ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

Office of Chief Counsel
Internal Revenue Service

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memorandum

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CC:DOM:FS:P&SI:RLBuch

date: MAY 1 1998

to: Associate District Counsel CC:WR:RMD:SLC
Rocky Mountain District (Salt Lake City)

from: Assistant Chief Counsel (Field Service) CC:DOM:FS

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subject: Applying Barred Adjustments When Making Computational Adjustments

This responds to your request for Significant Advice, dated April 7, 1998, in connection with a question posed by the Examination Division of the Ogden Service Center.

Disclosure Statement

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Issue

Whether adjustments that are otherwise barred by the I.R.C. § 6501 limitation on assessment may be asserted or otherwise taken into account when making a computational adjustment to a partner's tax liability under I.R.C. § 6231(a)(6).

Conclusion

The adjustments that are otherwise barred by the limitation on assessment under I.R.C. § 6501 may not be assessed or otherwise asserted, but such adjustments may be taken into account for the limited purpose of determining the proper amount of tax attributable to the adjustment of the partnership items.

Facts

On his 1983 tax return, the taxpayer elected to use income averaging. Each of the taxpayer's base years (1979 through 1982) were examined and adjusted, and such adjustments have become final. For income averaging purposes, the adjustments to 1979 through 1982 have increased the base year income, the result of which should have been an increase in the taxpayer's income tax liability for the 1983 tax year. The 1983 taxable year was never examined or adjusted to take into account the changes to the base year income.

In addition to the above, the taxpayer was an investor in a partnership for taxable year 1983, and the partnership is subject to the TEFRA unified audit an litigation procedures. The partnership was examined and during the course of the examination, the tax matters partner extended the period for assessment. Upon conclusion of the examination, a notice of final partnership administrative adjustment was issued; a petition for redetermination was filed with the Tax Court; and, a final decision of the Court has been entered. The service center is in the process of computing the taxpayer's share of the adjustments that resulted from the Tax Court decision. Once the partner's distributive share of the adjustments is taken into account, the appropriate tax rate will be applied and the tax will be assessed by way of computational adjustment. The service center is seeking advice as to the extent to which changes to the base year income can be taken into account for purposes of assessment.

Discussion

In 1982, Congress enacted the TEFRA unified audit and litigation procedures to simplify and streamline the partnership audit, litigation, and assessment process. The underlying principle of TEFRA is that "the tax treatment of items of partnership income, loss, deductions, and credits will be determined at the partnership level in a unified partnership proceeding rather than separate proceedings with the partners." Conf. Rep. No. 97-248 (1982). Partners are generally required to report items in a manner consistent with partnership treatment, and the Service may examine the partnership as an entity, rather than conduct separate examination as to each of the partners. Where applicable, the TEFRA provisions either supplant or augment the general administrative provisions.

<u>Limitation on Assessment</u>

Because tax is only assessed against the partners (and not the partnership), the partner's limitation on assessment controls the timeliness of any assessment as to that partner. The limitation on assessment is generally set forth in I.R.C. § 6501 and provides that taxes must generally be assessed within the later of three years from the date of filing the taxpayer's return or the due date for filing the taxpayer's return . I.R.C. § 6501(a). In the case of partnership items, I.R.C. § 6501(n)(2) provides for an "extension of the period in the case of partnership items" and refers to I.R.C. § 6229.

The TEFRA provisions set forth a minimum period within which the Service is able to conduct an examination of a partnership return and flow any adjustments through to the partners. Section 6229(a) provides that the period for assessment of any tax resulting from partnership items "shall not expire before the date which is 3 years after the later of" the filing of the partnership return or the due date for filing the partnership return. In essence, I.R.C. § 6229 sets forth a minimum period within which adjustments attributable to partnership items generally may be assessed against all partners of a partnership, without regard to a specific partner's limitation period under I.R.C. § 6501.

On occasion, the I.R.C. § 6229 minimum assessment period does not have an impact on the limitation on assessment. Take the example when a partnership return was due and was filed on March 15, 1995 and a partner's return was due and was filed on April 15, 1995. In this case, the I.R.C. § 6229 minimum assessment period does not impact the partner's limitation on assessment. The I.R.C. § 6501 limitation on assessment would generally expire on April 15, 1998: three years from the due/filing date of the partner's return. The minimum assessment period under I.R.C. § 6229 would have prevented the statute from expiring before March 15, 1998: three years from the due/filing date of the partnership's return. Accordingly, since the I.R.C. § 6501 assessment period remains open without regard to I.R.C. § 6229, assessments attributable to both partnership and nonpartnership items may be made at any time on or before April 15, 1998.

Unlike in the previous example, I.R.C. § 6229 may have an impact on the assessment period if the I.R.C. § 6229 period remains open beyond the period of limitation on assessment of I.R.C. § 6501. Take the example when a partner's return was due and was filed on March 15, 1995 and the partnership return was due and was filed on April 15, 1995. In this case, the I.R.C. § 6229 minimum assessment period extends the partner's limitation on assessment as to partnership items. The I.R.C. § 6501 limitation on assessment would generally expire on March 15, 1998: three years from the due/filing date of the partner's return. However, under the express language of I.R.C. § 6229, "the period for assessing any tax ... which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before" three years from the filing/due date of the partnership return. Accordingly, the minimum assessment period under I.R.C. § 6229 would have prevented the statute from expiring before April 15, 1998: three years from the due/filing date of the partnership's return. Accordingly, the I.R.C. § 6229 minimum assessment period for partnership items holds I.R.C. § 6501 open for assessments attributable to partnership items, while the period for assessing tax attributable to nonpartnership items would have closed.

The period for making an assessment may be extended by agreement. See I.R.C. § 6501(c)(4). Similarly, the minimum period for assessing partnership items may be extended by agreement. I.R.C. § 6229(b)(1). The impact of an extension agreement differs depending upon the nature of the extension agreement. An agreement to extend the I.R.C. § 6501 limitation period extends the period for assessing tax, without regard to the source of the adjustments. Conversely, an agreement to extend the I.R.C. § 6229 period extends the assessment period only for purposes of assessing partnership items. For an extension agreement to be limited extending the I.R.C. § 6229 minimum assessment period for partnership items, the agreement must expressly state that it is limited to partnership items. I.R.C. § 6229(b)(3).

The minimum period within which to assess partnership items may be extended by a partner, as to that partner, or by the tax matters partner. If the tax matters partner extends the minimum assessment period on behalf of the partners, such extension applies to the period for assessing partnership items as to all partners. I.R.C. § 6229(b)(1)(b).

Analysis

Applying the above to the facts submitted, the adjustments that are solely attributable to the income averaging issue cannot be asserted. The general statute of limitations as to the taxpayer's 1983 taxable year has closed, except to the extent it has been extended. The TMP of the partnership extended the I.R.C. § 6229(a) period, which holds the I.R.C. § 6501 period open only for purposes of making adjustments attributable to partnership items. As to all other adjustments, the limitation period has expired. Note that a similar analysis was applied in In re Madden, 96-1 USTC § 50,263 (Bankr. D. N.J. 1996), in which the court held that a year was barred for purposes of adjusting a net operating loss carryover while the year remained open for the limited purpose of adjusting partnership items.

The service center has inquired as to whether the adjustment could be treated as a mathematical or clerical error. The TEFRA provisions allow adjustments "to correct a mathematical or clerical error appearing on the partnership return." I.R.C. § 6230(b). Because the "error" does not appear on the partnership return, this provision does not apply. Furthermore, although a mathematical or clerical error may be assessed without certain notices that might otherwise be required, there is no provision in the code which allows such an error to be assessed after the expiration of the limitation on assessment. Lastly, as an aside, it does not appear as though the adjustment at issue meets the statutory definition of a mathematical or clerical error. See I.R.C. § 6213(g).

Having determined that the income averaging adjustment may not be asserted, the question remains as to the proper computation of the adjustment arising from the TEFRA partnership adjustments. Otherwise stated, may the Service take into account the correct base year income, although the base years are closed, for purposes of determining the proper adjustment to the tax liability of an open year. The Tax Court squarely faced this issue in Unser v. Commissioner, 59 T.C. 528 (1973), and held that the correct amount of taxable income must be used for each base period year, even though adjustment of a base period year may be barred by statute. In so holding, the Tax Court looked to the statutory language of I.R.C. § 1302, which uses "the taxable income for [the base] year" for computation purposes, as distinguished from the taxable income as reported. From this, the Tax Court held that "the inference is clear the income to be used for each base period year is the correct income for such year whether or not the assessment of a deficiency ... for such base period year is barred by the statute of limitations." Unser, 59 T.C. at 530. Similarly, the correct base period income should be taken into account when computing the proper amount of tax that arises from the partnership adjustments. However, as noted above, only tax attributable to the partnership adjustments may be assessed.

Regarding the mechanics of computing the tax liability, the correct tax attributable to the partnership adjustment can be derived by first determining the correct tax liability using income averaging and taking into account both the correct base year income and the partnership adjustments. Subtract from that amount the correct tax liability using income averaging but not including partnership adjustments. The difference between these numbers will be the tax liability that is solely attributable to the partnership adjustments.

If you have any questions or need assistance, please contact Ronald L. Buch, Jr. at 202-622-7329.

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