to read as follows:

§ 301.6241-4 *Payments nondeductible.*

(a) *Payments nondeductible.* No deduction is allowed under subtitle A of the Internal Revenue Code for any payment required to be made by a partnership under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63). Payment by a partnership of any amount required to be paid under subchapter C of chapter 63, including any imputed underpayment (as defined in § 301.6241-1(a)(3)), any amount under § 301.6226-3, or interest, penalties, additions to tax, or additional amounts with respect to an imputed underpayment or any amount under § 301.6226-3, is treated as an expenditure described in section 705(a)(2)(B).

(b) *Applicability date—(1) In general.* Except as provided in paragraph (b)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Par. 22. Section 301.6241-5 is added to read as follows:

§ 301.6241-5 *Extension to Entities Filing Partnership Returns.*

(a) *Entities filing a partnership return.* Except as described in paragraph (c) of this section, an entity that files a partnership return for any taxable year is subject to the provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) and

the regulations thereunder with respect to such taxable year even if it is determined that the person filing the partnership return was not a partnership for such taxable year. Accordingly, any item of income, loss, gain, deduction, or credit (as defined in § 301.6221(a)-1(b)(1)), any partner's distributive share thereof (as described in § 301.6221(a)-1(b)(2)), and any person holding an interest in the entity, either directly or indirectly, at any time during that taxable year are subject to the provisions of subchapter C of chapter 63 and the regulations thereunder for such taxable year.

(b) *Partnership return filed but no entity found to exist.* Paragraph (a) of this section also applies where a partnership return is filed for a taxable year, but the IRS determines that no entity existed at all for such taxable year. For purposes of applying paragraph (a) of this section, the partnership return is treated as if it were filed by an entity.

(c) *Exceptions.* Paragraph (a) of this section does not apply to –

(1) Entities for any taxable year for which an election under section 6221(b) is in effect, treating the return as if it were filed by a partnership for the taxable year to which the election relates, and

(2) Entities for any taxable year for which a partnership return was filed for the sole purpose of making the election described in section 761(a) (regarding election out of subchapter K for certain unincorporated organizations).

(d) *Applicability date—(1) In general.* Except as provided in paragraph (d)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100-22T in effect.* This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100-22T is in effect.

Kirsten Wielobob  
Deputy Commissioner for Services and  
Enforcement.

(Filed by the Office of the Federal Register on June 13, 2017, 8:45 a.m., and published in the issue of the Federal Register for June 14, 2017, 82 F.R. 27334.)

# Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as “rulings”) that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the sub-

stance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.  
E.O.—Executive Order.  
ER—Employer.

ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign corporation.  
G.C.M.—Chief Counsel’s Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.

PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statement of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

## **Numerical Finding List<sup>1</sup>**

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2017–01 through 2017–26 is in Internal Revenue Bulletin 2017–26, dated June 27, 2017.



## **Finding List of Current Actions on Previously Published Items<sup>1</sup>**

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2017–01 through 2017–26 is in Internal Revenue Bulletin 2017–26, dated June 27, 2017.

# **Internal Revenue Service**

## **Washington, DC 20224**

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## **INTERNAL REVENUE BULLETIN**

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

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## **We Welcome Comments About the Internal Revenue Bulletin**

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