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Audit Procedures for Pass-Through Entities

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This Portfolio revises and supersedes previous versions of 624-3rd T.M., *Audit Procedures for Pass-Through Entities*.

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Audit Procedures for Pass-Through Entities

PORTFOLIO DESCRIPTION

Bloomberg Tax Portfolio, *Audit Procedures for Pass-Through Entities*, No. 624-3rd, analyzes in detail the statutory rules of former §6221–§6234 governing the audits of "TEFRA partnerships." The Portfolio also considers briefly the analogous provisions governing the audit procedures for "subchapter S items" (former §6241–former §6245), before their repeal in 1996, and the provisions governing electing large partnerships (§6240–§6255), enacted in 1997. All of the remaining TEFRA procedures were repealed by the Bipartisan Budget Act of 2015, Pub. L. No. 114-74 ("BBA"), effective generally for partnership tax years beginning after December 31, 2017. Audits under the TEFRA procedures, however, will continue through the system for years to come.

Partners are generally required to file their returns consistently with the partnership return or provide notice of any variation to the IRS. Audits are conducted at the entity level and are limited to "partnership items" and related penalties. The IRS deals primarily with the Tax Matters Partner (TMP), who in turn has the duty under §6223(g) to keep the other partners informed of all administrative and judicial proceedings.

After the audit is completed, the IRS notifies the TMP of the proposed adjustments in a notice of final partnership administrative adjustment (FPAA). Certain classes of partners are given the right to participate in both administrative and judicial proceedings. There are special rules which apply to partners with a less than 1% interest in a large partnership, and other rules which apply to indirect partners, that is, the ultimate taxpayers when the partner is itself a pass-through entity. At the conclusion of the partnership proceeding, the IRS applies the partnership determination to each partner's tax liability by means of a computational procedure. The IRS may then also issue an "affected item notice of deficiency" to raise substantive issues on the partner's return related to the partnership determination.

The TMP of a TEFRA partnership also has the ability, in certain circumstances, to file amended partnership returns that will apply to all partners. This amended return, called an Administrative Adjustment Request (AAR), differs in several significant respects from non-TEFRA claims for refund. Specific procedural rules govern the filing, processing, and litigation concerning an AAR.

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DETAILED ANALYSIS

I. Overview

A. *Evolution of Audit Procedures*

1. Pre-TEFRA

Before the enactment of the Tax Equity and Fiscal Responsibility Tax Act of 1982 (TEFRA),[1] the Internal Revenue Service (IRS) audited partnership return items at the partner level. This procedure applied because partnership income, gain, deductions, loss, and credit flow through the partnership and are reported directly on the partners' income tax returns. No procedures existed that would have allowed the IRS to conduct a partnership-level proceeding because the partnership did not have a tax liability itself.

In the 1970s, limited partnerships increased dramatically in number as the favored entity for many tax shelter investments. Many of these limited partnerships had dozens or even hundreds of partners. Under the existing partnership audit procedures, the IRS was required to locate and coordinate the individual tax returns of each partner to ensure a consistent audit result. In addition, the §6501 statute of limitations had to be monitored separately for each partner's return. The coordination and monitoring of these individual returns placed a tremendous burden on the IRS's administrative resources, as well as the resources of the courts in which the litigation of the tax disputes was conducted.

In response to these administrative and judicial concerns, the Treasury Department proposed the first unified partnership-level audit procedures to Congress in 1978. Congress did not enact the bulk of the provisions proposed by Treasury at that time. The American Bar Association Section of Taxation offered its own proposal for partnership-level audit proceedings in 1979.[2] In 1981, the American Law Institute also proposed partnership-level audit procedures as part of its Federal Income Tax Project for Subchapter K.

2. TEFRA

Congress was finally persuaded to enact partnership-level audit procedures in 1982 as part of TEFRA. These procedures, set forth in §6221 to §6233, require all partners in a "TEFRA partnership" to report their "partnership items" consistently with the partnership's reporting. The partnership's reporting is then subject to audit at the partnership level (with varying participation rights for the partners), and the tax effect of the partnership adjustments on the partners' taxable income is accomplished by a mathematical computation and bill.[3] In 1997, Congress added penalty determinations to the partnership proceeding and added procedures for obtaining a declaratory judgment pertaining to the treatment on an oversheltered return of items that are not partnership items as part of the Taxpayer Relief Act of 1997 (1997 TRA).[4] TEFRA partnerships surged in popularity in the late 1990s and early 2000s with the boom of technical tax shelters. These tax shelters often involved the use of TEFRA partnerships to implement the tax strategy.

The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 ("BBA"), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

While the TEFRA partnership-level audit procedures are conceptually simple, the application of the concepts to actual cases has frequently proved difficult. In concept, the partnership proceeding is much like a declaratory relief action for issues that are common to all partners. The tax effect on the partners is then addressed in partner-level proceedings for each partner. This Portfolio will provide a detailed analysis of both the concepts and the implementation of these "TEFRA partnership audit procedures."

3. BBA

On November 2, 2015, the Bipartisan Budget Act of 2015 (the "BBA") effectively repealed the TEFRA and electing large partnership (ELP) procedures and replaced them with a new set of procedures.[5] On March 23, 2018, the Tax Technical Corrections Act of 2018[6] made a number of significant and retroactive amendments to the BBA.

The "BBA procedures" apply generally beginning with 2018 returns but were elective, under certain circumstances, for tax years that began after November 2, 2015 and before January 1, 2018.[7] The BBA procedures fundamentally change the manner in which the IRS determines, assesses and collects partnership adjustments.

Prior to BBA, three audit regimes applied to partnerships the TEFRA regime, the ELP regime and the small partnership regime outside of TEFRA. TEFRA partnerships were subject to a partnership-level administrative proceeding with the partnership item adjustments flowing through to be assessed to the partners in the "reviewed year." ELPs were subject to a part-

[1] Pub. L. No. 97-248, 96 Stat. 646 (1982).

[2] ABA Section of Taxation, "Proposal as to Audit of Partnerships," 32 *Tax Law*. 551 (1979).

[3] §6221; Reg. §301.6221-1. Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder, prior to their repeal by the BBA, Pub. L. No. 114-74.

[4] Pub. L. No. 105-34, §1231–§1243.

[5] *See* Pub. L. No. 114-74, §1101(a), §1101(b) and §1101(c). Note that the 2016 Consolidated Appropriations Act, Pub. L. No. 114-113, Div. Q, §411, made several corrections and clarifications to the 2015 act, effective as if originally included in the 2015 act. For a comprehensive discussion of the BBA audit rules, see 629 T.M., *The Partnership Audit Rules Under the Bipartisan Budget Act.*

[6] Pub. L. No. 115-141, Div. U. The amendments are effective as if included in §1101 of the BBA. Pub. L. No. 115-141, Div. U, §207.

[7] Pub. L. No. 114-74, §1101(g)(4); Reg. §301.9100-22.

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nership-level proceeding with the imputed tax liability paid at the partnership level. Small partnerships were audited entirely at the partner level outside of the TEFRA procedures.

Under the BBA, partnerships are subject to either partner-level audits (if the partnership is able to elect out of the BBA procedures and makes an affirmative election to do so) or the BBA procedures. Although some aspects of the BBA procedures are similar to the ELP procedures, there are several substantial differences.

For a comprehensive discussion of the BBA audit rules, see 629 T.M., *The Partnership Audit Rules Under the Bipartisan Budget Act.*

B. TEFRA Conceptual Framework

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

There are two central goals of the TEFRA partnership audit procedures: (1) consistent treatment of partnership items among all partners both on partnership returns and in partnership audits, and (2) administrative and judicial economy derived from unified audit and litigation proceedings. The difficult questions arise in determining when consistent treatment is required and when the unified proceedings are useful in obtaining consistent results. While the TEFRA procedures have been generally effective in increasing consistency, they have frequently failed in providing administrative and judicial economy.

Section 6222 requires all partners to report their respective distributive shares of partnership items consistently with the partnership tax return (Form 1065). This is the foundation for the unified audit procedures. Absent an express consistency requirement and a mechanism to enforce that requirement, the effectiveness of a partnership-level audit proceeding would be seriously diminished. Even if partnership-level determinations could be made, the application to the partners would require a separate analysis in each case. Section 6222 enforces this consistency requirement by allowing the IRS to make "computational adjustments" to make the partner's reporting consistent with that partner's distributive share as reported by the partnership. These issues are discussed more fully in IV., below.

The TEFRA procedures also provide for consistency in audit results by implementing unified partnership-level audit procedures. The partnership-level proceeding determines the correct amount of all "partnership items" and certain penalty issues. The partnership is represented by a tax matters partner (TMP) throughout the administrative and judicial phases of the proceeding. The other partners are also given an opportunity to participate. The IRS proposes audit adjustments by means of a notice of final partnership administrative adjustment (FPAA), the TEFRA equivalent of a notice of deficiency. The goal of the partnership proceeding is not to determine any tax. Instead, the goal is to determine adjustments to amounts that flow through from the partnership to the partners.

After the final partnership-level flow-through determinations have been made, either through settlement or judicial resolution, a partner-level proceeding is needed to determine the effect of the partnership flow-through changes to the partner's tax liability. The IRS computes the tax effect of the partnership item adjustments and penalties and sends the affected partners a "notice of computational adjustment" and a bill. The partner may then contest only the method of computation and not the underlying merits of the partnership-level adjustment. If substantive determinations are needed to determine the tax at the partner level, the IRS is generally required to issue an "affected item notice of deficiency" to propose adjustments to these "affected items."

The partners are allowed a little independence with respect to the refund procedures. Any partner can file an Administrative Adjustment Request (AAR), the refund claim equivalent. The IRS may allow the refund to that partner without allowing a similar refund to all other partners. This refund flexibility is severely restricted after the beginning of a partnership audit, however, and in practice the IRS probably cannot be expected to liberally allow inconsistent refund treatment.

One great benefit to the IRS from the TEFRA partnership audit procedures is that the minimum statute of limitations for all partners' partnership items is determined based on the filing date of the partnership return. The TMP may extend this partnership item statute of limitations for all partners by executing one partnership-level extension agreement. This partnership-level statute of limitations creates a minimum period of limitations and greatly diminishes the IRS's administrative burden in monitoring and controlling the statute of limitations for the individual partners.

While most of the discussion of this Portfolio concentrates on the partnership provisions, former §6244 extended the TEFRA partnership provisions to Subchapter S corporations for S corporation taxable years beginning after 1982 through taxable years beginning in 1996. Most of the specific incorporation of the TEFRA procedures to S corporations was left for regulations. Some regulations were enacted and most of the TEFRA partnership audit procedures were incorporated for audits of S corporations. The TEFRA procedures were then repealed for S corporation tax years beginning after December 31, 1996. The incorporation of these TEFRA procedures for the period during which they applied to S corporations is discussed more fully in XI., below.

The TEFRA procedures have also been extended to real estate mortgage investment conduits (REMICs). The incorporation of the TEFRA procedures for REMICs is discussed in XII., below.

C. Comparison to Non-TEFRA Audit Procedures

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

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While the TEFRA partnership audit procedures present a significant departure from the previous procedures for auditing partnership adjustments, there is a substantial degree of similarity in the steps for both non-TEFRA and TEFRA audits.[8] The non-TEFRA audit procedures are discussed in more detail in 623 T.M., *IRS Procedures: Examinations and Appeals*. The basic steps in TEFRA and non-TEFRA audits are summarized and compared in the Worksheets, below.

D. Electing Large Partnerships

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Prior to their repeal by the BBA, a partnership with 100 or more partners in the preceding year could elect treatment as an electing large partnership (ELP). An ELP may utilize streamlined flow-through procedures[9] and is subject to a specialized audit system.[10] These rules are discussed in XIII., below.

[8] See Caplin and Brown, "Partnership Tax Audits and Litigation After TEFRA," 61 *Taxes* 75 (1983), for a more detailed comparison of TEFRA and non-TEFRA partnership audit procedures.

[9] former §771–§777.

[10] §6240–§6255.

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II. Partnerships Covered

A. General Rule

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The initial inquiry in the TEFRA partnership audit procedure analysis is whether the procedures apply. This issue is governed by §6231(a)(1), which defines the "partnerships" that are subject to the TEFRA procedures. The partnerships that are subject to these TEFRA procedures are referred to as "TEFRA partnerships" throughout this Portfolio. See the Worksheets, below, for a flowchart illustrating the TEFRA partnership criteria.

Subject to the exceptions, elections and special rules discussed in this chapter, the following entities are covered by the TEFRA partnership audit procedures: (1) all entities which satisfy the definition of a partnership in §761(a) and are required to file a partnership return by §6031, and (2) all other entities which actually do file a partnership tax return and appear to satisfy the §6231(a)(1) definition. Representations on the partnership return may also dictate applicable procedures.[11]

Since the enactment of TEFRA, all states and several foreign jurisdictions have enacted laws providing for the formation of limited liability companies (LLCs). LLCs in most jurisdictions may be classified for federal tax purposes either as partnerships or associations that are taxable as corporations. For an LLC that is classified as a partnership for federal tax purposes, the TEFRA audit procedures apply.[12]

Section 761(a) defines a partnership broadly as any activity carried on jointly for profit which is not an association, corporation, trust, or estate. There are three notable exceptions to the broad range of this definition. First, certain investment entities, joint production or use arrangements, and temporary securities dealer arrangements may elect not to be treated as partnerships under §761(a). These ventures that elect out of partnership classification are not required to file partnership tax returns and are, therefore, not subject to the TEFRA partnership audit procedures.[13] Second, Reg. §301.7701-1(a)(2) provides generally that mere common ownership of property without the active conduct of a trade or business does not cause a venture to be considered as a partnership for tax purposes. Accordingly, simple joint ownership of a rental property, without more, will not cause the venture to be subject to the TEFRA procedures. Multiple working interests in an oil and gas leasehold can rise to the level of a joint venture that is considered a partnership, however.[14] Finally, some ventures that appear to be partnerships may not actually constitute a partnership for tax purposes either because of a lack of any business activity or because the activity is in the nature of pre-operating transactions.[15] Similarly, a partnership may be terminated and, therefore, not be subject to the TEFRA procedures.[16] The termination of a partnership for tax purposes is a question of federal, not state, law and is normally a partnership item determination.[17]

A special rule also exists for foreign partnerships. As with the general rule, the foreign partnership rule focuses on whether the partnership is required to file a U.S. partnership tax return under §6031. See X.A., below, for further discussion of this issue.

Section 6233 extends the TEFRA partnership audit procedures to any entity that actually filed a partnership tax return and that otherwise meets the §6231(a) definition.[18] As is indicated by the regulations, this section was enacted at least in part to cover situations in which an entity files a partnership return but the IRS determines that the entity should be taxable as an association.[19] Absent this provision, if the IRS prevails and the entity is found to be taxable as an association, partnership adjustments could not be made through the TEFRA proceeding and the non-TEFRA statute of limitations on corporate adjustments may have expired. The provision is also intended to apply in the event that it is determined at the conclusion of the proceeding that no entity exists.[20] Section 6233 will not protect the IRS, however, if TEFRA procedures were implemented for an entity that filed a partnership return but which would not

[11] *See NPR Invs., LLC v. United States*, 732 F. Supp. 2d 676 (E.D. Tex. 2010), *aff'd in part, rev'd in part*, 740 F.3d 998 (5th Cir. 2014).

[12] *See, e.g.*, Reg. §301.6231(a)(7)-2 (concerning TMP selection procedures for LLCs).

[13] See 700 T.M., *Choice of Entity: Business and Tax Considerations*; 710 T.M., *Partnerships; Overview, Conceptual Aspects and Formation*; and 725 T.M., *Limited Liability Companies*, for discussions of partnership definitions and the procedures for electing out of partnership treatment.

[14] *Jimastwolo Oil, LLC v. Commissioner*, T.C. Memo 2013-195. *See also Bergford v. Commissioner*, 12 F.3d 166 (9th Cir. 1993) (sale/leaseback venture involving co-owners of computer equipment deemed a partnership subject to TEFRA); *Momot v. Commissioner*, T.C. Memo 2006-207 (no interest abatement due to delays in determining whether activity constituted a partnership). *But see Rogers v. Commissioner*, 728 F.3d 673 (7th Cir. 2013) (proof trust funds held for partnership inadequate).

[15] *See Frazell v. Commissioner*, 88 T.C. 1405 (1987) (IRS argument that all activity was pre-operating activity rejected); *Ford v. Commissioner*, T.C. Memo 1987-44 (no business activity).

[16] *See, e.g., Sirrine Bldg. No. 1 v. Commissioner*, T.C. Memo 1995-185, *aff'd by unpub. opin.*, 117 F.3d 1417 (5th Cir. 1997).

[17] *Harbor Cove Marina Partners Partnership v. Commissioner*, 123 T.C. 64 (2004); CCA 201235015.

[18] *Green Gas Delaware Statutory Trust v. Commissioner*, T.C. Memo 2015-168 (trust that elected to be partnership and filed Form 1065). CCA 201025064 (TEFRA partnership procedures do not apply where a return shows only one partner because such a return is not a "partnership return" within the meaning of §6233).

[19] Reg. §301.6233-1(a). In CCA 200514011, the IRS Chief Counsel's Office concluded that a §501(d) apostolic organization that filed a partnership return in reliance on a PLR to such effect was not subject to the TEFRA audit procedures as the organization was a corporation for state law purposes.

[20] Reg. §301.6233-1(b). *See also, e.g., Andantech LLC v. Commissioner*, 331 F.3d 972 (D.C. Cir. 2003); *Frazell v. Commissioner*, 88 T.C. 1405 (1987); *Harrell v. Commissioner*, 91 T.C. 242 (1988); *BCP Trading & Invs., LLC v. Commissioner*, T.C. Memo 2017-151, *aff'd* 991 F.3d 1253 (D.C. Cir. 2021); CCA 201442056 (TEFRA procedures apply if purported partnership return is filed, regardless of whether a valid partnership exists). However, a §501(d) organization's mere filing of a partnership return does not turn it into a partnership as such an entity is a corporation for state law purposes. *See Kleinsasser v. United States*, 707 F.2d 1024 (9th Cir. 1983); *Blume v. Gardner*, 262 F. Supp. 405 (W.D. Mich. 1966), *aff'd*, 397 F.2d 809 (6th Cir. 1968); CCA 200514011.

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have been subject to the TEFRA procedures in any event because of the small partnership exception.[21]

Section 6233 also does not apply in the reverse situation. If the entity filed as a corporation but the IRS successfully reclassifies the entity as a partnership, the IRS presumably will have to implement a TEFRA proceeding to make the partnership adjustments. Section 6233 does not apply in this situation because the entity will not have filed a partnership return. However, §6229(c)(3) presumably will hold open the period of limitations for making a partnership item adjustment in this situation indefinitely, because no partnership return was filed.

Note: With the adoption of the "check-the-box" classification rules in Reg. §301.7701-1 through §301.7701-3, uncertainty about the status of an entity as a partnership or association has largely been eliminated and the significance of §6233 has been substantially diminished.

B. Partnership Tax Years Subject to TEFRA Election

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

TEFRA was originally enacted for partnership years beginning after September 3, 1982. This mid-year enactment led to much litigation over whether the tax year of a new partnership in 1982 began before September 4, 1982 (and was therefore subject to pre-TEFRA procedures) or after September 3, 1982 (and was therefore subject to TEFRA).[22] Once the 1982 tax year issues were resolved, TEFRA applied generally to partnership tax years from 1983 through 2017. The BBA, however, repealed the TEFRA procedures entirely for partnership tax years beginning after December 31, 2017.[23]

Comment: The determination of when a partnership's initial tax year begins is fact-intensive with a wide divergence of interpretation according to the applicable case law.

In addition, partnerships could elect to apply the BBA procedures for eligible tax years beginning after November 2, 2015 and before December 31, 2017.[24] If the BBA procedures apply, the TEFRA procedures cannot. Therefore, for partnerships that "opt in" to the BBA procedures for eligible partnership tax years before 2018 and for all partnership tax years after 2017, TEFRA can never apply. For the earlier years, however, TEFRA continues to apply. A partnership cannot opt in to the BBA procedures except for an eligible year.

C. Small Partnership Exception

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The most significant exception from the TEFRA partnership audit procedures is the small partnership exception provided in §6231(a)(1)(B). The theory behind this exception is apparently that the TEFRA procedures can be cumbersome to apply and the administrative burden is actually increased if the procedures are applied to a partnership where the partnership items flow through to only a few returns.

The small partnership exception has two requirements: (1) the partnership must have 10 or fewer partners; and (2) all partners must be individuals who are U.S. citizens or resident aliens, estates of deceased partners, or C corporations.[25] Thus, a small partnership may specially allocate items without jeopardizing its exception from the TEFRA rules. However, no partnership can qualify for the small partnership exception if it has a flow-through entity (other than an estate of a deceased partner) as a partner.[26]

Each partnership taxable year is examined separately to determine whether the small partnership exception applies.[27] Accordingly, a partnership may be covered by the TEFRA procedures in one year and not covered in the next because of the application of the small partnership exception in the second year.

Determining whether the small partnership exception applies is often difficult. For this reason, the IRS is given relief from an incorrect small partnership determination for a reasonable determination based on the partnership return. See II.E.2., below, for further discussion of this issue.

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[21] Reg. §301.6233-1(c).

[22] *See Frazell v. Commissioner*, 88 T.C. 1405 (1987); *Sparks v. Commissioner*, 87 T.C. 1279 (1986); *Samford v. Commissioner*, T.C. Memo 2000-266; *Consol. Cable, Ltd. v. Commissioner*, T.C. Memo 1990-657; *Countess Heart Watch P'ship v. Commissioner*, T.C. Memo 1989-236; *Grossman v. Commissioner*, T.C. Memo 1988-278; *L & B Land Lease Group 82-4 v. Commissioner*, T.C. Memo 1987-264; *Estate of Somashekar v. Commissioner*, T.C. Memo 1987-125.

[23] BBA §1101.

[24] BBA §1101(g)(4).

[25] §6231(a)(1)(B)(i).

[26] *Brumbaugh v. Commissioner*, T.C. Memo 2015-65 (any interest held by flow-through entity negates small partnership exception).

[27] Reg. §301.6231(a)(1)-1(a)(3).

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1. Ten or Fewer Partners

The numerical requirement of the small partnership exception is satisfied if the partnership does not have more than ten (10) partners at any one time during the taxable year.[28] Accordingly, if 11 K-1s are attached to a partnership return due to the transfer of an entire partnership interest during the taxable year by an existing partner to a new partner, the partnership will not be subject to the TEFRA procedures because there was never a time when the partnership had more than ten (10) partners. A husband and wife and their respective estates are only counted once in determining whether the 10-partner limit has been satisfied.[29]

2. All Individuals, Estates, or C Corporations

At all times during the partnership taxable year, all partners must be individuals other than nonresident aliens (i.e., U.S. citizens or resident aliens), C corporations, or estates of deceased partners.[30] For purposes of the small partnership exception, a partner that is a §501(a) tax-exempt organization that meets the definition of a C corporation is considered a C corporation. A foreign corporation is also considered a C corporation.[31] If at any time during the taxable year a nonresident alien, nominee, S corporation, partnership, trust, or other pass-through entity is a partner, the small partnership exception will not apply.[32] Even if the partner is an entity that is winding down during the taxable year, the partner will be treated as an entity so long as it is not considered terminated for federal tax purposes.[33]

There are several potential problems with the small partnership definition. First, it may be difficult to determine whether a foreign citizen has remained a resident alien throughout the partnership taxable year. If the foreign citizen is a nonresident alien at any point during the year, the small partnership exception does not apply.

Second, it is not altogether clear which types of partners fail to qualify as a natural person or estate. In general, the small partnership exception will not apply if the partner is a legal entity even if the entity is disregarded for tax purposes. For example, because a grantor trust is a separate legal entity, and not a "natural person," the presence of a grantor trust as a partner will render the partnership ineligible for the small partnership exception and thus subject to the TEFRA procedures. This is true even if the trust grantor is an individual and all trust items are reported directly on the grantor's return.[34] However, a custodian under the Uniform Gifts to Minors Act is disregarded and the partner is deemed a natural person.[35]

A rule similar to the grantor trust rule applies if a single-member limited liability company (LLC) holds a partnership interest. For federal tax purposes, the separate legal existence of the LLC is disregarded (unless it makes an election) and the ownership of the partnership interest is attributed to its single member. Nevertheless, even if the single member is an individual, the LLC is not a natural person and the partnership is not eligible for the small partnership exception.[36] The same applies for qualified subchapter S subsidiaries (Qsubs).[37]

Also, difficulties can arise if any partners make side arrangements with third parties. For example, if an individual has an undisclosed arrangement with a third party to share the partnership interest, this arrangement may constitute a sub-partnership.[38] Because this sub-partnership is not an individual, estate, or C corporation, the main partnership would not qualify for the small partnership exception. In addition, a person who holds an interest for the benefit of a third party as a nominee is obligated to inform the partnership of the existence of the relationship.[39] It is unclear, however, whether this obligation will be meticulously observed or whether the partnership will forward the information to the IRS. This side arrangement issue may present a difficult classification problem for the IRS.

D. Election to Be Covered

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the cor-

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[28] Reg. §301.6231(a)(1)-1(a)(1).

[29] §6231(a)(1)(B)(i). This is true whether the partnership interest is held jointly or by only one spouse. *See* Reg. §301.6231(a)(2)-1(a)(2), §301.6231(a)(12)-1(b).

[30] §6231(a)(1)(B)(i); Reg. §301.6231(a)(1)-1(a)(1). For this purpose, a C corporation is defined by §1361(a)(2). Reg. §301.6231(a)(1)-1(a).

[31] Rev. Rul. 2003-69, 2003-26 I.R.B. 1118.

[32] *See Brumbaugh v. Commissioner*, T.C. Memo 2015-65 (taxpayer did not qualify for small partnership exception because it had pass-through partner and thus was subject to TEFRA procedures).

[33] *Brennan v. Commissioner*, T.C. Memo 2012-187.

[34] *Primco Mgmt. Co. v. Commissioner*, T.C. Memo 1997-332. *Compare* §1361(b)(1)(B) *and* §1361(c)(2)(A)(i), expressly treating certain grantor trusts as eligible shareholders of an S corporation.

[35] *White v. Commissioner*, T.C. Memo 1991-552, *aff'd*, 991 F.2d 657 (10th Cir. 1993).

[36] Rev. Rul. 2004-88. *See Mellow Partners v. Commissioner*, 890 F.3d 1070 (D.C. Cir. 2018) ("the record makes it absolutely clear" that single-member LLCs, and not their individual owners, were partners; citing *Seaview Trading* to hold that electing disregarded status under the check-the-box regulations does not affect the tax consequences of a separate, higher level partnership, nor determine who holds a partnership interest for TEFRA purposes); *Seaview Trading, LLC v. Commissioner*, 858 F.3d 1281 (9th Cir. 2017) (citing Rev. Rul. 2004-88, court holds that single-member LLCs treated as disregarded entities (i.e., sole proprietorships) can be pass-through partners regardless of their elected classification under Reg. §301.7701-3, as §6231(a)(9) contemplated its application beyond the specific enumerated forms); CCA 200250012 (although LLC's member, a single-member LLC, was a disregarded entity under Reg. §301.7701-3 for federal tax classification purposes, it was still classified as pass-thru partner under §6231(a)(9)). *Cf.* PLR 200107025 (ownership of S corporation stock by an individual — both directly and indirectly through disregarded LLC or through disregarded limited partnership — did not terminate corporation's S election as ownership of partnership interest was attributed to its single member; pursuant to Reg. §301.7701-3(b)(1)(ii), a single owner domestic entity is disregarded as an entity separate from its owner unless it makes election).

[37] CCA 201219022, CCA 201030034 (Qsub is in effect a disregarded entity and constitutes a pass-through partner in a partnership and thus disqualifies the partnership from the small partnership exception, however, Qsub may be designated tax matters partners (TMP) assuming that, under state law, it constitutes a separate entity; deemed liquidation of the Qsubs upon partnership's S corporation election has no effect on the TMP designation because it occurred before the TMP designation was made and only a state law dissolution terminates TMP designation).

[38] *See, e.g., Bayou Berret Land Co. v. Commissioner*, 450 F.2d 850 (5th Cir. 1971).

[39] §6031(c); former Reg. §1.6031(c)-1T. *See also* FSA 200141021 (partnership with tax-exempt unidentified entity as its limited partner qualified for small partnership exception); CCA 201129039.

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responding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Partnerships can elect to be covered by TEFRA. The partnership may elect to be covered by the TEFRA procedures by attaching a statement to the partnership return for the first year in which the election is to be effective.[40]

Practical Point: If a particular partnership is not certain whether the TEFRA procedures apply and the partnership desires to have that certainty, the partnership could file this election to remove any doubt.

The statement must be identified as a specific election and must be signed by all persons who are partners at any time during the partnership taxable year.[41] The partnership can use IRS Form 8893, *Election of Partnership Level Tax Treatment*, as this statement. For any partnership tax year for which the due date of the return (determined without regard to extensions) fell before January 2, 2002, the partnership could elect to be covered by the TEFRA procedures only by filing the statement at least one year before the expiration of the §6229(a) partnership item statute of limitations (including extensions).[42] Either type of election is effective for the year in which the election is made and for all subsequent years unless the election is revoked with the consent of the IRS.[43] The partnership has the burden of proof to establish that a valid election was filed.[44] The election must clearly notify the IRS of the partnership's intent to make the election.[45]

E. Remedies After Incorrect Classification

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Given the complexity of determining whether the TEFRA partnership audit procedures apply to certain partnerships, improper classifications can occur. The result is that in some cases notices of deficiency will be issued to individual partners for TEFRA partnership adjustments and, in other cases, a Notice of Final Partnership Administrative Adjustment (an FPAA, the equivalent of a notice of deficiency for TEFRA partnerships) will be issued for items that are properly the subject of a notice of deficiency. An incorrect classification often means that the IRS is barred from making any adjustments because the statute of limitations has expired for the "correct" procedure by the time the error is discovered. See V.B., below, for further discussion of this issue.

1. Common Classification Problems

Several areas have presented challenging issues concerning the classification of a partnership as subject to the TEFRA procedures. Many of these problems relate to application of effective dates for changes in the law or delayed issuance of regulations. Most of these issues are no longer problem areas. There are still many cases pending in which these issues may be presented, however. For these cases, an analysis of the classification issue is critical.

The following classification issues present particular problems:

- The determination of whether a partner in a partnership that otherwise qualifies for the small partnership exception is a disqualified partner.[46]
- The determination of whether the same share requirement is satisfied for a partnership tax year ending prior to August 6, 1997.[47]
- The determination of whether an S corporation fits within a small S corporation exception for tax years beginning after January 1, 1983, and ending before November 30, 1986.[48]
- The effect of a subsequent partnership dissolution.[49]

Because of the significance of an incorrect classification, these issues should be carefully examined in any case where they are presented.

2. Relief for Reasonable IRS Mistake

If the IRS reasonably determines (based on the partnership return) that the TEFRA audit procedures apply for that tax year but the determination is wrong, the IRS nevertheless may apply the TEFRA provisions to the partnership and to the partners for that tax year.[50] Similarly, if an entity files a partnership return for a tax year but the entity is later determined not to be a partnership, the IRS may apply the TEFRA provisions for that tax year to the entity and to all persons holding an interest in such entity.[51] The IRS "determination" for this purpose occurs in the FPAA, not the Notice of Beginning of Administrative Proceeding (NBAP).[52]

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[40] Reg. §301.6231(a)(1)-1(b).

[41] Reg. §301.6231(a)(1)-1(b)(2); *Greenberg v. Commissioner*, 10 F.4th 1136 (11th Cir. 2021), *aff'g*, *Greenberg v. Commissioner*, T.C. Memo 2018-74; *Goddard v. Commissioner*, 2021 WL 5985581 (9th Cir. 2021) (unpub.) cert. denied 143 S. Ct. 208, rehearing denied 143 S. Ct. 518 (2022).

[42] Reg. §301.6231(a)(1)-1(b)(2).

[43] Reg. §301.6231(a)(1)-1(b)(3).

[44] *See Rodriguez v. Commissioner*, T.C. Memo 2013-221; *Petito v. Commissioner*, T.C. Memo 2000-363; *Christian v. Commissioner*, T.C. Memo 1990-229.

[45] *Wadsworth v. Commissioner*, T.C. Memo 2007-46.

[46] *See* II.C.2., above.

[47] *See* II.C.2., above.

[48] *See* XI.B.1., below.

[49] In CCA 201028037, the Chief Counsel's Office advised that the subsequent dissolution of the partnership has no effect on the TEFRA proceedings for the year in which it was a partnership. The IRS Chief Counsel's Office explained that a TEFRA proceeding is analogous to a class action of the partners for the year in issue, and the TMP is the agent for the partners, not the partnership.

[50] §6231(g)(1). *See, e.g.*, CCA 201550040 (if partnership files partnership return for entire year listing a flow-through entity as one of its partners, TEFRA applies and IRS may reasonably rely on return filed by partnership for such year in applying TEFRA procedures even if IRS subsequently discovers that partnership should not have filed the return in the manner it did and, if the partnership had filed correctly, TEFRA would not apply).

[51] §6233; Reg. §301.6233-1; CCA 201025064 (TEFRA procedures do not apply where a return shows only one partner, because such a return is not a "partnership" return within the meaning of §6233).

[52] *Sharma v. Commissioner*, T.C. Memo 2018-201.

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Comment: With the adoption of the "check-the-box" classification rules in Reg. §301.7701-1 through Reg. §301.7701-3, any uncertainty about the status of an entity as a partnership or association largely is eliminated and the significance of §6233 largely diminished.

In contrast, if the IRS reasonably determines (based on the partnership return) that the TEFRA provisions do not apply to the partnership but that determination proves to be wrong, the IRS may ignore the TEFRA procedures for that tax year and apply the normal deficiency procedures and limitations periods to the partners.[53]

The controlling factor is whether the IRS's determination, made on the basis of the partnership return for the taxable year, is reasonable. If it can be shown that the IRS's reliance was unreasonable, a taxpayer may attempt to pursue the procedural remedies discussed below. Otherwise, the IRS's erroneous determination controls which procedures will be followed, and the remedies discussed below do not apply.

Comment: It is not entirely clear as to the point in time when the IRS is entitled to rely on the partnership return. The IRS's position is that it may rely on the return at the beginning of the audit unless it is aware of facts to the contrary.[54]

3. Procedural Remedies

If the IRS has improperly and unreasonably included TEFRA partnership adjustments in a notice of deficiency, the taxpayer has two principal options: (1) convince the IRS to rescind the erroneous notice of deficiency pursuant to §6212(d), or (2) file a Tax Court petition and then file a motion to dismiss for lack of jurisdiction. The procedures for rescinding a notice of deficiency generally require the taxpayer to contact the IRS office issuing the notice of deficiency and obtain and execute Form 8626, *Agreement to Rescind Notice of Deficiency*. The notice of deficiency is considered rescinded when the IRS signs the Form 8626 which the taxpayer has executed.[55]

If the taxpayer cannot convince the IRS to rescind the notice of deficiency, the taxpayer should file a Tax Court petition and then file a motion to dismiss for lack of jurisdiction. The motion is a jurisdictional one because the Tax Court acquires jurisdiction only over items properly included in a notice of deficiency.[56] The TEFRA partnership adjustments cannot be included in a notice of deficiency and must be included in a notice of final partnership administrative adjustment (FPAA) (unless §6231(g) applies). Accordingly, the court lacks jurisdiction to decide the merits of partnership adjustments included in a notice of deficiency. As the issue is jurisdictional, the Tax Court must consider this characterization issue even if the petition is late.[57]

If there are proper adjustments in the notice of deficiency in addition to the improper TEFRA partnership adjustments, the appropriate motion is a motion to dismiss the TEFRA partnership adjustments combined with a motion to strike those adjustments. The remaining non-TEFRA adjustments may then go forward in the normal deficiency proceeding.

Unlike the procedures for an improper notice of deficiency, there is only one procedure for obtaining relief when an FPAA has been issued containing improper nonpartnership item adjustments. Section 6212(d), which authorizes recission of a notice of deficiency, does not have a TEFRA counterpart which would allow an FPAA to be rescinded. Accordingly, the partnership must file a petition and then a motion to dismiss the nonpartnership item adjustments for lack of jurisdiction. The Tax Court has jurisdiction only over partnership item adjustments in a case contesting an FPAA. Accordingly, a case filed after an FPAA has been issued to a non-TEFRA partnership may be dismissed for lack of jurisdiction in its entirety, because there are, by definition, no partnership items at issue. In addition, if an FPAA issued to a TEFRA partnership contains adjustments other than partnership items, the issues other than the partnership item adjustments may be dismissed and stricken.[58]

If an FPAA was issued and a partnership action was filed, any challenge to the characterization must be raised in the partnership proceeding. The doctrine of res judicata will bar any subsequent challenge in a partner-level proceeding.[59]

4. Recovering Attorney's Fees

A prevailing party in an administrative proceeding brought in connection with the determination, collection, or refund of a tax, interest, or penalty may recover reasonable administrative costs incurred in connection with the IRS proceeding.[60] However, a taxpayer will not be treated as the prevailing party if the IRS establishes that the "position of the United States" was substantially justified.[61] Recoverable costs include only those incurred on or after the earliest of: (1) the date the taxpayer receives the decision of the Internal Revenue Service Independent Office of Appeals (Appeals), (2) the date of the notice of deficiency, or (3) the date on which the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in Appeals is sent.[62]

Comment: While §7430 does not specifically address FPAAs, the FPAA should be treated as the equivalent of the notice of deficiency for §7430 purposes, as the two notices serve identical functions. Accordingly, the expenses allowed by §7430 that are incurred after an invalid FPAA has been issued should be recoverable if the taxpayer establishes that it is

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[53] §6231(g)(2); *Bridges v. Commissioner*, T.C. Memo 2020-51.

[54] *See* CCA 201319014 (citing *Harrell v. Commissioner*, 91 T.C. 242 (1988)); *Nehrlich v. Commissioner*, 327 Fed. Appx. 712 (9th Cir. 2009) (unpub.); *Doe v. Commissioner*, 116 F.3d 1489 (10th Cir. 1997). The TEFRA/non-TEFRA determination is made at the beginning of the audit and does not change based on the audit result. *See also Bedrosian v. Commissioner*, 143 T.C. 83, 107 (2014), *aff'd on other grounds*, 940 F.3d 467 (9th Cir. 2019), *reh'g denied*, No. 18-70066, 2019 BL 436330 (9th Cir. Nov. 13, 2019).

[55] Rev. Proc. 98-54, §5.

[56] *See Maxwell v. Commissoner* 87 T.C. 783 (1986).

[57] *McDermott v. Commissioner*, 336 Fed. Appx. 764 (10th Cir. 2009) (unpub.).

[58] *See N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987).

[59] *Katchis v. United States*, 99-2 USTC ¶ 50,744 (S.D.N.Y. 1999).

[60] §7430(a). *See BASR P'ship v. United States*, 915 F.3d 771 (Fed. Cir. 2019) (holding that under the qualified offer rule, a partnership can be a prevailing party and receive litigation costs in a TEFRA judicial proceeding). *But see* IRM. 34.8.2.10.3(4) (explaining IRS position that partnership cannot be prevailing party and receive litigation costs).

[61] §7430(c)(4)(B). *See McQuate v. Commissioner*, T.C. Memo 2014-165 (IRS position substantially justified because taxpayer failed to provide relevant documentation at time notice of deficiency issued).

[62] §7430(c)(2). For a further discussion of attorney's fees and costs recoverable under §7430, see 620 T.M., *Practice Before the IRS; Attorney's Fees in Tax Proceedings.*

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otherwise eligible for attorney's fees and the IRS cannot establish that its position is substantially justified.[63]

The Tax Court has changed its position with respect to whether attorney's fees and costs can be recovered when the IRS has improperly classified a partnership and has chosen the wrong procedure for adjusting the partnership items. The Tax Court originally took the position that, because the wrong notice was properly dismissed for lack of jurisdiction, the court did not have jurisdiction to award attorney's fees to the prevailing taxpayer.[64] The court later reversed itself and determined that, because the court had jurisdiction to decide the jurisdictional motion, it also had jurisdiction over ancillary matters such as the awarding of attorney's fees.[65]

[63] *See BASR P'ship v. United States*, 915 F.3d 771 (Fed. Cir. 2019) (§7430 fees and costs awarded to partnership prevailing on untimely FPAA).

[64] *Fuller v. Commissioner*, T.C. Memo 1986-33.

[65] *Weiss v. Commissioner*, 88 T.C. 1036 (1987).

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III. Key Definitions

A. *Types of Partners*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Once it is determined that a partnership is covered by the TEFRA partnership audit procedures, an entirely new set of terms and definitions applies.[66]

Section 6231(a)(2) defines a "partner" broadly to include any partner in the partnership plus any other person whose income tax liability is determined in whole or in part by taking partnership items into account, directly or indirectly. This definition includes the spouse of a partner who files a joint return, but does not include a shareholder of a partner that is a C corporation.[67] If an LLC is treated as a partnership for federal tax purposes, the members of the LLC are treated as "partners."[68] Because of the manner in which the TEFRA procedures apply, it is necessary to classify certain types of partners and groups of partners. All of these categories of partners have different rights and responsibilities with respect to the TEFRA partnership proceeding.

1. *Tax Matters Partner (TMP)*

The TEFRA procedures create a tax matters partner (TMP) who serves as the representative of the partnership (or perhaps more accurately, all of the partners) in the TEFRA proceeding.[69]

Practical Comment: Per FAA 20161801F, the TMP should execute documents related to the examination of the company as follows: [Name], as Tax Matters Partner of [Company Name]. The TMP for TEFRA S corporation proceedings (before being repealed by the Small Business Job Protection Act of 1996) is the "tax matters person."

The TMP has special rights to conduct the partnership audit,[70] extend the partnership statute of limitations,[71] select the forum for litigation of the partnership's tax dispute,[72] file a refund claim on behalf of the entire partnership,[73] and settle the partnership adjustments for all partners.[74] The TMP also receives certain notices and information from the IRS and must keep the other partners informed of the status of the TEFRA proceeding.[75] Finally, the TMP must provide the IRS with information concerning the partners' identities, addresses, and profits interests.[76]

Because of the critical role of the TMP, the rules governing the initial selection and succession of the TMP must be fully understood. As explained in this section, the TMP can be designated in one of four ways:

- designation by the partnership;
- "automatic designation" by statute;
- designation by the IRS; or
- designation by the Tax Court.[77]

a. *Persons Eligible to Be TMP*

Both in the initial selection of the TMP and in the replacement of the TMP (by the partnership, the IRS, or the Tax Court), the person to be designated must be eligible to be TMP. The list of eligible partners varies, however, depending on whether the partnership, the IRS, or the Tax Court is making the designation.

b. *Designation of the TMP by the Partnership*

The selection of the TMP by the partnership has two important elements: (1) who is eligible to serve as TMP; and (2) how the partnership can make the designation.

(1) *Eligibility*

The first eligibility requirement (which applies to all TMP designations) is that the TMP candidate must be a partner as defined in §6231(a)(2).[78] To satisfy this definition, the TMP candidate must have a capital and/or profits interest in the partnership.[79] Accordingly, if Schedule K-1 for the TMP candidate discloses a zero percent profits and capital interest, the IRS may challenge whether that "partner" can serve as TMP.[80] A bankruptcy trustee or court-appointed receiver does not meet this partner definition.[81] In addition, the consolidation of several

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[66] See the Worksheets, below, for a comparison of some of the non-TEFRA audit terms and steps with their TEFRA counterparts.

[67] Reg. §301.6231(a)(2)-1. The Tax Court treats a partner and his bankruptcy estate as a single partner for purposes of TEFRA procedures, although each may each satisfy the definition of a partner under §6231(a)(2). *Katz v. Commissioner*, 116 T.C. 5 (2001), *rev'd*, 335 F.3d 1121 (10th Cir. 2003) ("partner," as used in [former] Reg. §301.6231(c)-7T(a), does not encompass the bankruptcy estate; regulation does not convert partnership losses into nonpartnership items).

[68] *See, e.g.*, Reg. §301.6231(a)(7)-2 (concerning TMP selection procedures for LLCs).

[69] See discussion at XI.B.2., below.

[70] Reg. §301.6224(a)-1(a).

[71] §6229(b)(1)(B). The extension of the statute of limitations at the source partnership level applies to all tier and indirect partners. CCA 201028037. Note that the TMP or any other person with written authorization from the partnership may execute a consent to extend the assessment period under §6229(b)(1)(B). FAA 20161801F.

[72] §6226(a).

[73] §6228(a).

[74] §6224(c)(3); Tax Court Rule 248.

[75] Reg. §301.6223(g)-1.

[76] §6230(e).

[77] *See* Reg. §301.6231(a)(7)-1. A bankruptcy court may not exercise its authority under 11 U.S.C. §105 to designate a TMP. FSA 199950007.

[78] Reg. §301.6231(a)(7)-1(b)(1).

[79] *Montana Sapphire Assocs. v. Commissioner*, 95 T.C. 477 (1990); *Sente Inv. Club P'ship of Utah v. Commissioner*, T.C. Memo 1988-376.

[80] *But see Monetary II LP v. Commissioner*, 47 F.3d 342 (9th Cir. 1995) (former partner under largest profit interest test for year under examination can consent to extend statute of limitations for partnership items even after his resignation; individual not barred from serving as TMP once he resigns from partnership, and regulations do not require TMP be a partner at the time of his designation as such).

[81] *1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990) (court expressly reserved issue of whether a court could appoint a trustee or receiver as a TMP).

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bankrupt partnerships does not make a TMP in some of the partnerships a partner in other partnerships.[82]

It also appears that state law is relevant in determining the eligibility of a partner to serve as TMP. In *Barbados #7 Ltd. v. Commissioner*,[83] the Tax Court was faced with a situation in which the designation of the sole general partner as TMP was terminated when the general partner filed a petition in bankruptcy. The IRS argued that the general partner had been redesignated as TMP by operation of the regulations and, therefore, the statute of limitations extensions executed by the TMP after the filing of the TMP's bankruptcy petition were valid. The IRS reasoned that unless this redesignation was allowed, there would be no person authorized to act as TMP for the partnership during the administrative phase of the proceeding. The Tax Court agreed that the partnership could be left with no person eligible to serve as TMP, but indicated that the bankruptcy of the sole general partner resulted in a dissolution of the partnership under applicable Utah law and, therefore, no partner in the partnership was authorized to bind the other partners.

One additional variation of the "partner" requirement is whether a "pass-through partner" is eligible to be a TMP.[84] It can be argued that a pass-through partner has no ultimate tax consequence from the partnership items and, therefore, has no stake in the outcome of the TEFRA proceeding and should not be considered an appropriate candidate.[85] The pass-through partner is a partner in the partnership, however, and there is no statutory authority preventing pass-through partners from serving as the TMP.[86]

Comment: The requirement contained in §6226(d) concerning the need for an interest in the outcome of the proceeding applies only to partners other than the TMP seeking to file a petition in response to a Final Partnership Administrative Adjustment (FPAA).

Similarly, there is no conceptual reason for eliminating an S corporation or partnership from the category of entities eligible to fulfill the TMP duties. The ability of a corporation to serve as TMP should not depend on whether the corporation has properly made a Subchapter S election because a C corporation can serve as TMP.

If a pass-through partner acts as the TMP, it appears that the TMP of this pass-through partner is the logical person to act for the pass-through partner as TMP. The TMP of the pass-through partner is the only partner authorized to bind the other indirect partners to an administrative settlement, but no provision expressly limits the eligibility of these other indirect partners to serve as TMP.

Example: BCD Partnership (the "source partnership") is a general partnership comprising individuals B and C, who own 25% each, and D Partnership, which has a 50% interest. D Partnership (the "pass-through partner") is composed of X, an individual owning 75%, and Y Trust, a grantor trust owning 25%. Y Trust has been designated as the TMP of D Partnership.

There is no authority specifically addressing this point.[87] The better answer is probably that only Y Trust (the TMP of D Partnership) is authorized to act on behalf of D Partnership as TMP for the BCD Partnership. Even this conclusion does not resolve the question when the pass-through partner is not a TEFRA partnership or S corporation (e.g., if X and Y are both individuals and, therefore, D Partnership qualifies for the small partnership exception). In this situation, the better rule is probably that any general partner or other person authorized by state law to act for the pass-through partner can act on behalf of the pass-through partner as TMP of the source partnership.[88]

Finally, the regulations specify a preference in favor of U.S. persons. If a U.S. person and a foreign person both are eligible to serve as TMP, the designation must be made in favor of the U.S. person.[89]

The second major requirement for TMP candidates appointed by the partnership is that the candidate must be a general partner in the partnership. The partnership may not appoint a limited partner as TMP.[90] The regulations governing the appointment of the TMP by the partnership provide that the partnership's TMP designation is limited to persons who were general partners in the partnership at some time during the taxable year or are general partners in the partnership as of the designation.[91] In addition, §6231(a)(7)(A) and §6231(a)(7)(B) specifically limit the partnership's TMP designation to general partners. For purposes of determining the TMP of an LLC, only a member-manager of an LLC is treated as a general partner. A

[82] FSA 199952016.

[83] 92 T.C. 804 (1989).

[84] *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988). See III.A.5., below, for the definition of a pass-through partner.

[85] *See PAE Enters. v. Commissioner*, T.C. Memo 1988-222.

[86] *See* §6231(a)(2)(A); CCA 201304008; CCA 201116022.

[87] However, in CCA 201418051, the IRS Chief Counsel's Office advised that the current officer/manager of the LLC under state law can act for the LLC in its capacity as TMP; that a former officer/manager who is not currently a manager cannot act; and that an operating agreement or current board minutes should suffice to determine who the current officer/manager is.

Section 6223(h)(2) and Reg. §301.6223(h)-1 provide that the TMP of a pass-through partner is responsible for passing through notices received to the indirect partners. This provision does not address the issues that arise when the pass-through partner itself is the TMP.

[88] *See* CCA 201115023 (officer of LLC TMP can act if authorized by state law to act for LLC); CCA 201109026 (nonmanager-member cannot act because not authorized by state law).

[89] Reg. §301.6231(a)(7)-1(b)(2). *See* CCA 201503014 (foreign general partner-member cannot be designated TMP if any U.S. member is eligible, but if only U.S. member does not meet definition of eligible member under Reg. §301.6231(a)(7)-2, then foreign member can be designated TMP under Reg. §301.6231(a)(7)-1(b)(2)); CCA 201725028 (if U.S. partner is eligible to be a TMP, IRS consent is required to name a foreign partner as TMP).

[90] *Transpac Drilling Venture v. United States*, 16 F.3d 383 (Fed. Cir. 1994) (limited partner cannot become general partner for the sole purpose of being the TMP, since the TMP must meet the statutory requirements of general partner status; namely, the TMP must take on general liability).

[91] Reg. §301.6231(a)(7)-1(b)(1). *See* Rev. Rul. 2004-88 (LLC that is a disregarded entity for federal tax purposes, but a general partner of a partnership under state law, may be designated TMP); CCA 201030034 (Qsub is in effect a disregarded entity and constitutes a pass-through partner in a partnership and thus disqualifies the partnership from the small partnership exception; however, Qsub may be designated tax matters partners (TMP) assuming that, under state law, it constitutes a separate entity; deemed liquidation of the Qsubs upon partnership's S corporation election has no effect on the TMP designation because it occurred before the TMP designation was made and only a state law dissolution terminates TMP designation).

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member of an LLC who is not a member-manager is treated as a partner other than a general partner.[92]

Similarly, indirect partners claiming a partnership profit or loss through the pass-through partner (i.e., X and Y Trust in the preceding example) do not qualify. These indirect partners satisfy the partner definition in §6231(a)(2) and also have an interest in the outcome of the proceeding.[93] As the partnership's designation is limited to the general partners in the partnership, however, it does not appear that the partnership can designate an indirect partner as TMP. While indirect partners satisfy the §6231(a)(2) definition of partner, the indirect partners are not general partners in the source partnership. Thus, even if an LLC that is a partnership's general partner is a disregarded entity for federal tax purposes, the LLC's member is not eligible to be designated TMP by the partnership or to become the TMP under the largest profits interest rule.[94] Accordingly, it appears that only the IRS can designate an indirect partner as TMP under the authority of the flush language of §6231(a)(7).

Comment: While the issue was not expressly presented to the court, the language in the *Barbados #7* opinion may indicate that if all general partners have ceased to be partners in the partnership under state law, the IRS's attempt to designate a limited partner as TMP would not be effective.

(2) Designation

Once the eligible TMPs have been identified, the partnership must then follow the proper procedure to designate a TMP. A partnership designates a TMP either by designation on the partnership tax return or by separate written notice filed with the IRS submission processing center where the partnership return was filed.[95]

Comment: So long as a person designated on a partnership return is eligible to be a tax matters partner, such person is TMP, without regard to the partnership's operating agreement. Eligibility indicators include, for example, being a member of the partnership and having management control over it.

The most common form of TMP selection by the partnership is a designation on the partnership return (Form 1065).[96] The designation apparently cannot be made on an amended partnership return.[97]

If no designation is made on the original partnership return, a separate written notice which designates the TMP may be filed with the IRS submission processing center by the general partners who held more than 50% of all general partners' profits interests as of the close of the taxable year for which the designation is effective. All limited partnership interests of partners who are also general partners are added together for purposes of determining whether the 50% limit is met.[98]

Example: Partnership (P) has four general partners (B, C, D, and F) and 20 limited partners. The general partners each own 5% profits interests. In addition, F owns an 8% interest as a limited partner. The profits interests of the general partners are considered to be 28% (4 × 5%, plus F's 8%). Accordingly, general partners cumulatively owning more than 14% are needed to designate a TMP. F is deemed to own 13% (5% + 8%) for this purpose.

A third method for selecting a TMP applies if all general partners as of the end of the taxable year for which the designation is made are dead, liquidated, dissolved, adjudicated incompetent, no longer partners in the partnership, or have had their partnership items converted to nonpartnership items. If this is the case, the partnership may select an existing general partner as TMP for the designated year by filing a notice executed by partners possessing 50% of the profits interests of all partners as of the close of the designated taxable year.[99]

The separate notices that are filed to designate a TMP have three common elements:

- specific identification of the partnership and the designated TMP by name, address, and taxpayer identification number;
- a statement of the partnership taxable year for which the notice applies; and
- a declaration of the purpose of the notice.[100]

The partnership's TMP designation is effective on the date the statement is filed if no Notice of Beginning of Administrative Proceeding (NBAP) has been mailed to the partnership for that year, or 30 days after the date of filing if the IRS has sent an NBAP to the partnership.[101]

(3) Termination of the TMP and Replacement by the Partnership

There are often reasons to replace a TMP after the initial selection. For example, if a sole general partner was designated as TMP in 2008 and that general partner resigns and is replaced by another general partner in 2009, the initial TMP remains as TMP for 2008 unless the partnership makes a formal replacement. This is true because the identity of the TMP is determined annually based on the information provided to the IRS for each separate taxable year. Before the regulations, there was some question as to whether the general partner in 2009 was eligible to be appointed as TMP for 2008 because that partner had no capital or profits interest in the partnership for that year. The regulations clarify that the general partner in 2009 can be designated as TMP for 2008, provided that the general partner has an interest in the profits of the partnership at the time of

[92] Reg. §301.6231(a)(7)-2. In the case of a manager-managed LLC, all members are deemed to be member-managers eligible to be designated as a TMP for TEFRA audit purposes. The definition of a member-manager encompasses only the owners under state law and not the owners of the member. *See* CCA 201515030. In CCA 201138036, the IRS Chief Counsel's Office concluded that, assuming a nonmanager member designated as TMP actually was a qualified member under the regulations, acting as such did not make the individual a "manager" of the LLC contrary to the LLC's operating agreement, and thus did not limit the TMP's ability to represent the LLC members in the audit. *But see River City Ranches #1 Ltd. v. Commissioner*, T.C. Memo 2007-171 (if IRS is aware that TMP is acting in violation of his fiduciary duty to other partners, it may not be able to rely on TMP).

[93] *See PAE Enters. v. Commissioner*, T.C. Memo 1988-222.

[94] Rev. Rul. 2004-88.

[95] Reg. §301.6231(a)(7)-1(c). *See* CCA 202246010.

[96] *See* Reg. §301.6231(a)(7)-1(c).

[97] CCA 201219023.

[98] Reg. §301.6231(a)(7)-1(e).

[99] Reg. §301.6231(a)(7)-1(f).

[100] *See* Reg. §301.6231(a)(7)-1(c), §301.6231(a)(7)-1(d), §301.6231(a)(7)-1(e), §301.6231(a)(7)-1(f)(2), §301.6231(a)(7)-1(j).

[101] Reg. §301.6231(a)(7)-1(k).

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the designation.[102] In this situation, the partnership can replace the initial TMP so that one TMP will have responsibility for all partnership taxable years.

It is also necessary to designate a replacement TMP any time the designation of the original TMP has terminated. The designation of the TMP terminates with any of the following events: (1) the TMP's death, (2) an adjudication that the TMP is incompetent, (3) the liquidation or dissolution of a TMP, (4) the conversion of the TMP's partnership items to nonpartnership items under the special enforcement areas (such as bankruptcy),[103] (5) the resignation of the TMP, (6) the revocation of the designation of the TMP by the partnership, or (7) the designation of a new TMP pursuant to the three methods allowed for a new designation.[104] In addition, a corporate TMP's status may terminate when its corporate charter is revoked.[105]

Comment: Per FSA 199950007, the events listed above expressly terminate only the partnership's designation of the TMP. Presumably the TMP's designation under the "automatic designation" rule and a designation by the IRS will also be terminated by these events. The IRS does not consider a conditional resignation by a TMP to be effective.

Comment: An IRS criminal investigation of the TMP does not terminate the TMP's status unless the IRS notifies the TMP of the termination.

Once the TMP's designation is terminated, the terminated TMP is not authorized to act as TMP. All actions taken by the TMP before the termination remain valid.[106] For example, if the TMP executes a statute of limitations extension agreement (Form 872-P) after the TMP's termination (of which the IRS is aware), the agreement is invalid.[107] On the other hand, if the IRS is unaware of the termination of the TMP's authority or if the TMP's lack of authority is not conclusively established as to the IRS, a statute extension agreement obtained from the terminated TMP after termination may still be valid.[108] In fact, §6229(b)(2) specifically provides that, unless the IRS is notified of a TMP's bankruptcy, an agreement by the TMP to suspend the statute of limitations is valid and binding on all partners in the partnership despite the fact that the TMP's act of filing a bankruptcy petition effectively terminates his status as TMP under §6231(c)(2).[109]

At any time after a TMP's designation is terminated, the partnership is authorized to designate a new TMP.[110] The TMP eligibility rules are the same as for the original TMP designation. An alternate TMP also may be designated according to one of these three procedures to serve if the designated TMP dies or becomes legally incompetent.[111]

There are three procedures to designate a new TMP. The first method of replacement designation is by certification of a successor TMP by the outgoing TMP. This certification must contain a declaration that the outgoing TMP was properly designated as TMP and that the new TMP has been properly selected as TMP according to the partnership agreement.[112] This certification must be signed by the outgoing TMP and filed with the IRS submission processing center where the partnership return was filed.[113]

The second method for designating a new TMP requires the consent of the general partners who held more than 50% of the partnership profits interests held by all general partners as of the close of the year for which the designation is made. The designation of the new TMP is effective (and the former TMP's designation is terminated if not already terminated) when this majority group of general partners executes and files the notice with the IRS.[114]

Practical Comment: The general partners' limited partnership interests are added to their general partnership interest for purposes of determining whether the 50% requirement is satisfied.

The third method for designating a new TMP applies only if all general partners as of the close of the partnership taxable year for which the designation is made are dead, liquidated, dissolved, adjudicated incompetent, no longer partners in the partnership, or have had their partnership items converted to nonpartnership items. In such situations, a new designation of a TMP may be made by notice filed with the IRS that is executed by partners who held 50% of all of the profits interests in the partnership as of the close of the partnership taxable year for which the designation is effective.[115]

Comment: Because this provision applies only in limited circumstances, a sole general partner (or a TMP who holds 50% or more of the general partnership interests) typically cannot be removed as TMP by the partnership without the TMP's consent.

The partnership also may revoke the designation of a TMP without providing a replacement. This is done in the same general manner as a replacement designation.[116] An appointed TMP

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[102] Reg. §301.6231(a)(7)-1(d).

[103] *Phillips v. Commissioner*, 272 F.3d 1172 (9th Cir. 2001), *aff'g* 114 T.C. 115 (2000).

[104] Reg. §301.6231(a)(7)-1(l).

[105] *Compare Consol. Ltd. v. Commissioner*, T.C. Memo 1993-571; *TW Ancillary Ltd. v. Commissioner*, T.C. Memo 1993-572; *Transwestern Ltd. of Calif. v. Commissioner*, T.C. Memo 1993-573; *C-99 Ltd. v. Commissioner*, T.C. Memo 1993-574 (California law making actions merely voidable prevented subsequent Forms 872 from being invalid unless challenged by the IRS), *with Transpac Drilling Venture 1982-16 v. Commissioner*, T.C. Memo 1994-26 (Delaware law terminating corporation as general partner upon loss of charter rendered subsequent Form 872 invalid).

[106] Reg. §301.6231(a)(7)-1(l).

[107] *Barbados #7 Ltd. v. Commissioner*, 92 T.C. 804 (1989); *September Partners, Ltd. v. Commissioner*, T.C. Memo 1990-33. *See also* CCA 201402012 (TMP's disclosure on Form 872-P itself of his bankruptcy puts IRS on notice of his status as TMP under Reg. §301.6231(a)(7)-1(l)(iv) and Reg. §301.6231(c)-7 and likely invalidates statute extension).

[108] *San Gabriel Energy v. Commissioner*, T.C. Memo 1994-150; *Mock Dev. Project No. 1 v. Commissioner*, T.C. Memo 1990-49; *Dalton Dev. Project No. 1 v. Commissioner*, T.C. Memo 1990-47; *Kramer Dev. Project No. 2 v. Commissioner*, T.C. Memo 1989-686. *See also In re Miller*, 174 Bankr. 791 (B.A.P. 9th Cir. 1994) (taxpayer cannot set aside closing agreement based on alleged invalidation of extension requests signed by TMP where taxpayer fails to show TMP had notice both that he was under criminal investigation by IRS and that partnership items converted to nonpartnership items), *aff'd by unpub. opin.*, *Miller v. IRS*, 81 F.3d 169 (9th Cir. 1996).

[109] §6229(b)(2). For the mechanism for the TMP, or other partners, to provide notice to the IRS that the TMP is a bankruptcy debtor and, therefore, is ineligible to serve as TMP and to extend the statute under §6229, see Reg. §301.6229(b)-2.

[110] *Gateway Hotel Partners, LLC v. Commissioner*, T.C. Memo 2009-128.

[111] Reg. §301.6231(a)(7)-1(g).

[112] Reg. §301.6231(a)(7)-1(d).

[113] Reg. §301.6231(a)(7)-1(d).

[114] Reg. §301.6231(a)(7)-1(e).

[115] Reg. §301.6231(a)(7)-1(f).

[116] Reg. §301.6231(a)(7)-1(j).

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can also resign as TMP by filing a formal resignation notice with the IRS.[117]

Practical Comment: It is unclear whether resignation is available if the TMP has been designated by the IRS.

As with the initial designation of a TMP, the revocation, resignation, or replacement of a TMP is effective on the date the notice is filed (if an NBAP has not been mailed to the partnership) or thirty (30) days after the date of filing (if an NBAP has been mailed to the partnership).[118]

c. The "Automatic Designation" Rule

If the partnership fails to make an initial TMP designation or fails to designate a replacement TMP after a TMP designation is terminated, the "automatic designation" rule of §6231(a)(7)(B) takes effect. If this rule is impractical to apply, the IRS may then make a TMP designation. For this purpose, if a partnership attempted to designate a limited partner as the TMP, then the partnership has failed to designate a tax matters partner.[119]

Under the "automatic designation" rule of §6231(a)(7)(B), the TMP is selected in the following order of priority:

- the general partner with the largest profits interest (including all limited-partner profits interests held by the general partners);[120] or
- if there are two equal general partners, the general partner whose name appears first alphabetically.[121]

Comment: Under the regulations, if a general partner would not be eligible to serve due to death, incompetency, liquidation, dissolution, or conversion of partnership items to nonpartnership items, the general partner's partnership interest will be treated as zero for purposes of making the largest profits interest determination.

Comment: While the automatic designation actually is made by operation of the statute, in practice the designation is typically confirmed by notification from the IRS that the indicated partner is considered to be the TMP pursuant to §6231(a)(7)(B). Technically, this notification is not a formal TMP designation by the IRS, but rather is a notification that the IRS has interpreted the automatic designation rule to result in the selection of the notified partner as TMP.

Once selected by the automatic designation rule, the TMP has all of the rights and obligations of a TMP actually selected by the partnership. In addition, the IRS has taken the position in the regulations that a TMP selected under the automatic designation rule cannot resign and cannot have the designation revoked by the partnership unless the partnership designates a replacement TMP.[122]

Comment: While this provision is included in what is otherwise a legislative regulation defining the manner in which the partnership may make a TMP designation under §6231(a)(7)(A), Reg. §301.6231(a)(7)-1(m) deals with the automatic designation rule of §6231(a)(7)(B) and is therefore only an interpretative regulation. This interpretation lacks substantial conceptual justification, and results in an unfair imposition of obligations on the TMP in many cases.

d. Designation of the TMP by the IRS

The IRS may designate a TMP for the partnership when:

- the partnership failed to make designation or the partnership designation terminated and no replacement designation was made; and
- the IRS determines that the priority structure of §6231(a)(7)(B) — i.e., the automatic designation rule — is impractical to apply.[123]

The IRS considers the automatic designation rule impractical to apply if: (1) the K-1s do not disclose the general partner with the largest profits interest and the determination cannot otherwise be readily made; (2) each general partner is deemed to have a zero profits interest; or (3) the general partner with the largest profits interest has been suspended, is incarcerated, is residing outside the United States, cannot be located, or cannot perform the TMP function.[124] This standard is not met if the existing TMP is merely difficult to deal with.

The IRS may designate only a TMP who is eligible to serve. The eligibility rules are more liberal than the rules for a TMP designation by the partnership, however.

The IRS may designate only a partner as TMP. The requirement that the TMP be a general partner does not exist for designations by the IRS, however. The regulations clearly indicate that the IRS can designate a limited partner as TMP in appropriate circumstances.[125] This ability applies only to designations by the IRS, not the partnership. The IRS cannot be expected to recognize a limited partner as TMP during the administrative phase of a TEFRA proceeding unless the designation is made by the IRS.

It appears that the IRS can designate an indirect partner as TMP. The IRS is not limited to general partners to designate as TMP, so the IRS can designate an indirect partner as TMP because the indirect partner is a partner and has an interest in the outcome of the proceeding.[126]

The IRS also may, in certain circumstances, designate a non-U.S. person as TMP.[127]

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[117] Reg. §301.6231(a)(7)-1(i).

[118] Reg. §301.6231(a)(7)-1(k).

[119] Reg. §301.6231(a)(7)-1(m)(1)(i); CCA 201041037.

[120] Reg. §301.6231(a)(7)-1(m)(2). Reg. §301.6231(a)(7)-1(m)(3). *See also* CCA 201219017 (applying same rules to members of LLC).

[121] §6231(a)(7)(B). *See Amesbury Apartments, Ltd. v. Commissioner*, 95 T.C. 227 (1990).

[122] Reg. §301.6231(a)(7)-1(m)(3).

[123] §6231(a)(7) (flush language). Only the IRS can determine that §6231(a)(7)(B) is impractical to apply. *Monetary II LP v. Commissioner*, 47 F.3d 342 (9th Cir. 1995).

[124] Reg. §301.6231(a)(7)-1(o)(1), §301.6231(a)(7)-1(o)(2), §301.6231(a)(7)-1(o)(3).

[125] Reg. §301.6231(a)(7)-1(p), §301.6231(a)(7)-1(q). *See also* CCA 201543018 (where all general partners are entities, and are all dissolved, the IRS is required to designate the TMP from the remaining partners under Reg. §301.6231(a)(7)-1(p)(2)); CCA 201041037 (if the sole general partner dissolved at the close of the last taxable period at issue, IRS may select a TMP from the remaining limited partners).

[126] *See* CCA 201251013; CCA 201402014 (citing Reg. §301.6231(a)(7)-1(n)).

[127] CCA 201041037 (IRS may designate non-U.S. person as TMP where the general partner dissolved, the limited partner relinquished his citizenship and moved out of the country, and thus the only existing partner is a non-U.S. person). Compare Reg. §301.6231(a)(7)-1(b)(2), which limits the partnership's ability to designate a non-U.S. person as TMP.

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The designation of a TMP by the IRS requires an actual determination and formal action. The simple act of mailing a notice to a particular partner "as TMP" does not satisfy the requirements for designating a TMP. Certain partners have attempted to argue that the mailing of a notice addressed to them as TMP is a designation by the IRS. The Tax Court, however, has held that the mere addressing of duplicate notices to a person as TMP does not constitute an actual designation of that person as TMP.[128] In addition, the IRS is not required to make a designation of a replacement TMP. The power to designate a replacement TMP is for the purpose of administrative convenience and does not connote an obligation to make such a designation.[129]

If the IRS determines that the priority scheme of §6231(a)(7) is impractical to apply, the IRS must give 30 days' advance notice to the partnership that the IRS intends to designate a TMP.[130] This period gives the partnership the opportunity to make its own designation.[131] Within 30 days of its designation of a TMP, the IRS must notify all partners required to receive notice of the designee's name and address.[132] As with a TMP designated under the automatic designation rule, the IRS's position is that the IRS-designated TMP cannot resign, and the IRS designation cannot be revoked by the partnership without the designation of a replacement TMP.

Finally, the Tax Court has held that the IRS may not designate a replacement TMP when the existing TMP designation terminates after the commencement of the litigation phase of the TEFRA proceeding.[133] Tax Court Rule 250(b) gives the court the authority to remove and replace the TMP after a judicial proceeding has commenced.

e. Recognition and Selection of the TMP by the Tax Court

Two special rules apply to TMP designations when the TEFRA proceeding has advanced to the litigation stage in the Tax Court. First, under certain circumstances the Tax Court may disregard the designation of a TMP made during the administrative phase of the proceeding. Second, if circumstances leave the partnership without an acting TMP, the Tax Court itself may make the designation for the purpose of continuing the judicial proceeding.[134] The Tax Court will designate only a partner that has an interest in the outcome of the proceeding, but it can be a limited partner.

In cases in which the identity of a partnership's TMP is at issue, the Tax Court has held that the procedures for designating a TMP under then-temporary regulations are not dispositive on the issue of who would be recognized as TMP for purposes of conducting the Tax Court proceeding.[135] These cases hold that the temporary administrative regulations do not control the jurisdictional issue concerning whether the person filing a Tax Court petition as TMP has been authorized by the partnership to file the petition.[136]

Comment: It is not altogether clear whether the Tax Court's characterization of the regulations as "administrative regulations" is accurate, since the manner for designating a TMP is specifically delegated to regulations in §6231(a)(7) itself. This delegation makes the temporary regulations "legislative regulations," which are entitled to greater weight.

The Tax Court has also appointed a replacement TMP after the existing TMP fails or ceases to act. In *Computer Programs Lambda, Ltd. v. Commissioner (Computer Programs Lambda II)*,[137] the Tax Court determined that the orderly administration of a TEFRA judicial proceeding requires the existence of a TMP. The court also found that, because of the importance of a TMP to the functioning of the judicial process, the court has the inherent power to designate a TMP when the existing TMP fails or ceases to act. Finally, the court held that if there are no general partners eligible to act as TMP, it could designate a limited partner as TMP for the limited purpose of conducting the judicial proceeding.[138] Under these rules, the court first gives the partnership an opportunity to designate a replacement TMP. If no such replacement is designated, the Tax Court will designate a replacement. While the Tax Court has the authority to designate a TMP, it is not required to do so.[139] The IRS does not have the authority to designate a TMP for purposes of conducting the litigation.

The Tax Court Rules also allow the Tax Court to remove a TMP for cause.[140] Once the TMP is removed, the Tax Court presumably has the power to designate a new TMP if the partnership fails to do so.[141]

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[128] *Sierra Design Research & Dev. LP v. Commissioner*, T.C. Memo 1989-506; *PAE Enters. v. Commissioner*, T.C. Memo 1988-222.

[129] *Tempest Assocs. v. Commissioner*, 94 T.C. 794 (1990); *Seneca, Ltd. v. Commissioner*, 92 T.C. 363 (1989), *aff'd mem.*, 899 F.2d 1225 (9th Cir. 1990).

[130] Reg. §301.6231(a)(7)-1(r).

[131] The partnership procedures for designating a replacement TMP are discussed in III.A.1., above.

[132] §6231(a)(7); Reg. §301.6231(a)(7)-1(p)(2), §301.6231(a)(7)-1(r)(1).

[133] *Computer Programs Lambda, Ltd. v. Commissioner (Computer Programs Lambda II)*, 90 T.C. 1124 (1988).

[134] *See* Tax Court Rule 250 (providing for appointment and removal of TMP by Court). *See also Computer Programs Lambda, Ltd. v. Commissioner*, 90 T.C. 1124 (1988); *Transpac Drilling Venture 1983-63 v. United States*, 16 F.3d 383 (Fed. Cir. 1994). Section 6231(a)(7) does not permit the designation of a nonpartner as TMP under any circumstances. *See Cambridge Partners, LP v. Commissioner*, T.C. Memo 2017-194 and *1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990) (petition filed by court-appointed receiver dismissed for lack of jurisdiction; petition must be filed by TMP, and receiver could not qualify as TMP because he was never partner), *aff'd without published opinion*, 995 F.2d 235 (9th Cir. 1993). *See also Mont. Sapphire Assocs., Ltd. v. Commissioner*, 95 T.C. 477 (1990) (IRS could not select nonpartner as TMP).

[135] *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988); *Modern Computer Games, Inc. v. Commissioner*, T.C. Memo 1989-483. The temporary regulations were amended by proposed regulations and withdrawn when final regulations were issued in 1996. *See* T.D. 8698, 61 Fed. Reg. 67458 (Dec. 23, 1996).

[136] Rogovin, "The Four R's: Regulations, Rulings, Reliance and Retroactivity: A View from Within," 43 *TAXES* 756 (1965).

[137] 90 T.C. 1124 (1988).

[138] It is unclear whether the designation of a limited partner to serve as TMP in *Computer Programs Lambada II* can be used as authority for designating a limited partner as TMP in the administrative phase of a TEFRA proceeding. The Tax Court clearly believes that different rules apply with respect to TMP designations in the judicial phase of the proceeding as opposed to the administrative phase.

[139] *Cinema '84 v. Commissioner*, 412 F.3d 366 (2d Cir. 2005), *cert. denied sub nom. Reigler v. Commissioner*, 126 S. Ct. 631 (2005), *rev'g in part* T.C. Memo 1998-146.

[140] Tax Court Rule 250.

[141] *See* FSA 199952016 (concluding that, where the TMP of related partnerships needed to be removed, the Tax Court could appoint a nonpartner to

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f. Powers and Duties of the TMP

The TMP is charged with critical responsibilities in conducting both the administrative and judicial phases of a TEFRA proceeding. Significantly, however, a TMP's failure to fulfill these obligations is not grounds for relief for the adversely affected parties.[142] Accordingly, it is necessary for both the TMP and the other partners to understand the role the TMP plays in the TEFRA proceeding.

(1) Distribution of Information

One of the most onerous duties imposed on the TMP is the requirement to furnish information concerning the following items to all "notice partners" and all representatives of "five-percent notice groups": (a) the audit closing conference, (b) the proposed audit adjustments and information concerning administrative appeal, (c) the time and place of any conference with IRS Appeals, (d) the acceptance of any settlement offer by the IRS, (e) the TMP's consent to an extension of the statute of limitations with respect to all partners, (f) the filing of an Administrative Adjustment Request (AAR) on behalf of the partnership, (g) the filing of a petition for judicial review of an FPAA or a petition contesting the disallowance of an AAR which is filed by the TMP or any other partner, (h) the filing of an appeal from a judicial action, and (i) the final judicial redetermination of an FPAA or AAR.[143] In addition, the TMP is required to furnish copies of the NBAP and FPAA to all non-notice partners who have not become members of a five-percent notice group.[144]

The TMP also has the responsibility for submitting information to the IRS. The TMP is required to submit a list of all partners' names, addresses, profits interests, and taxpayer identification numbers to the IRS after the TMP receives an NBAP. In addition, the TMP is also required to update any information supplied within 15 days after being notified that the information supplied was incorrect or incomplete.[145] See VI.E.2., below, for further discussion of these "information base" requirements.

The TMP's informational duties continue through the judicial phase of the TEFRA proceeding. The TMP is required to send notice of the filing of all Tax Court petitions to all other partners in the partnership within five days after receipt of the Tax Court's Notification of Receipt of Petition.[146] The TMP must notify all partners of a Tax Court petition even when the TMP has not filed the petition. In this event, the TMP is obligated to notify the partners within five days of receipt of a copy of the petition from the petitioning partner.[147] If any partner requests a copy of a petition, the TMP must provide one within 10 days.[148] During the pendency of the proceeding, the court and the parties must directly serve the TMP with all papers even if the TMP did not file the petition.[149] Finally, because the TMP may settle a Tax Court case on behalf of all partners in the partnership pursuant to Tax Court Rule 248, the TMP is required to communicate the settlement and solicit responses from all partners before entering into the Tax Court decision.

(2) Extension of Statute of Limitations

From the IRS's standpoint, one of the TMP's most critical powers in the administrative phase of the TEFRA proceeding is the TMP's ability to execute an extension of the statute of limitations for the partnership items and affected items of all partners in the partnership.[150] This extension of the statute of limitations is effected on Form 872-O or Form 872-P.

Comment: Some partnership agreements contain express provisions that deny authority to the TMP to extend the statute of limitations on behalf of all partners. This creates a conflict between §6229, which gives the TMP the authority to execute the statute extension, and the partnership agreement, which denies that authority. Even though the partnership agreement is the operative legal document as to which actions the TMP may take on behalf of the partnership, a statute extension agreement executed by the TMP in violation of the partnership agreement probably would still be valid as between the partnership and the IRS. The partnership agreement cannot modify the Code.

Comment: Per FSA 20111701F, the operating agreement that limits the TMP's authority to execute consents to situations where such consent is deemed necessary or advisable by the board of managers does not override the TMP's statutory authority under §6229(b)(1)(B) to sign a consent.

As a practical matter, it is unlikely that the TMP will be willing to execute a statute extension agreement which would expose the TMP to liability to the other partners under the partnership agreement, so a limitation in the partnership agreement should have the effect of forcing the TMP to seek partner approval before executing the extension.

The impact of criminal investigations and other conflicts of interest on extensions signed by a TMP is discussed at V.C.4.e.(1), below.

(3) Settlement Powers

The authority of the TMP to settle disputes concerning the appropriate treatment of partnership items varies depending upon the stage in the TEFRA proceeding. The TMP's authority to enter into binding settlement agreements with the IRS at the administrative stage of the TEFRA proceeding is effective only as to certain non-notice partners.[151] The TMP does not have the authority to enter into an administrative settlement of a partnership item audit on behalf of notice partners or non-notice partners who have joined a five-percent notice group. In addition, non-notice partners who have not joined a five-percent notice group may eliminate the TMP's administrative settlement authority by filing a written "no settlement" statement declaring

serve as a representative, and thus perform the same functions as a TMP, for all of the partnerships).

[142] §6230(f).

[143] Reg. §301.6223(g)-1(b). See III.A.2. and III.A.3., below, for further discussion of the notice partner and five-percent notice group classifications.

[144] Reg. §301.6223(g)-1(a). See VI.C.1., below, for further discussion of the TMP's informational responsibilities.

[145] §6230(e); Reg. §301.6230(e)-1.

[146] Tax Court Rule 241(f)(1).

[147] Tax Court Rule 241(f)(2).

[148] Tax Court Rule 241(g).

[149] Tax Court Rule 246.

[150] §6229(b)(1)(B).

[151] §6224(c)(3)(A).

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that the TMP does not have the authority to bind that partner to a settlement.[152]

The TMP acquires additional settlement authority after issuance of the notice of final partnership administrative adjustment (FPAA). If the FPAA is contested in Tax Court, Tax Court Rule 248(a) gives the TMP the authority to bind all partners in the partnership to a settlement reflected in a Tax Court Decision. Even the partners that have filed a notice of election to participate pursuant to Tax Court Rule 245(b) can be bound by the TMP's settlement.

Comment: The only authority for the expanded settlement power of the TMP at the judicial stage is Tax Court Rule 248. It is unclear whether a Tax Court Rule can provide settlement authority to the TMP which is not otherwise provided by the Code. The validity of this Tax Court Rule has not been tested in any reported litigation.

(4) Conducting Audit and Litigation

The statutory scheme of the TEFRA partnership audit procedures places the TMP at the focal point for conducting the administrative and judicial phases of the proceeding. The TMP is the first partner to receive all notices and is charged with disseminating the information concerning all stages of the audit to the other partners.[153] The TMP also must provide certain information to the IRS, including a list of the names, addresses, profits interests, and taxpayer identification numbers of all partners (including indirect partners).[154]

The TMP also must update the information provided within fifteen (15) days of the receipt of any new information.

The TMP may choose the forum in which to litigate the merits of an FPAA or the disallowance of an AAR.[155] The IRS also contacts the TMP in an attempt to gather information concerning the books and records of the partnership. With the exception of the limitation on the TMP in settling disputed partnership items at the administrative level, the TMP essentially bears all responsibility for conducting the partnership audit and litigation.

(5) Using a Power of Attorney

There is little guidance in the Code or regulations concerning who may sign a power of attorney in a TEFRA proceeding, or the extent to which the TMP's duties can be delegated to a representative under a power of attorney.[156] Given that the statutory and regulatory scheme specifically defines the TMP's duties, the absence of an express provision authorizing the power of attorney to act on the TMP's behalf suggests that such delegation of the TMP's authority would be ineffective. Accordingly, the execution of these documents by the TMP's representative may be invalid.[157]

A representative can be designated to receive copies of information supplied by the IRS to the TMP. This designation is made by sending the designation form to the IRS submission processing center where the partnership return is filed or (if applicable) the IRS office that issued the Notice of Beginning of Administrative Proceeding (NBAP) to the partnership.[158] The designation should be made on Form 2848, *Power of Attorney and Declaration of Representative*, signed by the TMP (or by all partners) with appropriate language to indicate that the matter is for "TEFRA partnership proceedings" and the tax form number for "Form 1065."[159] A power of attorney granted by a partner that does not specifically state that it covers the partner's TEFRA partnership proceedings will not be recognized in the TEFRA proceeding.[160] The dissolution of the partnership does not affect the TMP's authority to grant a power of attorney. As long as the TMP itself does not dissolve, the TMP can sign a Form 2848, *Power of Attorney and Declaration of Representative*.[161]

Comment: Under CCA 201028037, only partners for the year at issue can signe the appropriate Forms.

g. Practical and Ethical Problems for the TMP

As illustrated by the foregoing discussion, the TMP has wide-ranging powers and obligations with respect to the conduct of the TEFRA partnership proceedings. In fact, many of the administrative and judicial economies enacted as part of the TEFRA partnership audit procedures do little more than shift the administrative burden for coordinating the partnership audit from the IRS and the Tax Court to the TMP. The duties of coordinating the audit of the various partners, obtaining consents to the extension of the statute of limitations, coordinating the partners for purposes of settlement, and other administrative aspects of the resolution of the dispute are placed on the TMP.

With these duties come myriad practical and ethical problems in administering the TEFRA proceeding. For example, as an ethical matter, the TMP clearly should solicit responses from the partners before extending the statute of limitations or entering into settlement agreements either at the administrative or judicial level. As these actions are binding on all partners in the partnership, the question arises as to what percentage of accep-

[152] §6224(c)(3)(B); Reg. §301.6224(c)-1(c).

[153] §6223(g). The TMP also is the person to whom the IRS sends, pursuant to §7602(c), reasonable notice in advance that the IRS may make contacts with third parties related to the determination or collection of the TEFRA partnership's tax liability. Reg. §301.7602-2(c)(3)(ii) *Ex. 6(a)*. If the IRS is scrutinizing transactions between the partnership and specific, identified partners, or transactions with third parties for the benefit of specific, identified partners that will affect only the separate tax liability of these partners, then the IRS also should provide to those partners advance notice of third-party contacts relating to such transactions. However, the IRS does not send advance notice of contacts with any partners because it considers such contacts to be the equivalent of contacting the partnership. Reg. §301.7602-2(c)(3)(ii) *Ex. 6(a)* and *Ex. 6(b)*.

[154] §6230(e); Reg. §301.6230(e)-1.

[155] §6226(a), §6228(a).

[156] *See generally* AM 2015-004 (IRS Office of Chief Counsel advised that the general partner of partnership, or member-manager in case of a limited liability company, may sign a power of attorney for purposes of a TEFRA partnership-level examination, and stated that the IRS has authority to make inquiries of, and disclose details of a TEFRA partnership-level examination to, any person who is a party to, or has authority to represent a party in, the partnership examination, or any individual, if the IRS employee reasonably believes such discussion will be helpful and appropriate to obtaining information that can determine partnership items).

[157] *But see Madison Recycling Assocs. v. Commissioner*, T.C. Memo 1992-605 (TMP could delegate to his attorney-in-fact his authority to consent to extension of limitations period under §6229(b)(1)(B)); *Madison Recycling Assocs. v. Commissioner*, T.C. Memo 2001-85 (consents by the TMP's attorney were valid); *Amesbury Apartments, Ltd. v. Commissioner*, 95 T.C. 227 (1990).

[158] Reg. §301.6223(c)-1(e), Reg. §601.504(b)(1).

[159] Reg. §601.504(b)(1).

[160] Reg. §301.6223(c)-1(e)(3).

[161] CCA 201028037.

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tance should be required before the TMP will enter into the respective agreement. The TMP should also be concerned with potential liability from the dissenting partners. The partnership agreement should probably specify the required approval percentage for actions taken pursuant to the TMP function. While an action taken in violation of such a provision would still be binding as to the IRS, the partnership agreement would provide a basis for an action by the other partners against the TMP for any breach. The partnership agreement should also provide a mechanism for contribution toward the expenses of conducting the administrative and judicial phases of the TEFRA proceeding. These provisions are particularly necessary when the partner ultimately designated as TMP is not the original TMP and may even have been designated without that partner's consent. It is important that the partnership agreement provide a mechanism for the partners to participate in the decisions concerning the conduct of the TEFRA proceeding as well as contribute to the associated expenses.

There are additional situations in which the TMP's interest may be in conflict with the interests of the remaining partners. For example, issues concerning allocations and the recourse or nonrecourse nature of debt generally find a general partner (e.g., the TMP) on the opposite side from the limited partners. In view of the TMP's liberal authority to control the administrative and judicial phases of the TEFRA proceeding, the TMP can make the decisions which best serve the TMP's position, possibly to the detriment of the limited partners. The courts have generally been unsympathetic to partners' claims that the TMP did not or could not represent the interests of the partnership as a whole.[162]

h. Action by Incorrect TMP

There are two events for which it is critical to identify the correct TMP: (1) the execution of an extension of the statute of limitations and (2) the filing of a petition by the TMP in response to a notice of final partnership administrative adjustment (FPAA).

While the TMP has a number of important responsibilities, the most important TMP function from the IRS's standpoint is the ability to extend the statute of limitations for the partnership items of all partners.[163] If the partner who executes the extension agreement is not the correct TMP, the extension agreement is invalid.[164]

It is also critical to have the correct TMP acting for the partnership when a petition is filed contesting the FPAA. Only the partnership's TMP may file a petition within the first 90 days after the date the FPAA is mailed to the TMP.[165] If the partner who files a petition during this 90-day period does not have a proper TMP designation, the petition filed will be dismissed unless the court finds that the person filing the petition did so with the authorization of the TMP.[166]

Comment: Where the identity of the TMP is in doubt, the partnership should have a notice partner file a "back-up" petition during the 60-day period following the TMP's 90-day period to ensure that at least one valid petition is filed in response to the FPAA.

2. Notice and Non-Notice Partners

The term "notice partner" derives from the partner's right to receive a Notice of Beginning of Administrative Proceeding (NBAP) and a notice of final partnership administrative adjustment (FPAA) directly from the IRS. In partnerships that have 100 partners or less, all partners are notice partners. In partnerships with more than 100 partners, only partners who have at least one percent profits interests are notice partners.[167] Because "indirect partners" (e.g., the partners in a second-tier partnership) are included within the definition of partner, these indirect partners must be counted in determining the number of partners in the partnership. The partners who do not have a one percent interest in a partnership with more than 100 partners are called "non-notice" partners.

There are detailed rules for determining a partner's profits interest for the notice partner classification. If a partner owns a partnership interest on the last day of the partnership taxable year, the partner's profits interest is determined as of the close of the year. If the partner completely disposes of the partnership interest (either at once or in stages) before the close of the taxable year, but still reports a distributive share of partnership items for the year, the partner's profits interest is determined immediately before the last disposition of the partnership interest. Finally, if the partner completely disposes of the partnership interest before the close of the taxable year and is not required to report any distributive share of partnership items for the year, the partner is considered to have a zero profits interest for the year.[168]

If notice partners do not receive direct mailings of the NBAP and FPAA, the notice partners are given a special opportunity to drop out of the partnership proceeding by converting their partnership items to nonpartnership items. Non-notice partners do not have this right. Another consequence of being a notice partner is that only notice partners are allowed to file Tax Court petitions in response to an FPAA.[169] While the IRS apparently engages in a practice of mailing NBAPs and FPAAs directly to non-notice partners in some circumstances, this di-

[162] In *Adams v. Johnson*, 355 F.3d 1179 (9th Cir. 2004), limited partners brought suit against the TMP and IRS agents, contending that the IRS agents used the threat of their criminal investigation of the TMP to gain concessions that facilitated audits of the partnerships promoted by the TMP, to the partners' detriment. The limited partners asserted claims for money damages under *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971), alleging that the IRS's audits of the partnerships and the IRS's assessment and collection of partnership taxes violated their rights to due process, conflict-free representation under the Fifth Amendment, and access to the courts under the First Amendment. Noting that specific remedies are available to a partner challenging an audit pursuant to TEFRA, the court held that the partners could not pursue a *Bivens* action and upheld the dismissal of the complaint. In the same group of cases, the Sixth Circuit also held that the failure of the IRS to remove a TMP under criminal investigation was not a ministerial act justifying the abatement of interest under §6404(c). *Mekulsia v. Commissioner*, 389 F.3d 601 (6th Cir. 2004). Also see cases involving consents to extend the statute of limitations by conflicted TMPs at V.C.4.e., below.

[163] §6229(b)(1)(B).

[164] See generally V.C.4.e., below.

[165] §6226(a). *See Quantum Invs. LLC v. Commissioner*, T.C. Memo 2000-247 (trustee of trust not authorized as TMP for LLC).

[166] *See Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987); *Sierra Design Research & Dev. LP v. Commissioner*, T.C. Memo 1989-506; *Sente Inv. Club P'ship of Utah v. Commissioner*, T.C. Memo 1988-376.

[167] §6231(a)(8), §6223(b).

[168] Reg. §301.6231(d)-1.

[169] §6226(b).

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rect mailing does not entitle the non-notice partner to file a Tax Court petition in response to the FPAA.[170]

The other major consequence of being a notice partner is that the TMP does not have the authority to enter into an administrative settlement on behalf of a notice partner.[171] On the other hand, the TMP can bind non-notice partners to settlements under certain circumstances. The non-notice partner can eliminate this settlement authority either by joining a five-percent notice group or by filing a "no settlement" statement with the IRS that expressly revokes the TMP's settlement authority.[172] If the TEFRA proceeding advances to the judicial phase, however, the TMP will have the authority to bind all notice and nonnotice partners to a settlement in certain circumstances even if the partners have filed a notice of election to participate in the judicial proceeding.[173]

The lack of direct information and ability to participate for non-notice partners raises serious due process concerns.[174] The TEFRA proceeding can redetermine the non-notice partner's tax liability without allowing the non-notice partner any direct ability to object. Non-notice partners have certain procedural options, however, that can lessen these concerns. The principal procedural device is to form a five-percent notice group or a five-percent litigation group. These groups allow non-notice partners to participate in the TEFRA proceeding on a collective basis.

There is a special notice category for the spouse of a partner. This special category applies so long as the spouse does not also directly own an interest in the partnership. If the spouse does not own a separate interest, the spouse is treated as a partner for participation purposes, but is not counted as a separate partner for the 100-notice-partner limit or the 10-partner small partnership exception.[175] In addition, the mailing of notice to one partner is treated as the mailing of notice to the spouse.[176] The spouse can become entitled to direct notice only if the spouse: (1) is identified on the partnership return, or (2) files an identification statement in the same manner as if the spouse were an indirect partner.[177]

Note: Section 3201(d) of the 1998 IRS Reform Act directed the IRS to, wherever practicable, send any notice relating to a joint return separately to each joint filer and, thus, appeared to require direct notice to the nonpartner spouse. The IRS's position is that, although the NBAP and the FPAA are notices subject to this provision, whether it would be practicable to mail separate notices to the partner and the nonpartner spouse in TEFRA cases is a business decision to be made by the IRS.[178]

[170] *Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913 (1988).
[171] §6224(c)(3).
[172] §6224(c)(3)(B); Reg. §301.6224(c)-1(c).
[173] Tax Court Rule 248(a).
[174] *See* Rosen, "TEFRA's New Partnership Auditing Procedures: Was the Small Partner Left Out?" 38 *Tax Law Rev.* 479 (1983). *But see 1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990). In *Jordan v. United States*, 863 F. Supp. 270 (E.D.N.C. 1994), the court declined to address the due process claim asserted by a non-notice partner on the ground that he lacked standing, having received actual notice of IRS audit actions.
[175] Reg. §301.6231(a)(2)-1(a)(2).
[176] Reg. §301.6231(a)(2)-1(a)(3)(i).
[177] Reg. §301.6231(a)(2)-1(a)(3)(ii). See III.A.6., below, for the rules concerning the filing of an identification statement.
[178] CCA 199919033.

3. Five-Percent Notice Group

Section 6223(b)(2) provides that if a group of partners has in the aggregate a 5% or greater interest in the profits of a partnership and requests that one of their members receive the TEFRA notices, the designated member must be treated in most respects as a notice partner. When partners form this five-percent notice group, the group representative becomes entitled to receive the NBAP and the FPAA directly from the IRS[179] and the TMP no longer has the power to bind the group members to an administrative settlement.[180] The notice group is recognized 30 days after the filing of a statement, signed by all group members, which identifies the group, the group representative and the applicable taxable years. The statement must be filed with the IRS submission processing center where the partnership return was filed or, if an NBAP has been issued to the partnership, with the office issuing the NBAP.[181] The group representative also must provide a copy of the statement to the TMP within 30 days after the statement is filed with the IRS.

The designation of a notice group may cover more than one year; but each group member must have a profits interest in at least one of the designated years, and the group must satisfy the 5% profits interest requirement in each year.[182] Each group member's profits interest is determined in the same manner as discussed in the preceding section for the 1% profits interest test. A notice partner may be a member of a notice group and can be used to help give a prospective notice group sufficient profits interest to qualify.[183] However, no one partner may be a member of more than one notice group. After the formation of a notice group, additional members may be added by filing a statement executed by the new member.[184]

The statement that creates the notice group must designate the partner who is to act as the representative of the group. This representative receives the notices provided by the IRS and has the obligation to distribute the information contained in those notices to the other group members. The designation of a representative of a notice group does not authorize the representative to file a Tax Court petition in response to an FPAA. Rather, for judicial purposes, a "five-percent litigation group" may not act through a representative and all members must execute the appropriate pleadings before the group will be recognized by the court.[185]

Once a partner has become a member of a notice group, that partner remains in the notice group until the group terminates. A notice group terminates when the designated representative of a group dies, is dissolved, resigns, or is adjudicated incompetent.[186] The outgoing representative may designate a new representative by filing a statement with the IRS and with the partnership's TMP that declares the status of the new representative.[187]

[179] Reg. §301.6223(b)-1(a).
[180] §6224(c)(3)(A); Reg. §301.6224(c)-1(a).
[181] Reg. §301.6223(b)-1(b)(3).
[182] Reg. §301.6223(b)-1(b)(5).
[183] Reg. §301.6223(b)-1(c)(1).
[184] Reg. §301.6223(b)-1(c)(3).
[185] Reg. §301.6223(b)-1(e), §301.6226(b)-1(a).
[186] Reg. §301.6223(b)-1(d).
[187] Reg. §301.6223(b)-1(d).

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Comment: The conversion of the representative's partnership items to nonpartnership items does not terminate the group, although it does terminate the representative's interest in the outcome of the proceeding. The apparent reason for retaining the representative is that the representative serves only the function of receiving and disseminating information. Apparently the function served by the representative is considered sufficiently ministerial so that an interest in the outcome of the proceeding is not required.

Comment: As a practical matter, the formation of a notice group may be somewhat less critical than it would otherwise seem. The IRS has adopted an administrative practice of sending NBAPs and FPAAs to all partners including non-notice partners in many cases. In addition, the IRS typically distributes administrative settlement proposals to all non-notice partners. This IRS administrative practice, while not enforceable as an affirmative right of the non-notice partners, may lessen the need to form a notice group in the administrative phase of the TEFRA proceeding.[188]

4. Five-Percent Litigation Group

It is important to distinguish the five-percent litigation group from the five-percent notice group. As discussed in the preceding section, §6223(b)(2) allows partners holding partnership profits interests aggregating 5% or more to designate a representative to receive the notices provided under the TEFRA procedures when the individual group members would not otherwise be entitled to receive such notices.

Section 6226(b)(1) refers to a "five-percent group" that may file a petition to contest an FPAA. This five-percent litigation group, however, may not act through a representative. Group members with a combined interest of at least 5% must sign the petition, or the petition is invalid.[189] The group members' profits interests are determined in the same manner as for a notice group. Presumably, the group also may not act through a group representative during the resulting proceeding, although the group should be able to be represented by an attorney.[190]

5. Pass-through Partner

Section 6231(a)(9) defines a "pass-through" partner as an individual or entity through which "indirect" partners hold an interest in a TEFRA partnership. Examples of pass-through partners include partnerships, estates, trusts, S corporations, nominees, or other similar persons.

Example: BCD Partnership is a general partnership consisting of B and C, who are individuals, and D Partnership, a general partnership consisting of X and Y, who are individuals. BCD Partnership is the "source" partnership, D Partnership is the "pass-through" partner, and X and Y are "indirect" partners.[191]

The existence of a pass-through partner in any source partnership almost always precludes that partnership from being a "small partnership" as defined in §6231(a)(1)(B), and therefore assures the source partnership of being subject to the TEFRA procedures. The only form of pass-through partner that does not result in this characterization is the estate of a deceased individual partner. See X.B., below, for further discussion of issues involving pass-through partners.

The persons who ultimately take the source partnership distributive share into taxable income are referred to as indirect partners, i.e., the indirect partners report the source partnership distributive share indirectly through the pass-through partner. If the pass-through partner is a nominee for the beneficial owners of the partnership interest, the nominee is required to furnish information to the partnership concerning the identity of the beneficial owners.[192] In addition, all pass-through partners are required to furnish all notices received from the IRS to the indirect partners within 30 days of receipt.[193] This obligation continues until the indirect partner has filed with the IRS an "identification statement" which declares that the partner wishes to receive all notices directly.[194] The pass-through partner may also bind the indirect partner to a settlement until the identification statement is filed.[195]

The pass-through partner may become a member of a five-percent notice group, but the percentage interests of any indirect partners who have filed the identification statement are excluded in computing the profits interest allocated to the pass-through partner.[196]

If the pass-through partner is a partnership itself, the TMP of the pass-through partner is responsible for communicating information regarding the source partnership to the indirect partners.[197] There is no clear guidance on this issue when the pass-through partner is a partnership that is not a TEFRA partnership and, therefore, does not have a TMP. However, any general partner of the pass-through partner can bind the unidentified indirect partners to a settlement.[198]

Comment: A partnership is not made a TEFRA partnership merely because it is a pass-through partner in another TEFRA partnership.

6. Indirect Partner

As discussed in the preceding section, an indirect partner is a person who claims a distributive share of partnership items

[188] *See Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913, 914 n.2 (1988).

[189] Reg. §301.6226(b)-1(a). *But see* Tax Court Rule 241(d)(3)(A). As with the TMP designation rules discussed in III.A.1.f., above, it is unclear whether the regulations can limit the Tax Court's jurisdiction.

[190] *See* Tax Court Rule 241(d)(1)(F).

[191] §6231(a)(9), §6231(a)(10); Reg. §301.6222(a)-2(a).

[192] §6031(c); Reg. §1.6031(c)-1T.

[193] §6223(h)(1); Reg. §301.6223(h)-1(a).

[194] §6223(c)(3).

[195] §6224(c)(1); Reg. §301.6224(c)-2. *See also* CCA 201025060 (because a pass-through partner can sign a settlement agreement that binds the indirect partners, a trust can therefore sign an agreement through its trustee that will bind the grantors/beneficiaries, but if a grantor/beneficiary signs on his own behalf, the agreement binds only the signing spouse), CCA 201035017 (a pass-through partner cannot bind indirect partners as to partner-level items on Part II of Form 870-LT; therefore, indirect partners must sign the form).

[196] Reg. §301.6223(b)-1(c)(6)(i).

[197] §6223(h)(2). On February 1, 2017, LB&I announced 13 examination campaigns, one of which relates to identifying, linking, and assessing tax of "terminal investors" in TEFRA exams. See Large Business and International Compliance Campaigns, available at https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns.

[198] Reg. §301.6224(c)-2(b). These issues are discussed more fully in X.B., below.

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through a pass-through partner.[199] The indirect partner's interest in the source partnership is determined by its share of the source partnership's distributive share.

Example: BCD Partnership is the source partnership in which D Partnership is a 50% partner. X is a 30% partner in D Partnership. X's profits interest in BCD Partnership is 15% (30% × 50%).

The indirect partner may effectively bypass the pass-through partner and receive notices directly from the IRS by filing an "identification statement" identifying the partner as an indirect partner and requesting direct communication from the IRS.[200] The IRS is not required to examine other returns or information in its possession (for example the partnership return of a pass-through partner) to identify the indirect partners of a pass-through partner.[201] Therefore, only filing the identification statement will ensure acknowledgement of the indirect partner by the IRS. If the indirect partner does not qualify as a notice partner after this identification statement is filed, the indirect partner is eligible to become a member of a five-percent notice group unless the pass-through partner joined a notice group before the indirect partner files the statement.[202]

If the indirect partner does not file the identification statement, a settlement agreement executed by the pass-through partner binds the indirect partner.[203] In addition, the failure to file the identification statement may result in a special partnership item statute of limitations that will not expire until at least one year after the identification statement is filed.[204] Accordingly, the indirect partner should be sure to file the §6223(c)(3) identification statement with the IRS if the indirect partner wishes to participate directly in the partnership proceeding.

7. *Participating Partner*

The term "participating partner" has significance in the context of litigation involving an FPAA or AAR. The Tax Court Rules provide that the TMP must give notice of the commencement of a judicial action resulting from an FPAA or AAR to all partners within five days after receiving the Notification of Receipt of Petition from the Court (if the TMP files) or five days after receiving a copy of the petition from the petitioning partner (if a partner other than the TMP files).[205] This notice is intended to provide the partners with an opportunity to file a notice of election to participate pursuant to Tax Court Rule 245(b). This election causes the partner to be considered a participating partner for purposes of the litigation and gives the partner additional procedural protections. See VII.D., below, for further discussion of the election and procedural benefits of participating partner status.

B. Types of Items

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The most difficult aspect of the TEFRA partnership audit procedures is determining which items are most appropriately determined at the partnership level and then applying those partnership-level determinations to the partners' tax returns. The TEFRA solution to this issue is to create five categories of items of taxable income, loss, or credit and adopt special procedural rules for each category. The five categories of items are: (1) partnership items, (2) affected items, (3) nonpartnership items, (4) converted items (i.e., items which were once partnership items but have become nonpartnership items), and (5) penalties. Each of these categories has a significant role in the TEFRA partnership audit process. The partnership item and most penalty determinations are made in the partnership-level proceeding. The affected items, nonpartnership items and converted items are determined in partner-level proceedings.

1. *Partnership Items*

The partnership item characterization is critical because only partnership items (and certain penalty determinations) are governed by the partnership-level proceeding.[206] An item is considered to be a partnership item if: (1) the item must be taken into account for the partnership's taxable year; *and* (2) the regulations determine that the tax treatment of the item is more appropriately determined at the partnership level.[207]

a. *Partnership Item Definition in Regulations*

In view of the critical importance of the classification of items as partnership items, it is not surprising that the first regulation issued under the TEFRA partnership audit procedures addressed the definition of partnership items. The central theme of this regulation is that an item is a partnership item to the extent that the item is *required* to be determined at the partnership level.[208] This question usually focuses on whether an examination of the merits of the item must be made by examining the partnership books and records. Section 6231(a)(3) states that the partnership item determination must be for an item in Subtitle A. Reg. §301.6231(a)(3)-1 expands this requirement to include the "… legal and factual determinations that underlie the determination required … ." In practice, courts have frequently

[199] *See* §6231(a)(10).

[200] §6223(c)(3). *See* CCA 201502012.

[201] Reg. §301.6223(c)-1(c).

[202] Reg. §301.6223(b)-1(c)(6).

[203] §6224(c)(1). The following persons acting for the pass-through partner can bind the indirect partners who have not identified themselves as such to the IRS to a settlement: (1) the TMP of a TEFRA partnership; (2) any general partner of a non-TEFRA partnership; (3) an officer of an S corporation; and (4) any person authorized in writing to act on behalf of a trust, estate, or nominee. Reg. §301.6224(c)-2(b). *See also* CCA 201025060 (a pass-through partner can sign a settlement agreement that binds the indirect partners; therefore, a trust can sign an agreement through its trustee that will bind the grantors/beneficiaries, but if a grantor/beneficiary signs on his own behalf, the agreement binds only the signing spouse), CCA 201035017 (a pass-through partner cannot bind indirect partners as to partner-level items on Part II of Form 870-LT; therefore, indirect partners must sign the form).

[204] §6229(e). See V.C.4.c., below, for further discussion of this issue.

[205] Tax Court Rule 241(f), §6223(g), Reg. §301.6223(g)-1(b)(1).

[206] §6223(a), §6225(a), §6226(a).

[207] §6231(a)(3).

[208] Reg. §301.6231(a)(3)-1.

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been willing to gloss over the Subtitle A restriction in an effort to qualify items under the partnership item definition.[209]

To break this issue down further, there are two major components of the partnership item definition: (1) all items appearing on the partnership return, and (2) the aspects of certain other issues which are more appropriately determined at the partnership level. In applying this general theme, the regulations specify the following items as partnership items:[210]

- partnership income, gain, loss, deduction, or credit;
- nondeductible partnership expenditures (e.g., charitable contributions);
- potential partnership tax preference items;
- tax-exempt partnership income;
- the amount, character, and changes in partnership liabilities;
- the partnership aspects of the investment tax credit and investment tax credit recapture;
- the partnership aspects of the at-risk determination;
- the partnership aspects of the oil depletion allowance;
- the "hot asset" determination with respect to partnership distributions;
- the determination of whether a partnership distribution will be treated as a sale or exchange under §751(b);
- guaranteed payments;[211]
- optional basis adjustments pursuant to §754 and all attendant determinations (such as the transferee's basis in a partnership interest);
- a §743(b) election;[212]
- the partnership aspects of partnership contributions, distributions, and partner transactions with the partnership pursuant to §707(a) and §707(b);[213]
- the partnership's accounting methods, elections, characterization of assets, profit motive, and eligibility for the §41 research and development credit;
- the character, amount, §721(b) investment company determination, and partnership basis determination (including the partner's basis in contributed property, if necessary) with respect to money and property the partnership receives from a partner;[214] and
- the nature (e.g., loan or distribution), character (e.g., capital asset, inventory, etc.), amount, and partnership's adjusted basis determinations for money and property transferred from the partnership to the partner.

These specific items, as well as any other item for which the merits of the item must be determined by an examination of the partnership books and records, are considered to be partnership items. If the partnership is a TEFRA partnership, these partnership items are subject to adjustment *only* through a TEFRA proceeding.

There are also factors that can affect the determination of what is a partnership item. Thus, the term "partnership item" also includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc. Examples of these determinations are:

- the partnership's method of accounting, taxable year, and inventory method;
- whether an election was made by the partnership;
- whether partnership property is a capital asset, §1231 property, or inventory;
- whether an item is currently deductible or must be capitalized;
- whether partnership activities have been engaged in with the intent to make a profit for purposes of §183; and
- whether the partnership qualifies for the research and development credit under §30.[215]

The regulations also contain examples of items that are specifically excluded from the partnership item definition:

- the partner's investment tax credit recapture on property contributed to the partnership;
- the partner's basis in a partnership interest acquired from another partner (unless the §754 election applies); and
- the cost of assets sold to the partnership.[216]

b. Other Items Defined as Partnership Items

There have been a number of cases and rulings that have addressed the partnership item issue. The following items have been determined to be partnership items:

- the issue of whether the partnership is a sham, lacks economic substance, or was availed of for an impermissible reason;[217]
- certain determinations related to the partnership item statute of limitations;[218]

[209] For an example, see the statute of limitations discussion in V., below.

[210] Reg. §301.6231(a)(3)-1(a).

[211] Certain guaranteed payment offset issues determined at the partner level can constitute affected items. *Woody v. Commissioner*, 95 T.C. 193 (1990).

[212] CCA 201028037 (citing Reg. §301.6231(a)(3)-1(a)(3)).

[213] *ES NPA Holding, LLC v. Commissioner*, T.C. Memo 2021-68 (discussing whether contributed partnership interest was capital or profits is partnership item).

[214] *Nussdorf v. Commissioner*, 129 T.C. 30 (2007). For further discussion, see III.B.2.c., below.

[215] *See* Reg. §301.6231(a)(3)-1(b).

[216] Reg. §301.6231(a)(3)-1(c)(2)–Reg. §301.6231(a)(3)-1(c)(4).

[217] *See United States v. Woods*, 571 U.S. 310 (2013); *Cross Refined Coal, LLC v. Commissioner*, 45 F.4th 150 (D.C. Cir. 2022); *Full-Circle Staffing, LLC v. Commissioner*, 832 Fed. Appx. 854 (5th Cir. 2020), *aff'g* T.C. Memo 2018-66; *RJT Invs. X v. Commissioner*, 491 F.3d 732 (8th Cir. 2007); *Petaluma FX Partners v. Commissioner*, 591 F.3d 649 (D.C. Cir. 2010); *Leblanc v. United States*, 410 Fed. Appx. 323 (Fed. Cir. 2011) (unpub.); *Schell v. United States*, 84 Fed. Cl. 159 (2008), *aff'd*, 589 F.3d 1378 (Fed. Cir. 2009), *cert. denied*, 131 S. Ct. 346 (2010); *Napoliello v. Commissioner*, 655 F.3d 1060 (9th Cir. 2011). Jurisdiction over the sham issue exists because a partnership return was filed. §6233(b); Reg. §6233-1(b).

[218] For further discussion of this issue, see V.C.1.

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• the items covered by a partnership settlement agreement;[219]

• the determinations of whether contributions and distributions by related partnerships and their partners constitute a disguised sale;[220]

• special allocations of partnership items among partners;[221]

• the manner in which a bankrupt partner's distributive share is allocated between the partner and the partner's bankruptcy estate;[222]

• a claim that a person was not a partner to the extent the claim would affect the distributive share of other partners;[223]

• the release of a partner from the partner's deficit restoration obligation;[224]

• a claim that the TMP acted improperly in representing the partnership;[225]

• the determination that nonconventional fuel credits are not distributable to partners;[226]

• whether a partnership owned a building for purposes of determining when such partnership must report its gross rents as income;[227]

• a functional inquiry into the roles and activities of a partnership's individual partners for purposes of determining whether such partners were limited partners for purposes of the §1402(a)(13) exception to self-employment tax on distributive shares of partnership income;[228]

• application of the mitigation provisions to a partnership item;[229]

• the partnership's claim of right;[230]

• the applicability of penalties to the individual partners of a sham partnership, including penalties that relate to nonpartnership items such as outside basis;[231]

• whether a penalty imposed with respect to partnership items was approved as required by §6751(b);[232]

• §1446 withholding;[233] and

• whether a partnership acquired a partnership interest or a real estate interest.[234]

On the other hand, the following items have been determined not to be partnership items:

• the allocation of partnership items between divorced spouses;[235]

• the determination of whether a partnership and its partner had a separate joint venture;[236]

• the identity of indirect partners;[237]

• the characterization of partnership item flow-through amounts as active or passive in the partner's hands;[238]

• adjustments to a partner's nonrecourse liabilities based on an at-risk determination;[239]

• the treatment on a consolidated return of a payment by a parent to a partnership in which a subsidiary (but not the parent) is a partner;[240]

• a partner's claimed right to a consistent settlement;[241]

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[219] *Slovacek v. United States*, 36 Fed. Cl. 250 (1996).

[220] FSA 200049023.

[221] CCA 201210034.

[222] *Katz v. Commissioner*, 335 F.3d 1121 (10th Cir. 2003).

[223] *See, e.g., Alpha I LP v. United States*, 682 F.3d 1009 (Fed. Cir. 2012) (citing *Blonien* and *Katz*, concluding that identity of true partners in partnership should be determined at partnership level because partner identity could affect distributive shares reported to partners); *Katz v. Commissioner*, 335 F.3d 1121 (10th Cir. 2003) (recognizing relationship between allocation and partner identity, court prevented bankrupt taxpayer from allocating his share of losses from partnerships between his bankruptcy estate and himself); *Blonien v. Commissioner*, 118 T.C. 541 (2002) (partner identity was more appropriately determined at partnership level because it could affect allocation of partnership items among partners), *supplemented*, T.C. Memo 2003-308; FSA 200049023. *Cf. Grigoraci v. Commissioner*, T.C. Memo 2002-202 (inquiry turns on facts of particular case and effect that partner identity would have on distributive shares). *But see Greenberg v. Commissioner*, 10 F. 4th 1136 (11th Cir. 2021); *Goddard v. Commissioner*, 2021 WL 5985581 (9th Cir. 2021) (unpub.), *cert. denied* 143 S. Ct. 208, *rehearing denied* 143 S. Ct. 518 (2022) (abandonment of a partnership interest not a partnership item even though other partners' interest could be affected); CCA 202019003 (change of identity of true partner in partnership is not a partnership item because determination will not affect distributive shares of partnership's other partners; IRS may adjust true partner's return to reflect inclusion of partnership items from Schedule K-1 originally issued to presumed partner without opening separate TEFRA proceeding with respect to presumed partner).

[224] *Bassing v. United States*, 563 F.3d 1280 (Fed. Cir. 2009).

[225] *Clark v. United States*, 68 F. Supp. 2d 1333 (N.D. Ga. 1999).

[226] *CAT Partners v. Commissioner*, T.C. Memo 2009-190.

[227] *See Gluck v. Commissioner*, T.C. Memo 2020-66, *aff'd,* 2022 WL 802766 (2d Cir. Mar. 17, 2022).

[228] *See Soroban Cap. Partners LP v. Commissioner (Soroban I)*, 161 T.C. 310 (2023) (limited partner exception in §1402(a)(13) does not apply to a partner who is limited in name only; court extends functional analysis similar to that used in *Renkemeyer v. Commissioner*, 136 T.C. 137 (2011) to limited partners in state law partnerships by analyzing limited partners' functions and roles in the partnership); *Denham Cap. Mgmt. LP v. Commissioner*, T.C. Memo 2024-114 (same); *see also Soroban Cap. Partners LP v. Commissioner (Soroban II)*, T.C. Memo 2025-52 (application of functional analysis test by examining parters' role in generating income and management, time devoted to the business, capital contributions, and additional factors indicated partners were not passive investors). *But see Sirius Sols., L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026) (rejected the IRS's definition of "limited partner" in *Soroban I* and the functional analysis test). For further discussion of the §1402(a)(13) exception as it applies to partners and limited partners, and related court cases, see 735 T.M., *Private Equity Funds*, at VI.J.

[229] CCA 201024061.

[230] *Richard J. O'Neill Trust v. Commissioner*, T.C. Memo 2022-108.

[231] *United States v. Woods*, 571 U.S. 310 (2013); *Petaluma FX Partners, LLC v. Commissioner*, 792 F.3d 72 (D.C. Cir. 2015).

[232] *Ginsburg v. United States*, 17 F.4th 78 (11th Cir. 2021); *Mellow Partners v. Commissioner*, 890 F.3d 1070 (D.C. Cir 2018); *Warner Enterprises, Inc. v. Commissioner*, T.C. Memo 2022-85. *See also, Genecure, LLC v. Commissioner*, T.C. Memo 2022-52 (penalty approval for partner not approval for partnership).

[233] *YA Global Invs., LP v. Commissioner*, 151 T.C. 11 (2018) (partnership's liability for §1446 withholding); CCA 201526014.

[234] *Gluck v. Commissioner*, T.C. Memo 2020-66, *aff'd* 2022 BL 90186 (2d Cir. Mar. 17, 2022) (unpub).

[235] FSA 200102043.

[236] *Deitch v. Commissioner*, T.C. Memo 2022-84.

[237] *Olson-Smith, Ltd. v. Commissioner*, T.C. Memo 2005-174.

[238] *Estate of Quick v. Commissioner*, 110 T.C. 172 (1998), *supplemented by* 110 T.C. 440 (1998).

[239] *Russian Recovery Fund Ltd. v. United States*, 81 Fed. Cl. 793 (2008).

[240] Rev. Rul. 2006-11; FSA 200217031.

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• the amount and character of the gain or loss upon disposition of an interest in a TEFRA partnership;[242]

• The claimed abandonment of a partnership interest;[243]

• the computation of a partner's foreign tax credit;[244]

• employment taxes and worker classification issues;[245]

• a TEFRA partnership's Form 1042 withholding;[246]

• a loss carryback resulting from an election by a trust as an indirect partner of an entity that reached a settlement agreement with the IRS on the tax treatment of an asset sale;[247] and

• a partner's outside basis in a partnership.[248]

2. Affected Items

a. General Definition

As discussed above, the partnership proceeding is designed to determine partnership item adjustments to the flow-through amounts reported by the partnership. Because the partnership items flow through the partnership and are reported in the taxable income of the partners, a separate partner-level proceeding is necessary to compute the tax due from the partnership item adjustments. Adjustments to partnership items frequently have an effect on the partners' separate or "nonpartnership" items. Nonpartnership items which are affected by adjustments to partnership items are called "affected items."[249]

The affected item category is essentially a means for implementing a special statute of limitations rule. An affected item definition is needed because the IRS, in applying partnership item adjustments, must adjust some of the partners' nonpartnership items in making a final determination of the partners' tax liability for that taxable year. For example, because the amount of a partner's medical deduction depends on the partner's adjusted gross income, an adjustment resulting from a partnership proceeding affects the adjusted gross income and therefore the amount of the medical deduction. While this medical deduction adjustment results from the partnership proceeding, it is clear that the partner's medical deduction computation is not a partnership item. If the partnership proceeding concludes after the partner's §6501 nonpartnership item statute of limitations has otherwise expired, however, a nonpartnership item adjustment to the medical deduction would be barred.

The affected item category was created to resolve statute of limitations problems for items like the medical deduction. To avoid these problems, §6229(a) was expanded to apply the §6229 partnership item statute of limitations to affected items. This keeps the statute of limitations open on these affected items until the partnership proceeding has concluded and the effect of the partnership proceeding on these affected items can be determined.

Because the affected item category is a critical statute of limitations issue, it is necessary to understand the affected item definition. Section 6231(a)(5) defines "affected item" broadly as any item to the extent such item is affected by a partnership item. The regulations state that the definition includes items unrelated to items reflected on the partnership return.[250] There are two types of affected items: (1) items related to partnership items that require examination of additional substantive issues at the partner level; and (2) items that need only be examined to compute the partner-level tax (e.g., items such as the medical expense limitation which change when partnership item adjustments change the partner's adjusted gross income).

The Tax Court confirmed this two-part analysis of affected items in *N.C.F. Energy Partners v. Commissioner*,[251] The "computational" category is defined to include items (such as the adjusted gross income limitation items) that are affected items only to the extent that the partnership item adjustments change the computational aspects of the affected item. The "substantive" category of affected items includes items which not only have a computational aspect, but also have a substantive determination element.[252]

Practical Comment: The example of this category in the *N.C.F.* case is the negligence penalty which has: (1) a computational aspect in that the partnership item adjustments determine the partner's underpayment of tax and (2) a substantive element in that the partner's own negligence may have an impact on whether the negligence penalty applies. Penalties that are related to adjustments to partnership items were effectively removed from the category of affected items by the amendment of §6221.

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[241] *Rigas v. United States*, 486 Fed. Appx. 491 (5th Cir. 2012) (unpub.); *Prochorenko v. United States*, 243 F.3d 1359 (Fed. Cir. 2001); *Monti v. United States*, 223 F.3d 76 (2d Cir. 2000).

[242] *Regents Park Partners v. Commissioner*, T.C. Memo 1992-336.

[243] *Greenberg v. Commissioner*, 10 F.4th 1136 (11th Cir. 2021); *Goddard v. Commissioner*, 2021 WL 5985581 (9th Cir. 2021) (unpub.), *cert. denied* 143 S. Ct. 208, *rehearing denied* 143 S. Ct. 518 (2022).

[244] CCA 201210036, CCA 201109020.

[245] FAA 20145001F.

[246] CCA 201024058, citing Chief Counsel Notice CC-2009-027 (§1446 more appropriately is determined at the partnership level; thus, examinations with respect to §1446 are subject to TEFRA partnership procedures).

[247] *United States v. Steinbrenner*, 949 F. Supp. 2d 1210 (M.D. Fla. 2013) (because trustee's determination to carry back loss to earlier year is matter determined by trustee and depending on circumstances of family trust (and therefore determined at partner level) and not matter determined at partnership level and depending on circumstances of partnership, trustee's determination to carry back loss is neither partnership item nor attributable to partnership item; IRS's independent action in denying distribution of loss by trustee and trustee's choice among alternatives to loss carryback intervene to interrupt any chain of causation or hint of attribution between partnership item and trust beneficiary's refund).

[248] *United States v. Woods*, 571 U.S. 310 (2013); *Logan Trust v. Commissioner*, 616 Fed. Appx. 426 (D.C. Cir. 2015) (reversing Tax Court's contrary holding in *Tigers Eye Trading, LLC v. Commissioner*, 138 T.C. 67 (2012)).

[249] §6231(a)(5).

[250] Reg. §301.6231(a)(5)-1(a). *See Domulewicz v. Commissioner*, T.C. Memo 2010-177 (to extent legal fees paid to an S corporation involved in Son-of-Boss transaction were related to partnership involved in transaction and to the transaction, the fees and S corporation's deduction of the fees were affected by the partnership-item determination in that the fees were nondeductible); *Bedrosian v. Commissioner*, 144 T.C. 152 (2015) (partner invested in Son-of-Boss transaction through sham partnership; deductibility of professional fees paid and claimed as deduction at partner level is factual affected item subject to deficiency procedures).

[251] 89 T.C. 741 (1987).

[252] *See* 1997 TRA §1238(a). As amended, §6221 requires that the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item be determined at the partnership level. This effectively establishes penalties as a separate category of items as discussed below.

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b. Computational Affected Items

The first category of affected items reflects the items for which only computational issues are required at the partner level. A typical example of this type of affected item is the partner's medical deduction that is affected by the adjustment to the partner's adjusted gross income caused by the partnership adjustments. Another example is the amount allowable as a deduction for investment interest expense under §163(d) when both the partner and the partnership report investment income, directly related expenses, and interest on indebtedness properly allocable to property held for investment. The §163(d) limitation for the partner can be determined only after the partnership item issues have been adjusted and combined with the partner's own investment income, expense, and interest. The effect of partnership adjustments on a net operating loss carryover is also generally a computational affected item.[253]

Because computational affected items by definition do not involve substantive partner-level determinations, an expedited procedure exists for their assessment. The IRS will make a computational adjustment at the conclusion of a partnership proceeding to apply the partnership item adjustments to each of the partners and send a bill.[254] The computational affected items are included in this computational adjustment. A notice of deficiency is not required before the assessment of tax against each partner.[255] See VIII.B., below, for further explanation of the computational adjustment procedures.

c. Substantive Affected Items

The other recognized category of affected items consists of items that require substantive (not merely computational) partner-level determinations. These items are governed by §6230(a)(2)(A)(i), which applies deficiency procedures to affected items that require partner-level determinations. It's not entirely clear when an affected item requires a substantive partner-level determination. The Eleventh Circuit held that the IRS makes "partner level determinations" under TEFRA when adjusting a partner's affected item requires the IRS to inspect and account for information particular to that partner, even if the IRS already possesses that information and the taxpayer never disputes adjustment.[256] Accordingly, an "affected item notice of deficiency" will be issued by the IRS to propose substantive affected item adjustments. See VIII.B., below for further discussion of the substantive affected item procedures.

The line between partnership items and affected items is often hard to determine. Three areas that have proven particularly difficult are: (1) "outside" basis, at-risk, and passive loss issues; (2) determination of beneficial ownership; and (3) income from the discharge of indebtedness.

(1) "Outside" Basis, At-Risk and Passive Losses

The partner's basis in the partnership (the "outside" basis), the at-risk determination, and the passive loss characterization present similar problems. Each of these determinations has some elements which may be more appropriately determined at the partnership level and other elements which may be more appropriately determined at the partner level. For example, most questions concerning the partner's outside basis can be resolved by examination of the partnership's books and records for the amount of cash contributions, income or loss items, and distributions.[257] If an issue arises concerning the partner's basis in contributed property, however, this issue would appear to be more appropriately determined by examining the partner's books and records and, therefore, the item may not be a partnership item.

The at-risk determination also involves both partnership item and nonpartnership item issues. For example, some issues concerning the recourse or nonrecourse nature of a partner's share of a partnership liability are more appropriately determined at the partnership level. There is no necessary characterization of at-risk determinations as partnership items simply because they could have an effect on the allocation of partnership liabilities.[258] A personal assumption of liability by a partner is not a partnership item.[259] In addition, determinations regarding whether the partner is at risk with respect to borrowed funds used to make a capital contribution to the partnership or whether independent stop loss agreements exist are more appropriately made at the partner level.[260]

Similarly, in making the characterization of a loss as passive or active, issues such as whether the activity is a trade or business activity is a partnership item, but the determination of material participation by the partner is an affected item.[261]

Due to the difficulty in characterizing the outside basis, at-risk, and passive loss issues as partnership items or nonpartnership items, the IRS has developed a two-stage strategy. First, the IRS typically includes these issues in the FPAA as a partnership item. Second, the IRS adopted regulations that provide that the outside basis, at-risk, and passive loss issues are affect-

[253] *Maxwell v. Commissioner*, 87 T.C. 783 (1986); *Cummings v. Commissioner*, T.C. Memo 1996-282. *See also Bob Hamric Chevrolet v. United States*, 849 F. Supp. 500 (W.D. Tex. 1994) (IRS properly assessed deficiency under computational adjustment procedures; court rejected argument that partner-level determination is needed for IRS to determine which income and deductions were contained in net loss; adjustments made to reflect impact of settlement agreement on carryover loss attributable to such partnership income or loss required no partner-level factual determinations other than a computation); CCA 201020013 (carryforwards are generally disallowed through computational adjustments rather than through affected item notices of deficiency), CCA 201447037 (carryback can be directly assessed to extent it is purely computational based on amount of partnership losses, without regard to whether it is passive or not, however, to extent such computational adjustment allows any portion of the NOL to survive and passive loss rules apply to eliminate any remaining amount, affected item deficiency procedures apply to disallow remaining amount).

[254] Reg. §301.6231(a)(6)-1(a).

[255] §6230(a)(1), §6230(a)(2)(A).

[256] *See Estate of Keeter v. Commissioner*, 75 F.4th 1268 (11th Cir. 2023).

[257] *See Univ. Heights at Hamilton Corp. v. Commissioner*, 97 T.C. 278 (1991) (dealing with basis as a subchapter S item); CCA 201140025 (value and basis of note in partnership's hands and any partnership bad debt claim arising from note is partnership item; however, limitation of partner's share of losses to outside basis under §704(d) must be determined through affected item notice of deficiency rather than through an FPAA).

[258] *Russian Recovery Fund Ltd. v. United States*, 81 Fed. Cl. 793 (2008).

[259] *Hambrose Leasing 1984-5 LP v. Commissioner*, 99 T.C. 298 (1992) (determination of partners' amount at risk with respect to partnership liabilities personally assumed is not a partnership item, but an affected item as to which the court lacks jurisdiction in partnership-level proceeding).

[260] *Roberts v. Commissioner*, 94 T.C. 853 (1990); *Hayes v. Commissioner*, T.C. Memo 1995-151.

[261] *Estate of Quick v. Commissioner*, 110 T.C. 172 (1998), *supplemented by* 110 T.C. 440 (1998); CCA 201307007.

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ed items to the extent that they are not partnership items.[262] Because affected items are typically determined after the conclusion of a partnership proceeding, this strategy gives the IRS two chances to keep the statute of limitations open for these issues. If the court holds that certain issues may not be determined in the partnership proceeding, the IRS can still raise the issue as a substantive affected item in an affected item notice of deficiency.[263] A partnership proceeding is not required, however, if the determination does not require any change to partnership items.[264]

Comment: Under CCA 201025074 the IRS is bound by partnership item treatment on return unless FPAA is issued.

The dual nature of these items means that these issues typically cannot be resolved completely in a partnership proceeding. The partnership proceeding can determine most or all of the substantive questions "provisionally," but the ultimate adjustment is an affected item because partner-level determinations remain.[265] Because the issue is jurisdictional, the Tax Court cannot even accept a stipulation in a partnership proceeding that purports to establish outside basis.[266]

The complicated interplay of the partnership-level components and partner-level components of the outside basis determination was illustrated in many of the "basis bump" cases common in the late 1990s and early 2000s. This is illustrated in the following example.

> *Example:* Taxpayer T forms X LLC and S Corp. X LLC purchases a currency position involving a $10,000 long position and a $9,500 short position that are substantially offsetting in risk. S Corp. purchases 100 shares of stock in NYSE Corp., a publicly traded company with a cost basis of $500. X LLC and S Corp. form XS Partnership by contributing the currency position and the NYSE Corp. stock. X LLC claims a $10,000 outside basis in its partnership interest. This is equal to X LLC's basis in the long position unreduced by any obligation to close the short position. The theory for this technical position is that X LLC's outside basis is not reduced by the partnership's assumption of a contingent liability. S Corp. claims an outside basis of $500, its basis in the NYSE Corp. shares.
>
> Both currency positions expire out of the money, resulting in a $500 loss to XS Partnership. After this transaction closes, X LLC transfers its partnership interest in XS Partnership to S Corp. in a tax-free transaction. X LLC's outside basis of $10,000 is thereby transferred to S Corp. Because S Corp. is now the sole partner in XS Partnership, a technical termination of the partnership occurs and XS Partnership's assets (consisting only of the NYSE Corp. stock) are deemed distributed to S Corp. The distributed assets are allocated the outside basis that S Corp. had in the partnership interests, i.e., the $500 in its original interest and the $10,000 in the interest transferred from X LLC. Therefore, the NYSE Corp. stock now has a basis in S Corp.'s hands of $10,500. S Corp. then sells the NYSE Corp. stock for $500 and recognizes a $10,000 loss.

The IRS attacks every aspect of this transaction. XS Partnership is a TEFRA partnership because it partners are pass-through entities. The only pure partnership item adjustment is the $500 loss claimed by the partnership upon the expiration of the currency positions. This adjustment is proposed in an FPAA and assessed through computational adjustment procedures. The challenge to S Corp.'s basis in the NYSE Corp. stock is an affected item, however. It would appear that the issue of the S Corp.'s basis in a partnership interest acquired from another partner (i.e., X LLC) might have partnership item elements. For example, if the IRS attacks X LLC's basis in its contribution of the currency position to XS Partnership, that is an item the partnership must determine, and the IRS adjustment must be included in an FPAA. However, the actual adjustment is a change to the gain recognized on S Corp.'s sale of the NYSE Corp. stock. This clearly has elements that XS Partnership is not required to determine. Therefore, the IRS disallowance of the $10,000 in transferred basis requires an affected item notice of deficiency.[267]

(2) Determination of Beneficial Ownership

The boundaries between partnership items, affected items, and nonpartnership items are also tested on the issue of whether the nominal owner of an interest in a partnership is in fact holding the interest for the benefit of other undisclosed owners. In *Hang v. Commissioner*,[268] the IRS followed its standard practice and attempted to characterize this issue as a Subchapter S item (the partnership item equivalent under the now-repealed TEFRA rules for S corporations) on the theory that the S corporation was required to determine the proper allocation of its Subchapter S items to the beneficial owners. The Tax Court observed, however, that the S corporation was required to determine the allocation of items only among the nominal owners and that any beneficial ownership issues had to be determined exclusively at the shareholder level. Accordingly, the

[262] Reg. §301.6231(a)(5)-1. *See* CCA 201447036 (application of §465 to partner is affected item governed by minimum limitations period provided under §6229).

[263] *See* Reg. §301.6231(a)(6)-1. *See also Greenwald v. Commissioner*, 142 T.C. 308 (2014) (partner's outside basis is typically an affected item).

[264] *Roberts v. Commissioner*, 94 T.C. 853 (1990); *Gustin v. Commissioner*, T.C. Memo 2002-64.

[265] *United States v. Woods*, 571 U.S. 31 (2013) (outside basis of a sham partnership must be zero). *See also Greenwald v. Commissioner*, 142 T.C. 308 (2014) (partner's outside basis is typically an affected item); *Ginsburg v. Commissioner*, 127 T.C. 75 (2006) (adjustments based on limiting claimed partnership losses to the partner's outside basis, the §465 at-risk limitations, and the §469 passive loss rules are affected items because the IRS has to determine these items on the basis of factors that are unique to the partner); *But see Allen Family Foods, Inc. v. Commissioner*, T.C. Memo 2000-327 (court has jurisdiction in S corporation proceeding to determine if amounts constitute a distribution but lacks jurisdiction to determine shareholders' basis); *AD Global FX Fund LLC v. United States*, 2014-1 USTC ¶ 50,244 (SD NY 2014).

[266] *Dial U.S.A. v. Commissioner*, 95 T.C. 1 (1990) (the IRS and the S corporation shareholders could not stipulate to the amount of the shareholders' outside basis in an S corporation proceeding because the determination is not required to be made at the S corporation level and was therefore not an S corporation (partnership) item).

[267] *See Thompson v. Commissioner*, 729 F.3d 869 (8th Cir. 2013); *Napoliello v. Commissioner*, 655 F.3d 1060 (9th Cir. 2011); *Desmet v. Commissioner*, 581 F.3d 297 (6th Cir. 2009); *Estate of Keeter v. Commissioner*, T.C. Memo 2018-191, *aff'd* 75 F.4th 1268 (11th Cir. 2023).

[268] 95 T.C. 74 (1990). *See also Olsen-Smith, Ltd. v. Commissioner*, T.C. Memo 2005-174.

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court held that the beneficial ownership issue was not a Subchapter S item.

It is not clear, however, whether this beneficial ownership issue can even be characterized as an affected item. It is not apparent how any S corporation-level or partnership-level determination affects the beneficial ownership determination. It may be that this issue is a "pure" nonpartnership item which must be adjusted within the general §6501 statute of limitations.[269]

Comment: The *Hang* decision is troubling in at least one respect. The §6231(a)(2) definition of "partner" (and, accordingly, "shareholder") seems to be broad enough to include an undisclosed beneficial owner. In fact, the special §6229(e) statute of limitations for unidentified partners seems to contemplate exactly the situation presented in *Hang*. If this "partner" definition is broad enough to include an undisclosed owner, it would seem that this undisclosed owner's distributive share of partnership items would almost necessarily be a partnership item itself.

(3) Income from the Discharge of Indebtedness

In SCA 200011048, the IRS National Office addressed whether the tax liability of a partner that is attributable to the increase of a partnership's COD income should be assessed through the deficiency procedures. Citing §6231(a)(3), Reg. §301.6231(a)(3)-1(a), and *Maxwell v. Commissioner*,[270] the National Office stated that both the partnership's aggregate and each partner's distributive share of the COD income are partnership items.[271] However, §108(d)(6) provides that the exclusion from gross income provisions is applied at the partner level. Thus, the National Office determined that the inclusion of COD income at the partner level includes nonpartnership item factors and, therefore, is an affected item. The National Office noted that COD income may be excluded from computing a partner's tax liability under §108(a)(1)(B) if the partner is insolvent. Because this insolvency is a factual determination that, under §108(d)(6), must be made at the partner level, the National Office advised that §6230(a)(2)(A)(i) mandates that the IRS follow the affected item deficiency procedures before making an assessment of tax attributable to COD income.[272]

The issue was different when the TEFRA procedures applied to S corporations, however. Because the insolvency issue is determined at the corporate level for an S corporation, the COD income determination is an S corporation item for the years those items were covered by the TEFRA procedures.[273]

3. Nonpartnership Items

The term "nonpartnership item" is defined in the negative. Section 6231(a)(4) defines a nonpartnership item as any item that is not a partnership item. As discussed above, this definition necessarily includes affected items. For purposes of analysis, however, nonpartnership items are typically viewed as a separate category, i.e., a category of items that is not dependent on a partnership item determination.[274] These nonpartnership items may be assessed by only applying the deficiency procedures of §6212. Section 6230(a)(2)(C) was added to the Code to allow the issuance of a nonpartnership item notice of deficiency without precluding the later issuance of an affected item notice of deficiency after a partnership proceeding.

4. Converted Items

A converted item is an item that at one time was a partnership item but has been converted to a nonpartnership item due to the occurrence of certain specified events. The conversion of items from partnership items to nonpartnership items from any of these events causes yet another statute of limitations to apply. Section 6229(f) provides that the statute of limitations for assessment of the newly converted nonpartnership items will not expire before the date which is one year after the date on which the conversion occurs. These statute of limitations issues are discussed more fully in V.E., below. For further discussion of the converted item procedures, see VIII.C., below.

There are three types of converted items: (1) converted items from settlement, (2) deficiency converted items, and (3) special enforcement area converted items.

a. Converted Items from Settlement

This category of converted items is created when the IRS and a partner enter into a settlement agreement with respect to specified partnership item adjustments. The settlement converts only the specific partnership item adjustments covered by the settlement agreement.[275] When the settlement agreement converts the partnership items to nonpartnership items, the IRS assesses the tax due from the settlement as a computational adjustment. The partner is not entitled to a notice of deficiency before the assessment.[276] For a discussion of the procedures for contesting a computational adjustment, see VIII.B., below.

Comment: One additional item deserves attention even though it technically is not a converted item. When a partnership proceeding concludes after an FPAA and is not contested or is contested and the decision in the resulting case becomes

[269] *See Watkins v. Commissioner*, T.C. Memo 2014-197 (issue of whether nominal partner is disregarded is not a partnership item). *But see Grigoraci v. Commissioner*, T.C. Memo 2002-202 (adjustments attributable to determination of true shareholder are affected items).

[270] 87 T.C. 783 (1986).

[271] *Blonien v. Commissioner*, T.C. Memo 2003-308 (allocation of COD income to partners is a partnership item).

[272] *See also* FSA 199941015.

[273] *Chesapeake Outdoor Enters., Inc. v. Commissioner*, T.C. Memo 1998-175.

[274] *See Miller v. Commissioner*, T.C. Memo 2009-182 (CRAT distributions of partner are affected items); *Goldberg v. Commissioner*, T.C. Memo 2007-81 (deductibility of attorney fees paid in Son-of-BOSS transaction is a nonpartnership item). *But see Domulewicz v. Commissioner*, T.C. Memo 2010-177, *aff'd & rem'd sub nom. Desmet v. Commissioner*, 581 F.3d 297 (6th Cir. 2009) (fees are affected item if reason for disallowance relates to partnership determination).

[275] §6231(b)(1)(C). Settlement with the U.S. Attorney General (or a delegate) also converts specified partnership audit adjustments. §6231(b)(1)(C). *See also Schell v. United States*, 589 F.3d 1378 (Fed. Cir. 2009) (settlement agreement may not convert all issues relating to items settled). It is important to note that the IRS does not enter into a settlement agreement with a partner when it enters into a settlement agreement with a tax matters partner. *See Davis v. United States*, 811 F.3d 335 (9th Cir. 2016).

[276] Section 6230(a)(2)(A)(ii) specifically excludes the conversion resulting from a settlement agreement from the deficiency procedures. *See Powell v. Commissioner*, 96 T.C. 707 (1991). *See also Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995) (settlement agreement between taxpayer and IRS regarding taxpayer's claim attributable to partnership items converted those items into nonpartnership items, thereby giving district court jurisdiction over claim, and agreement did not preclude a refund of a deficiency paid after the assessment period had expired).

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final, the result of the action is applied to the partners by means of a computational adjustment for which the deficiency procedures do not apply. Although this procedure is very similar to converted items from settlement, the situation is not described in §6231(b) or §6231(c) and, therefore, is not technically a converted item.

b. Deficiency Converted Items

This category of converted items is distinguished from the converted items from settlement because a special deficiency procedure applies after the conversion. There are two general types of deficiency converted items. First, the following events automatically convert the partner's partnership items to nonpartnership items for the applicable partnership taxable year:

- the partner files suit under §6228(b) after the IRS fails to allow an AAR with respect to any partnership item for that partnership taxable year,[277] and
- the IRS fails to issue a timely NBAP or FPAA to a notice partner and the partner either fails to elect to have the partnership outcome apply after the partnership proceeding has terminated or affirmatively elects to drop out of an ongoing partnership proceeding.[278]

Second, the IRS has the option in certain defined circumstances to send a notice informing the partner that the IRS has elected to convert the partner's partnership items to nonpartnership items. This election may not be made after an NBAP has been issued to the TMP with respect to the partnership items.[279] The election is available in the following circumstances:

- the partner: (a) has reported the partnership items inconsistently with the partnership's reporting of those items, (b) has filed a notice of inconsistent treatment (Form 8082) as required by §6222(b), and (c) has not subsequently filed an AAR which makes the partner's reporting of the partnership items consistent with the partnership's reporting;[280]
- the partner: (a) has reported inconsistently with the partnership, (b) has effectively notified the IRS of the inconsistent treatment by virtue of establishing that the partner reported the partnership items consistently with a schedule received from the partnership, and (c) has not filed an AAR to make the partner's reporting consistent with the partnership's reporting;[281] or
- the partner has filed an AAR which does not make the partner's treatment of the items consistent with the partnership's reporting of the items.[282]

Whether the converted items are converted automatically or at the IRS's election, the same procedure for adjusting the converted items applies. The IRS must issue a converted item notice of deficiency to make any adjustment to these converted items. This generally must be done within one year after the conversion date unless an extension agreement is executed.[283] See VIII.D., below, for further discussion of these deficiency procedures.

c. Special Enforcement Area Converted Items

The final category of converted items arises when the segregation of partnership items and nonpartnership items causes potential problems for the IRS. In these cases, the affected partner's partnership items are converted to nonpartnership items to assist in the administration of the case. These "special enforcement area converted items" are actually a type of deficiency converted items, however, because the deficiency procedures applicable to deficiency converted items also apply after conversion of special enforcement area converted items. The special enforcement area converted items are appropriately considered as a distinct category, however, because they usually arise in the context of the IRS taking deficiency action separate and apart from the partnership item determinations and the items are converted to help coordinate with that independent action. For further discussion of special enforcement area converted item procedures, see VIII.C., below.

The following events convert the partner's partnership items to nonpartnership items under the special enforcement areas for the taxable years affected:

- the partner elects to convert the partnership items to nonpartnership items after receiving a notice from the IRS that tentative carryback allowances or refunds with respect to the partnership items have been "frozen" based on an IRS determination that it is highly likely that the partnership is an abusive tax shelter,[284]
- the IRS makes a jeopardy assessment under §6861 or a termination assessment under §6851 against the partner for the same year as the partnership taxable year,[285]
- the partner receives a notification from the IRS that the partnership items for a particular year or years have been converted to nonpartnership items because the partner is the subject of a criminal investigation,[286]
- a notice of deficiency is mailed to the partner which recomputes the partner's gross income based on an indirect method of proof,[287]
- a bankruptcy petition or receivership proceeding is filed by or for the partner,[288] and
- the partner requests a prompt assessment with respect to a decedent's estate or dissolving corporation's return pursuant to §6501(d).[289]

[277] §6231(b)(1)(B).
[278] §6231(b)(1)(D).
[279] §6231(b)(3).
[280] §6231(b)(1)(A), §6231(b)(2)(A).
[281] §6231(b)(1)(A), §6231(b)(2)(A), §6222(b)(2).
[282] §6231(b)(1)(A), §6231(b)(2)(B).
[283] §6229(f).
[284] §6231(c)(2); Reg. §301.6231(c)-1, Reg. §301.6231(c)-2. For a discussion of the procedures involved when the IRS makes a determination to freeze a refund or tentative allowance, see Rev. Proc. 84-24.
[285] §6231(c)(1)(A); Reg. §301.6231(c)-4(a).
[286] §6231(c)(1)(B); Reg. §301.6231(c)-5(a). *See Miller v. IRS (In re Miller)*, 174 B.R. 791 (B.A.P. 9th Cir. 1994).
[287] §6231(c)(1)(C); Reg. §301.6231(c)-6(a).
[288] §6231(c)(2); Reg. §301.6231(c)-7. *See, e.g., Vennes v. Commissioner*, T.C. Memo 2021-93 (partnership items converted into nonpartnership items when receivership was created for partner's assets and related entities). For further discussion, see X.D., below.
[289] §6231(c)(2); Reg. §301.6231(c)-8(a). The Second Circuit, reversing the Tax Court, held that where a decedent's estate requested a prompt assessment,

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Note: The IRS has also proposed to allow the IRS to convert adjustments related to "listed transactions" to nonpartnership items under the authority of special enforcement area converted items.[290] This marks a considerable expansion of the concept. The only reason the IRS is adding listed transactions as special enforcement area converted items is because converting partnership items to nonpartnership items can make the IRS's job simpler. This is not a compelling enough reason to allow the IRS to unilaterally waive the TEFRA procedures on a case-by-case basis.

5. Penalties

Penalties have fit awkwardly into the statutory scheme since TEFRA's inception. For partnership tax years ending before August 5, 1997, penalties were characterized as substantive affected items subject to the affected item notice of deficiency procedures.[291] The characterization of penalties and additions to tax as affected items caused uncertainty regarding the level at which penalties based on partnership item adjustments should be determined.

Before this 1997 amendment of §6221, the characterization of additions to tax as affected items raised a number of difficult questions. First, *N.C.F.* held that the penalty issues were not properly included in an FPAA and, therefore, were not properly subject to the jurisdiction of the court in the partnership proceeding. There were clearly aspects of the penalty determinations, however, which were more appropriately addressed at the partnership level. In this respect, *N.C.F.* seemed to be inconsistent with *Maxwell*.[292] *Maxwell* appeared to concede that any negligence attributable to the partnership's reporting position was a proper subject for the partnership proceeding, while *N.C.F.* held that the Tax Court lacked jurisdiction in the partnership proceeding to address the negligence issue.[293] Similarly, whether the partnership had substantial authority for positions on the partnership return and whether or not partnership assets were overvalued appeared to be issues more appropriately determined at the partnership level. *N.C.F.* did not allow these issues to be addressed in the partnership proceeding.

A second problematic aspect of the pre-1997 TRA characterization of penalties as affected items was the loss of most of the benefits of the TEFRA procedures. One of the central themes of the TEFRA procedures is the consistency and administrative and judicial economies derived from one consolidated proceeding as opposed to separate proceedings for each partner. Because many partnership audits ultimately result in the assertion of penalties by the IRS, the procedure that had evolved was a consolidated proceeding for partnership items and an additional affected item notice of deficiency issued to each partner for the penalties. If these partners contested the assertion of the penalties, the TEFRA procedures actually added one additional proceeding to the already burdensome number of proceedings which the TEFRA procedures were intended to alleviate.

The treatment of penalties was changed by the amendment of §6221 in 1997, for partnership tax years ending after August 6, 1997, to require that the applicability of any penalty, addition to tax, or additional amount relating to an adjustment to a partnership item is determined at the partnership level.[294] Similarly, Congress amended §6230(a)(2)(A)(i), which relates to the interplay between deficiency procedures and TEFRA proceedings. Specifically, penalties, additions to tax, and additional amounts that relate to adjustments to partnership items are excluded from deficiency proceedings. Delinquency penalties do not relate to partnership item adjustments, and therefore, are not subject to §6221.[295] For accuracy-related penalties, if the issues that form the basis of the penalty assertion relate to partnership-level items, those issues must be raised in the partnership proceeding and cannot be addressed in a subsequent affected item proceeding.[296] On October 4, 2001, the IRS published regulations implementing the 1997 TRA change[297] which explain that partnership-level determinations include all legal and factual determinations underlying the determination of the penalty and partnership-level defenses.[298] The IRS also issued modified computational adjustment procedures that allow the IRS to assess penalties under those procedures.[299] Partner-level penalty defenses, however, still may be asserted in partner-level proceedings. See VIII.E., below, for further discussion of the partner-level penalty procedures.

C. Types of Forms and Notices

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

As is discussed in the Worksheets, below, the TEFRA partnership audit procedures adopt a procedural scheme which closely parallels the procedural scheme that exists for nonpartnership item audits. With this scheme comes a completely new

thereby converting partnership items into nonpartnership items, those items were also nonpartnership items as to the decedent's spouse, who filed a joint return with the decedent but who never held any interest in the partnership; thus, the deficiency procedures applied to the assessments against the spouse attributable to those items. *Callaway v. Commissioner*, 231 F.3d 106 (2d Cir. 2000), *rev'g* T.C. Memo 1998-99. Relying on *Dubin v. Commissioner*, 99 T.C. 325 (1992), the Tax Court had held that the partnership items of the joint filing surviving spouse did not convert when the deceased's partnership items converted. In *Dubin*, however, the husband and wife owned the interest as joint property; therefore, each was treated as having a share of partnership items that could be affected by the partnership proceeding independently of the other's share.

[290] Prop. Reg. §301.6231(c)-9, 74 Fed. Reg. 7205 (Feb. 13, 2009).

[291] Reg. §301.6231(a)(6)-1T.

[292] *Maxwell v. Commissioner*, 87 T.C. 783 (1986).

[293] *Compare Maxwell v. Commissioner*, 87 T.C. 783 (1986) and *Farris v. Commissioner*, T.C. Memo 1986-567, *with N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741, 745 (1987).

[294] §6221, as *amended by* 1997 TRA §1238.

[295] CCA 201121016.

[296] *Kraus v. United States*, 398 Fed. Appx. 35 (5th Cir. 2010) (unpub.); *Fears v. Commissioner*, 129 T.C. 8 (2007). *See also Malone v. Commissioner*, 148 T.C. 372 (2017) (regardless of whether §6662(a) and §6662(b)(1) negligence penalty is nonpartnership item or factual affected item unrelated to adjustment to partnership item, deficiency procedures applied to determination of penalty because there were no adjustments to partnership items).

[297] T.D. 8965, 66 Fed. Reg. 50541 (Oct. 4, 2001).

[298] Reg. §301.6221-1(c).

[299] *See* Reg. §301.6231(a)(6)-1(a).

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set of TEFRA forms and notices. These forms and notices are discussed in greater depth elsewhere in the Portfolio. A summary of the forms and notices is presented here with cross-references to the more intensive discussion.

1. Notification of Inconsistent Treatment

Section 6222 establishes the general rule that a partner must report the partnership items in a manner consistent with that reported on the partnership return. If the partner reports the partnership items inconsistently, the IRS may make a computational adjustment and bill the partner for any additional tax due or (presumably) refund any overpayment reported by the partner. If the partner wishes to avoid this automatic adjustment, the partner may notify the IRS that the partner is taking a position inconsistent with the position taken on the partnership return. This notification of inconsistent treatment is made by filing Form 8082 with the partner's return.[300]

Practical Comment: When filed as a notification of inconsistent filing of the original return, Form 8082 must be filed with that return.

The IRS may then either elect to convert the partner's partnership items to nonpartnership items or accept the partner's inconsistent treatment. The procedures concerning this notification of inconsistent treatment are discussed more fully in IV.A.3., below.

2. Notice of Beginning of Administrative Proceeding (NBAP)

The TEFRA partnership audit procedures require the IRS to issue a Notice of Beginning of Administrative Proceeding (NBAP) to the TMP, all notice partners, and all five-percent notice group representatives to inform them of the commencement of the partnership audit. The NBAP procedures are discussed more fully in VI.E., below.

3. 60-Day Letter

The 60-day letter is the TEFRA equivalent of the 30-day letter under non-TEFRA procedures. The 60-day letter informs the partners of the IRS Revenue Agent's determination with respect to proposed partnership item adjustments. This letter is typically accompanied by Form 870-PT which the partner may sign if the partner agrees with the Revenue Agent's conclusions. If the partner does not agree with the Revenue Agent's conclusions, the letter gives the partner the opportunity to file an administrative appeal with the IRS Appeals office which has jurisdiction over the partnership within 60 days. The procedures governing the 60-day letter are discussed more fully in VI.F., below.

4. Notice of Final Partnership Administrative Adjustment (FPAA)

The notice of final partnership administrative adjustment (FPAA) is the TEFRA partnership equivalent of the notice of deficiency under non-TEFRA procedures. The FPAA presents the IRS's final administrative determination with respect to the partnership's partnership items and penalties. The FPAA is mailed to the TMP, to all notice partners, and to the representatives of all five-percent notice groups. Mailing the FPAA to the TMP suspends the partnership item statute of limitations and triggers the period in which the TMP or the notice partners may file a petition in Tax Court, a federal district court, or the Court of Federal Claims to challenge the determinations made in the FPAA. If no partner files a petition to contest the FPAA during the allotted period, the partnership item adjustments contained in the FPAA become final with no refund procedure available. The procedural rules concerning the FPAA are discussed in more detail in VI.I., below.

Note: Before the repeal of the TEFRA S corporation audit rules, the FPAA-equivalent for S corporation situations was the notice of final S corporation administrative adjustment (FSAA). There were no significant procedural differences between the rules governing FSAAs and FPAAs.

5. Notice of Computational Adjustment

The notice of computational adjustment notifies the partner of the manner in which the IRS has applied partnership item adjustments and penalties to the partner's tax liability. This notice should not be confused with the notice of assessment, or bill. The partner will receive a separate notice of assessment that actually bills the partner for any tax, penalty, and interest due. The notice of computational adjustment explains how the amount to be assessed is computed. IRS Form 4549-A is typically provided with the notice.[301] The requirement to "determine" a deficiency does not apply to the notice of computational adjustment.[302] The partner is generally limited to a refund procedure to contest the IRS's computation reflected in the notice of computational adjustment. See VIII.B., below, for further discussion of the computational adjustment procedures.

6. Affected Item Notice of Deficiency

As illustrated in III.B.2., above, a special category of nonpartnership items exists called affected items. These items do not fit within the definition of partnership items but are nevertheless governed by the partnership item statute of limitations. The IRS and the Tax Court have divided affected items into two categories: (1) "computational affected items" which do not require a substantive determination at the partnership level (e.g., the effect of partnership item adjustments on the adjusted gross income limitation for medical expenses), and (2) "substantive affected items" which do require a substantive determination at the partner level (e.g., certain aspects of the partner's "outside" basis in the partnership, the at-risk determination and the passive loss determinations). The IRS adjusts computational affected items in a notice of computational adjustment. If the IRS desires to make adjustments to substantive affected items, the IRS must issue a special notice of deficiency

[300] Reg. §301.6222(b)-1(a). If the Form 8082 is filed after the original partner return was filed, then it cannot serve as a notice of inconsistent treatment with respect to the original return because the IRS would not be able to assess the inconsistently reported item under §6222(c). CCA 201016070.

[301] Notice CC-2009-027; *Gosnell v. United States*, 2011-2 USTC ¶ 50,488 2011 BL 169818 (D. Ariz. June 28, 2011, *aff'd on other issues* 525 Fed. Appx. 548 (9th Cir. 2013)).

[302] *Bush v. United States*, 106 Fed. Cl. 563 (Fed. Cl. 2012) (standard set forth in *Scar v. Commissioner*, 814 F.2d 1363 (9th Cir. 1987), does not apply to a notice of computational adjustment).

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with respect to those affected items.[303] This affected item notice of deficiency is discussed more fully in III.B.2., above, and VIII.B., below.

7. Administrative Adjustment Request (AAR)

The AAR is the TEFRA equivalent of a refund claim. Only the TMP may file an AAR which applies to all partners. Any other partner may file an AAR with respect to that partner's own share of the partnership items. No partner, however, may file an AAR after the IRS issues an FPAA to the partnership. These procedural issues and other procedural and substantive issues for AARs are discussed in IX., below.

D. Types of Assessments

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

There are three types of assessments that may arise with respect to a TEFRA partnership: (1) computational adjustments, (2) consistency assessments, and (3) math error assessments.

1. Computational Adjustments

As discussed above, the partnership-level proceeding essentially determines changes to flow-through amounts from the partnership. Any additional tax that results must be assessed through a partner-level action. The computational adjustment is the device which applies a partnership-level determination to the partner's taxable income. The computational adjustment includes partnership item adjustments, affected item computations which do not require substantive partner-level determinations, and penalties. If substantive partner-level determinations are required for a particular issue, an affected item notice of deficiency is issued with respect to that issue.[304] See VIII.B., below, for further discussion of the computational adjustment procedures.

2. Consistency Assessment

Section 6222 establishes the requirement that each partner must report partnership items consistently with the partnership return. A special consistency requirement is imposed on foreign partnerships that do not file U.S. returns. Certain exceptions are also provided to the general consistency rules. If these exceptions do not apply, the IRS may make a consistency assessment, which adjusts the partner's reporting of the partnership items to conform to the partnership reporting. Procedurally, this consistency assessment is another type of computational adjustment. It is helpful conceptually to analyze the consistency assessment separately, however. See IV.A.4., below, for further discussion of this type of assessment.

3. Math Error Assessment

The third type of assessment applies if a mathematical or clerical error appears on the partnership return. These types of errors include addition, subtraction, multiplication, or division errors; incorrect use of a table; inconsistent entries; and the failure to observe certain statutory limits.[305] In addition, the changes resulting from a substituted return AAR (and probably a claim for refund AAR) are treated as math error assessments.[306] In a math error situation, the IRS is authorized to correct the error, make any additional assessment, and send a notice of correction of the error to all partners.[307] This adjustment procedure parallels the math error procedure which exists for nonpartnership items under §6213(b). As this math error assessment is not a full-blown TEFRA partnership audit proceeding, the rule limiting the IRS's obligation to issue notice only to notice partners apparently does not apply for math error assessments. Accordingly, all partners including non-notice partners receive the notice of the math error assessment.

Any partner may challenge the math error assessment by filing a written notice with the IRS submission processing center that issued the notification of math error assessment. This notice must: (1) state that it is a request that the math error assessment not be made; (2) state the name, address, and taxpayer identification number of the partner and partnership; and (3) be signed by the partner filing the request.[308] If this request is sent to the IRS submission processing center, the IRS may not make the math error assessment against the requesting partner without first instituting a TEFRA proceeding. In a large partnership where only one partner contests the math error assessment, it is doubtful that the IRS would implement the partnership proceeding to make the math error correction for the one objecting partner. This is not one of the specified areas in which the IRS may elect to convert the objecting partner's partnership items to nonpartnership items, however, so the partnership proceeding appears to be the only means to make the correction on that partner's return.[309]

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[303] §6230(a)(2). *See* SCA 200011048 (tax liability of a partner that is attributable to the increase of cancellation of indebtedness income of a partnership should be assessed through the deficiency procedures).

[304] Reg. §301.6231(a)(6)-1. *See also Estate of Quick v. Commissioner*, 110 T.C. 172 (1998), *supplemented by* 110 T.C. 440 (1998).

[305] §6213(g)(2).

[306] See IX.A., below, for further discussion of the procedures governing a substituted return AAR and a claim for refund AAR.

[307] §6230(b)(1).

[308] §6230(b)(2); Reg. §301.6230(b)-1(a).

[309] *See* §6231(b), §6231(c).

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IV. Consistency Requirement

A. Consistent Return Requirement

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Section 6222, the first substantive Code provision in the TEFRA partnership audit procedures, establishes the consistency requirement. The consistency requirement is the conceptual backbone of the TEFRA procedures. The procedures were enacted primarily to ensure that all partners reported all partnership items on a basis consistent with the partnership and all other partners. To implement this concept, the TEFRA procedures establish the consistent return requirement (§6222), a consistent settlement requirement (§6224(c)(2)), and a unified procedure for adjustment and litigation of partnership items (§6226 and §6228). The unified procedures are discussed in other sections of this Portfolio.

Section 6222(a) states the general rule that each partner (including indirect partners) must report partnership items in a manner consistent with the reporting of the partnership item on the partnership return. If the reporting is not consistent or the partner files no return,[310] and if the partner does not qualify for an exception from consistent treatment, the IRS may make a special form of computational adjustment (referred to in this Portfolio as a consistency assessment) to bring the partner's treatment in line with the partnership reporting. The IRS may also assert the negligence penalty on any underpayment due to inconsistent reporting.[311]

1. Consistency with Partnership Return

To satisfy the consistent return requirement, the partner's reporting of the partnership items must be consistent with the partnership return which is actually filed. For example, if the partnership return capitalizes certain start-up costs but the partner deducts the partner's proportionate share of those costs, the partner has taken an inconsistent position and is potentially subject to a consistency assessment.[312] Similarly, if a partnership reports income from the discharge of indebtedness, §1231 gain, and ordinary loss items, a partner who fails to report these items on the partner's individual income tax return and who does not notify the IRS of the inconsistent treatment is subject to a consistency assessment.[313] For purposes of identifying an inconsistency, it does not matter that the partner's reporting may have been consistent with a Schedule K-1 received from the partnership. For example, if the partner receives a K-1 showing the partner's distributive share of partnership loss to be $15,000, but the partnership return actually filed reports the partner's distributive share of the loss to be $5,000, the partner has technically taken an inconsistent position with the partnership return.[314] As is discussed below, however, this partner may qualify for an exception from the consistent return requirement.

The application of the consistent return requirement is unclear when conforming the partner's inconsistency results in an overpayment. For example, if in the preceding example the partner claimed a $5,000 loss when the partnership return reported a distributive share loss of $15,000 for that partner, the consistency assessment would actually result in a refund. Although the computational adjustment procedures usually deal with consistency assessments of tax deficiencies, it appears that a computational adjustment can be made in this situation to generate the refund.[315]

The consistent return requirement applies in a slightly different manner with respect to indirect partners. An indirect partner is a partner who reports the partnership items through a pass-thru partner, who holds a direct interest in the original or "source" partnership. If the indirect partner files consistently with the source partnership return, the indirect partner will be deemed to have satisfied the consistent return requirement even if this reporting is inconsistent with the reporting on the pass-thru partner's return.[316] Thus, the pass-thru partner is ignored for purposes of the consistent return requirement.

2. Unfiled Partnership Return as Inconsistency

Section 6222(b)(1)(A)(ii) defines as an inconsistency the situation in which the partner reports the distributive share of a partnership which has not filed a partnership return. This is a logical result because the partner has reported a distributive share of partnership income or loss but the partnership has in effect reported no income or loss because it has not filed a return. In spite of the inconsistency, however, the partner in this situation is not subject to a consistency assessment. Pursuant to §6222(c)(1), the IRS may make a consistency assessment only when a partnership return has been filed. Accordingly, there is no apparent consequence within the scope of the TEFRA provisions for an inconsistency arising from the failure of the partnership to file a partnership return.[317]

A different rule applies when a foreign partnership fails to file a partnership return. See X.A., below, for further discussion of this issue.

3. Exceptions

There are two principal methods by which the partner may avoid the consistency assessment: (1) by filing a notice of inconsistent treatment, or (2) by establishing that the partner reported consistently with a schedule received from the partnership.

a. Notice of Inconsistent Treatment

When the partner is aware that the partner is treating an item inconsistently with the treatment on the partnership return, the partner may avoid the threat of a consistency assessment

[310] *See Randell v. United States*, 64 F.3d 101 (2d Cir. 1995).
[311] §6222(d).
[312] Reg. §301.6222(a)-1(c) *Ex. 2.*
[313] *Davis v. Commissioner*, 98-2 USTC ¶ 50,600 (10th Cir. 1998) (unpub.).
[314] Reg. §301.6222(a)-1(c) *Ex. 3.*
[315] *See also* §6230(d)(5).
[316] Reg. §301.6222(a)-2(b).
[317] *Jimastowlo Oil, LLC v. Commissioner*, T.C. Memo 2013-195.

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by filing Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*. This Form 8082 must contain the partner's name, the partnership's name, a description and the amount of the inconsistently reported item, and an explanation of the basis of the inconsistent reporting. The regulations do not specify a time for filing Form 8082, but the regulations incorporate the instructions as the operative guidelines for filing the notice of inconsistent treatment.[318] The instructions indicate that Form 8082 must be filed when the partner's original or amended return is filed.

The notice of inconsistent treatment avoids a consistency assessment only for the items disclosed on Form 8082. For example, if the partner reports two items inconsistently with the partnership return and files Form 8082 to identify one of the inconsistent items, the IRS may make a consistency assessment with respect to the unidentified inconsistent item.[319]

If the partner files Form 8082, the IRS may not adjust the partnership items disclosed on that form except: (1) after commencing a TEFRA partnership proceeding, or (2) after notifying the partner under §6231(b)(1)(A) that all of that partner's partnership items have been converted to nonpartnership items.[320] If the IRS converts the partner's partnership items to nonpartnership items, the IRS may then adjust all partnership items (not only the inconsistent items) which have been converted.[321] If the partner determines that the inconsistent reporting was improper before the IRS converts the partnership items, the partner can file an AAR to make his reporting consistent with the partnership. The IRS cannot convert all of the partnership items after receiving this AAR.[322]

Special rules apply concerning the notice of inconsistent treatment made by indirect partners. There are two circumstances in which a notice of inconsistent treatment relieves the indirect partner from a potential consistency assessment. First, the indirect partner may file Form 8082 directly to disclose the inconsistent treatment between the indirect partner and the source partnership. Second, the indirect partner will be deemed to have filed a notice of inconsistent treatment if the indirect partner's pass-thru partner has filed a notice of inconsistent treatment and the indirect partner has filed consistently with the treatment reported by the pass-thru partner.[323]

b. Reliance on Erroneous K-1

The second means for escaping a potential consistency assessment is for the partner to establish that the partner reported the partnership items consistently with a schedule received from the partnership. This claim typically arises if the partner can establish that the Schedule K-1 received was consistent with the partner's reporting.

To fit within this exception, the partner must file an election within 30 days after receipt of the notice of computational adjustment. This election must: (1) identify the partner and the partnership, (2) clearly state that it is an election to be excepted from consistent return requirement, and (3) enclose the partnership schedule which the partner claims to be consistent with the partner's reporting.[324] If this election is properly made, the partner will be treated as if a notice of inconsistent treatment was filed with the partner's return. Accordingly, the IRS may make the adjustments to the inconsistent partnership items only after commencement of a partnership proceeding or after converting the partner's partnership items to nonpartnership items.

4. Consistency Assessment

The consistency assessment is a special form of computational adjustment which can be made without first commencing a partnership proceeding. The IRS may make this assessment when the partner: (1) has reported partnership items inconsistently with the partnership return, (2) has not filed a notice of inconsistent treatment, (3) does not establish that the partner filed consistently with a schedule received from the partnership, and (4) has not filed an AAR making the partner's treatment consistent with the partnership's. The IRS typically notifies the partner of the apparent inconsistency before making the computational adjustment.[325] Because §6222 removes the restriction on assessment under §6225, the IRS does not have to issue an FPAA at the source partnership level. This does not remove the restriction on assessment under §6230(a)(2)(A)(i) or other restrictions that may apply, however. Under §6230(a)(2)(A)(i), if the deduction is an affected item requiring partner-level determinations, the IRS may have to issue an affected item notice to disallow the deduction as an affected item.[326] The IRS also may choose to make the consistency assessment in connection with an audit of non-TEFRA items. If the IRS obtains a statute extension agreement in the non-TEFRA audit, the Form 872 should be modified to indicate that it also covers the consistency assessments.[327] If the IRS decides to include a consistency assessment amount in a notice of deficiency, the Tax Court may have jurisdiction over the amount.[328]

Because this consistency assessment is a form of computational adjustment, the procedures for contesting the adjustment are the same as those for other computational adjustments. These procedures generally limit the partner to contesting only the computational aspects of the adjustment. The partner may not contest the substantive issue of whether the partner can be forced to report consistently with the partnership return. The procedure for contesting the computational adjustment is essentially a refund procedure. See VIII.A., below, for further discussion of the procedures for contesting a computational adjustment. If the IRS also asserts penalties against the partner for not reporting consistently, the penalties are asserted in a notice

[318] Reg. §301.6222(b)-1.

[319] Reg. §301.6222(b)-2(b).

[320] Reg. §301.6222(b)-2(a). *See Jenkins v. Commissioner*, 102 T.C. 550 (1994) (must be actual inconsistency with item partnership is required to take into account for inconsistency procedures to apply).

[321] Reg. §301.6222(b)-2(c).

[322] §6231(b)(2)(A)(ii).

[323] Reg. §301.6222(a)-2(c).

[324] Reg. §301.6222(b)-3.

[325] See the Worksheets, below, for an example of this inconsistency notification.

[326] CCA 201020017. *See also* CCA 201447037 (carryback can be directly assessed to the extent it is purely computational, however, to extent such computational adjustment allows any portion of the NOL to survive and passive loss rules apply to eliminate any remaining amount, affected item deficiency procedures apply to disallow remaining amount).

[327] *See* FSA 200125014 (citing §6222(c)).

[328] *See Winter v. Commissioner*, 135 T.C. 238 (2010).

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of deficiency because there is no partnership-level proceeding in which the penalties could be raised.[329]

B. Consistent Settlement Requirement

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

In addition to the consistent return requirement, §6224(c)(2) contains a requirement that the IRS must offer consistent partnership item settlements to all partners governed by the TEFRA partnership proceeding who request the same settlement.[330]

Practical Comment: If a partner enters into a settlement agreement with the U.S. Attorney General (or a delegate) after Mar. 9, 2002, the U.S. Attorney General (or a delegate) also must offer consistent partnership item settlements to all partners governed by the TEFRA partnership proceeding who request the same settlement.

The consistent settlement right is limited to the partners in the same partnership. Partners in one partnership in a related group of partnerships are not entitled to a settlement consistent with a partner in a different but related partnership.[331] In addition, the IRS is not required to extend a settlement to a partner for a taxable year not covered by TEFRA simply because the IRS entered into a favorable settlement with a similarly situated partner for a TEFRA year.[332]

The consistent settlement requirement is looser than the consistent return requirement in that the IRS must offer a consistent settlement only to partners who request the settlement. There is no provision that requires all partners to settle on a consistent basis. Thus, absent a qualifying consistent settlement request or some proof that a taxpayer has been singled out for disparate treatment based on impermissible considerations such as race or religion, and absent a contractual agreement to the contrary, the IRS does not have to settle on the same terms with all similarly situated taxpayers.[333] There is also no requirement that the IRS offer consistent settlement of affected items as part of the consistent settlement.[334] However, consistent settlement terms also may include partnership-level determinations of penalties or additions to tax relating to partnership items.[335]

Note: The statute contemplates that there is some type of dispute between the partnership and the IRS during the course of an administrative proceeding. Thus, the mere fact that some partners receive refunds after filing amended returns but a particular partner does not because the IRS examines that partner's refund claim does not rise to the level of a settlement as contemplated by §6224(c).[336] Similarly, the failure of the IRS to collect or timely assess against one partner is not a settlement agreement that creates a consistent settlement right.[337]

The consistent settlement requirement is binding on the IRS.[338] The right to a consistent settlement is not itself a partnership item, however.[339] Therefore, the right may have to be raised in a computational adjustment proceeding unless the Tax Court exercises jurisdiction over the issue in a partnership proceeding.[340] Once the IRS settles with a partner, however, the other partners in that partnership obtain the right to a consistent agreement unless the IRS can prove that the original settlement agreement was procured by fraud. In order to establish fraud, malfeasance, or misrepresentation of fact within the meaning of §6224(c), the party making such allegations must prove that the execution of the settlement was induced by intentional and deliberate misstatements or silence calculated to mislead or deceive.[341]

Temporary and proposed regulations published in January 1999 provided that consistent settlements must be identical to the original settlement whether they are comprehensive or partial settlements. A consistent agreement may not be limited to selected items from the original settlement.[342] The consistent settlement rules apply to both partial and full settlements and to partnership-level determinations of penalties related to adjustments to partnership-level items.[343] Reg. §301.6224(c)-3 generally retains the language contained in the temporary and proposed regulations and clarifies that the consistent settlement rules apply to both partial and full settlements.

Mechanically the consistent settlement procedure is designed to work as follows:

- the IRS and a partner agree to a settlement of partnership item issues and partnership-level penalty determinations;[344]

[329] *Malone v. Commissioner*, 148 T.C. 372 (2017).

[330] §6224(c)(2).

[331] *Vulcan Oil Tech. Partners v. Commissioner*, 110 T.C. 153 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999).

[332] *Estate of Campion v. Commissioner*, 110 T.C. 165 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999).

[333] *Estate of Campion v. Commissioner*, 110 T.C. 165 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999).

[334] Section 6224(c)(2) is expressly limited to partnership items, apparently because affected items typically involve some partner-level determinations.

[335] Reg. §301.6224(c)-3(b)(1).

[336] *See Rigas v. United States*, 486 Fed. Appx. 491 (5th Cir. 2012) (unpub.) (as a matter of law, IRS's payment of refunds to some partners did not constitute settlement agreement under §6224(c) because (1) settlement agreements are made with individual partners after an administrative proceeding is initiated to resolve partnership-level items and there was no such proceeding in the present case, and (2) since refund claims were paid, no dispute ever arose between those partners and the IRS).

[337] CCA 201107023; CCA 201103044.

[338] §6224(c)(1). For settlement agreements entered into with the U.S. Attorney General (or a delegate) after Mar. 9, 2002, the consistent settlement requirement also is binding on the U.S. Attorney General. §6224(c)(1).

[339] *Rigas v. United States*, 486 Fed. Appx. 491 (5th Cir. 2012) (unpub.); *Prochorenko v. United States*, 243 F.3d 1359 (Fed. Cir. 2001); *Monti v. United States*, 223 F.3d 76 (2d Cir. 2000).

[340] *See Vulcan Oil Tech. Partners v. Commissioner*, 110 T.C. 153 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999); *H Graphics/Access LP v. Commissioner*, T.C. Memo 1992-345.

[341] *H Graphics/Access Ltd. v. Commissioner*, T.C. Memo 1992-345.

[342] Reg. §301.6224(c)-3(b)(1).

[343] Reg. §301.6224(c)-3(b)(1).

[344] The settlement contemplated by §6224 means any written agreement between a partner and the IRS which resolves all or some of the partner's partnership items. Reg. §301.6224(c)-3. Prior to the issuance of this regulation which clarifies that the consistent settlement rules apply to both partial and full settlements, Reg. §301.6224(c)-3T, applicable for partnership tax years begin-

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• the TMP learns of the settlement and informs all partners of the contents of the settlement;[345]

• within the later of: (a) 150 days after the FPAA is mailed to the TMP or (b) 60 days after the settlement, another partner files a written "consistent settlement statement" with the IRS office that entered into the settlement which: (1) is identified as a request for consistent settlement, (2) contains the name, address, and tax identification number of the requesting partner and the partnership, (3) identifies the settlement agreement for which a consistent settlement is desired, and (4) is signed by the requesting partner;[346]

• the IRS extends the same settlement offer to the requesting partner; and

• the partner executes the documents which constitute the settlement agreement.[347]

The critical link in this mechanism is the TMP, who must learn of the settlement and inform the other partners. Absent execution of this step, the other partners may be unaware of the existence of the settlement until after the period expires within which to request a consistent settlement. Except under the Tax Court Rules, there is no express requirement that the IRS notify the TMP of a settlement with another partner and there is no extension of time if the TMP fails to inform the other partners.[348] These procedures place a heavy burden on the TMP to receive and disseminate the settlement information in a timely fashion. At least one court has held, however, that the failure of the IRS to notify the other partners of a settlement means the right to a consistent settlement remains open.[349]

The first "settlement offer" is typically the Form 870-PT or Form 870-lT which accompanies the 60-day letter of FPAA. If the IRS makes a different settlement offer, the IRS prepares a new Form 870-PT or Form 870-LT (or court stipulation) reflecting the new offer. Unlike the 60-day letter, however, usually only the TMP receives this new settlement document directly from the IRS. Frequently the other partners must rely upon the TMP to receive a copy of the new settlement document.[350] In view of the relatively short time in which the other partners may request a consistent settlement, the procedures require quick and accurate action by the TMP to provide a meaningful opportunity for consistent settlements by all partners.

The consistent settlement requirement apparently extends to settlements entered into after issuance of the FPAA. While §6224(c)(2) does not specifically refer to judicial settlements, Reg. §301.6224(c)-3T(c)(3) appears to contemplate judicial settlements by defining the period for filing the consistent settlement statement as the later of 150 days after the FPAA is mailed to the TMP or 60 days after the settlement agreement was executed. Because no settlement agreements other than that reflected in the FPAA itself are typically available during the 150-day period after issuance of the FPAA, and because the FPAA is issued in the same form to all notice partners, the 60-day period is meaningless unless it is intended to apply to judicial cases after issuance of the FPAA. No Code or regulation otherwise limits the consistent settlement requirement to administrative settlements before the issuance of the FPAA.

A consistent agreement does not give the partner further consistent settlement rights. If a consistent agreement must be offered to a requesting taxpayer, the consistent agreement is not a settlement agreement which starts a new period in which other partners may request consistent settlement terms.[351]

The consistent settlement requirement does not dictate that the IRS will make only one settlement offer in any TEFRA partnership proceeding. The following example illustrates how multiple offers may be made in the context of a single proceeding:

Example (1): P Partnership is governed by the TEFRA partnership audit procedures. During the course of the administrative proceeding, the IRS issues a settlement offer which would allow each partner 50% of the partnership distributive loss reported on the partnership return. Twenty of P's 75 partners accept this settlement offer. Later in the proceeding the IRS issues a settlement offer which would allow 60% of the distributive share of P's partnership loss. The remaining 55 partners accept this settlement.

The above facts do not violate the consistent settlement requirement. When the 50% settlement offer is made and accepted by the 20 partners, the acceptance of the settlement offer converts those 20 partners' partnership items to nonpartnership items.[352] The conversion of these 20 partners' partnership items to nonpartnership items effectively drops them out of the TEFRA proceeding. Therefore, when the 60% offer is made and accepted by the remaining 55 partners, the consistent settlement requirement is satisfied because all partners still remaining in the TEFRA proceeding were given the same settlement offer.[353] There is no requirement that the IRS go back to the 20 partners who accepted the 50% offer and give those partners the opportunity to accept the 60% offer.[354]

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ning before October 4, 2001, did not specifically provide that partial settlements were covered. *See Prochorenko v. United States*, 243 F.3d 1359 (Fed. Cir. 2001), *aff'g* 45 Fed. Cl. 494 (2000) (partner's post-judgment settlement was not a settlement agreement "with respect to partnership items," therefore, it did not give another partner a claim for a consistent settlement under §6224(c)(2)). If the settlement agreement includes concessions of both partnership and nonpartnership items, pursuant to Reg. §301.6224(c)-3, the settlement is not subject to the consistent settlement provisions. *Greenberg Bros. P'ship #4 v. Commissioner*, 111 T.C. 198 (1998), *aff'd sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002).

[345] Reg. §301.6223(g)-1(b)(1)(iv).

[346] Reg. §301.6224(c)-3(c). *See Vulcan Oil Tech. Partners v. Commissioner*, 110 T.C. 153 (1998) (requests for consistent settlements untimely; motions to set aside less favorable settlements denied), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999). If the IRS honors an oral request for consistent agreement which is not backed by a timely written component, this could result in a new settlement agreement which provides other partners an additional period within which to request consistent settlement. FSA 199905001.

[347] *See Cinema '85 v. Commissioner*, T.C. Memo 1998-213; *First Blood Assocs. v. Commissioner*, T.C. Memo 1998-228, *vac'd and rem'd sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002).

[348] §6230(f); *Vulcan Oil Tech. Partners v. Commissioner*, 110 T.C. 153 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999).

[349] *Monti v. United States*, 2002-1 USTC ¶ 50,243 (E.D. N.Y. 2001).

[350] Reg. §301.6223(g)-1(b)(1)(iv).

[351] Reg. §301.6224(c)-3(b)(2).

[352] §6231(b)(1)(C).

[353] *See* Reg. §301.6224(c)-3(b), Reg. §301.6224(c)-3(d) *Ex. 3.*

[354] *Slovacek v. United States*, 40 Fed. Cl. 828 (Fed. Cl. 1998).

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There are a number of problems associated with the consistent settlement requirement. One problem arises with respect to settlements involving allocations between partners. The following example illustrates this issue.

Example (2): BCD Partnership is composed of B, C, and D who have specially allocated items of partnership income between them on the following basis:

Partner	Tax-Exempt Income	Taxable Income
B	20%	40%
C	20%	40%
D	60%	20%

The IRS determines that the partnership underreported its taxable income by $5,000 and that B, C, and D should have reported both tax-exempt and taxable income on an equal 1/3-1/3-1/3 basis. A settlement is offered on this basis.

It is unclear how the consistent settlement rule applies if D accepts the settlement. It appears that the IRS would be required to allow B and C to reduce their share of taxable income in a consistent settlement. It does not appear, however, that B and C can agree to the settlement on the change in the allocation but contest the assertion of the additional $5,000 in taxable income. B and C cannot require consistent treatment on certain terms of the settlement while rejecting consistent treatment on other terms.[355]

Another problem arises when the settlement attempts to cover years which are governed by the TEFRA procedures and years which are not.

Example (3): P Partnership was not governed by the TEFRA procedures in 2013 because of the small partnership exception. In 2014 one of the individual partners in P transferred that partner's partnership interest to a revocable trust, thereby taking P out of the small partnership exception for 2014. The partners in P are subjected to a non-TEFRA audit for 2013 and a TEFRA audit for 2014. The IRS, however, failed to control the statute of limitations for two of P's partners for 2013 and, therefore, no adjustments were made. The remaining P partners had their entire 2013 loss disallowed. The IRS wishes to make a settlement offer to the P partners in the TEFRA proceeding which would disallow the 2014 distributive share to the two partners who avoided adjustment in 2013 because of the statute of limitations, while allowing the full partnership distributive loss to the partners whose distributive share was disallowed in 2013.

It appears that this proposed IRS offer violates the consistent settlement requirement, in that it treats two partners differently from all the rest. This is true even though the 2014 settlement is premised on the disallowance of the respective partners' 2013 loss. Therefore, the two partners who escaped adjustment in 2013 are nevertheless entitled to have their full distributive share of the loss allowed in 2014 in the same manner as all the other partners. As the TEFRA partnership audit procedures are presently constructed, there is no mechanism by which the IRS may withhold the 2014 settlement offer from the two partners who received the statute of limitations "windfall" for the non-TEFRA 2013 year and the consistent settlement rules do not extend to a non-TEFRA year.[356]

[355] *Greenberg Bros. P'ship #4 v. Commissioner*, 111 T.C. 198 (1998), *aff'd sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002).

[356] *Estate of Campion v. Commissioner*, 110 T.C. 165 (1998), *aff'd by unpub. opin. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999).

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V. Statute of Limitations

A. *Steps for Statute of Limitations Analysis*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TEFRA partnership statute of limitations rules have evolved to a point where they are almost Byzantine in complexity. Where there is complexity, there is confusion, and where there is confusion, there are errors. It is therefore critical that the applicable period of limitations be analyzed in each case to determine if the IRS has acted in a timely manner.

Ultimately, there is only one period of limitations that must be analyzed, the period of limitations on assessment of the tax at issue. This period of limitations is impacted at multiple stages from many events, however. Because analysis is so complex, a methodical step-by-step approach is helpful. The TEFRA statute of limitations issues should be analyzed in the following steps:

- First, determine that the partnership is a TEFRA partnership.
- Second, determine the type of item at issue (i.e., partnership item, converted item, affected item, or nonpartnership item). Each type of item has its own statute of limitations.
- Third, analyze the effect of the partnership proceeding on the statute of limitations.
- Fourth, determine the effect of the partner-level proceeding on the statute of limitations.

B. *Importance of Correct Classification*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

A threshold issue in determining the statute of limitations is whether or not the TEFRA procedures apply. This issue depends on whether the partnership is a "partnership" within the meaning of §6231(a)(1). This is discussed further in II., above. The determination of whether a partnership is TEFRA or non-TEFRA can often be sophisticated and fact-intensive. Each partnership audit should be examined to ensure that the IRS has made a proper classification of the partnership and has applied the proper statute of limitations.

If the IRS determines that the partnership is subject to the TEFRA procedures, the IRS monitors and extends the partnership item statute of limitations according to the rules discussed below. If it ultimately is determined that the IRS has improperly classified the partnership as a TEFRA partnership, however, the IRS must make the proposed adjustments at the partner level within the time allotted by the nonpartnership item statute of limitations for each partner. As a practical matter, by the time a court has made the determination that the IRS improperly controlled the TEFRA partnership item statute of limitations, the nonpartnership item statute of limitations has often expired. This leaves the IRS with no ability to adjust the items.

This statute of limitations issue is less likely to exist when the IRS classifies the partnership as non-TEFRA but it is ultimately determined that the TEFRA procedures do apply. The IRS will often have monitored and extended the nonpartnership item statute of limitations and failed to extend the TEFRA partnership item statute of limitations. Even if the TEFRA partnership item statute of limitations has expired when the IRS learns of the incorrect classification, however, the IRS will probably not be barred from making any adjustment to the partnership items because the §6501 nonpartnership item statute of limitations typically functions as the maximum period of limitations.[357]

As explained at II.E.2., above, §6231(g) allows the IRS to apply TEFRA audit procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply.[358] Similarly, the IRS can apply normal deficiency procedures if it reasonably determines, based on the partnership's return, that they apply. Other than the leeway granted by §6231(g), no provision extends or mitigates the correct statute of limitations when the IRS has incorrectly applied the wrong audit procedures and therefore controlled the wrong statute of limitations.

C. *Partnership Items*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The partnership item statute of limitations determination requires recognition of the two stages in the TEFRA process: (1) the partnership-level proceeding; and (2) the partner-level proceeding. Even more importantly, it is critical to recognize the prevailing two-part statute of limitations for partnership items: (1) the minimum period of limitations based on §6229 that applies to all partners (the "Minimum Period"); and (2) the maximum period of limitations based on §6501 that applies separately to each partner (the "Maximum Period").

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[357] *See Charlton v. Commissioner*, 990 F.2d 1161 (9th Cir. 1993), *aff'g* T.C. Memo 1991-285 (for a partnership not subject to TEFRA the individual partner's return, not the partnership information return, triggers the period for assessing deficiencies). But see, V.C. below for further discussion of this issue.

[358] §6231(g) (deficiency notice incorrectly sent to a taxpayer personally does not bar the IRS from sending a second notice to the partnership when the partnership's return is still open).

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1. The Minimum Period and the Maximum Period

At first blush, the concept of a statute of limitations for a partnership proceeding appears simple. A key goal of TEFRA is to have a unified proceeding with the same result for every partner. Consistent with this goal, the initial understanding was that the §6229 partnership item statute of limitations was the exclusive partnership item statute of limitations, i.e., the maximum period in which to assess the tax attributable to partnership item adjustments. The cases now interpret §6229 as a Minimum Period that operates as an extension of the Maximum Period, i.e., the general partner-level §6501 statute of limitations.

It is helpful to understand the nature of the confusion and controversy on this issue. The prevailing rule that §6229 operates as the Minimum Period is based on a technical interpretation of §6229 itself. Section 6229 provides that the partnership item statute "shall not expire before" three years from the date the partnership return is deemed filed. Section 6501, by contrast, provides that the tax "shall be assessed" within the three-year period, as extended. The courts have interpreted this difference in language to mean that §6229 establishes the Minimum Period while §6501 establishes the Maximum Period.

While this literal interpretation finds support in the plain meaning of each section, if §6229 is not the exclusive statute for partnership items, results occur that are inconsistent with the conceptual foundation of the TEFRA procedures. This conceptual problem is illustrated by the following example:

> *Example:* P Partnership is composed of T, an individual, and B Trust. P Partnership and T file their respective 2013 returns on April 15, 2014. B Trust files its return on September 15, 2014, pursuant to an extension. The IRS audits P Partnership and issues an FPAA on June 2, 2017, without obtaining any form of extension. If §6229 is the exclusive partnership item statute of limitations, the FPAA is untimely and no adjustment may be made to either T or B Trust. If §6229 merely extends the underlying §6501 partner statute of limitations, however, the FPAA is untimely only with respect to T. The §6501 statute of limitations as to B would not expire until September 15, 2017. This result directly contradicts the general scheme of the TEFRA procedures because it results in inconsistent treatment of the two partners.

In spite of the conceptual problem with interposing §6229 as only a Minimum Period, the Tax Court has adopted this interpretation. In *Rhone-Poulenc Surfactants & Specialties LP v. Commissioner*,[359] the Tax Court held that §6229 provides a minimum amount of time for assessing tax attributable to partnership items, effectively creating the Minimum Period.

The dissenting opinions in *Rhone-Poulenc* rejected the majority's incorporation of the §6501 statute of limitations because there was no direct reference to §6501 in §6229. The dissent believed this was unpersuasive as a matter of statutory construction. The dissent also noted that the majority's interpretation frustrated the statutory scheme and consistent treatment that were the hallmarks of the TEFRA procedures. The statutory construction argument should have been much more compelling to justify such an anomalous result.

The Tax Court's majority position, however, has been approved in every circuit that has decided the issue.[360] Accordingly, notwithstanding the conceptual flaws in the position, the prevailing rule is clearly that §6229 establishes a minimum period of limitations.

The apparent resolution of this controversy means there are two periods that must be analyzed in the partnership proceedings. The first is the Minimum Period. This is the three-year period (as suspended or modified) that begins on the later of the date the partnership return is due (without extensions) or the date the partnership return is filed.[361] The partnership return must be filed according to IRS procedures to start the Minimum Period.[362] The second period is the Maximum Period. This is the individual §6501 statute of limitations for each partner, as suspended or modified with respect to partnership and affected items.

The statute of limitations that is analyzed in the partnership proceeding is whether the FPAA was issued on a timely basis. As a practical matter, there is a priority in which the two statutes of limitation are analyzed. The first to be analyzed is the Minimum Period. If the FPAA is issued when the §6229 partnership item statute of limitations is open, the statute of limitations is open for all partners. For this reason the IRS relies on the Minimum Period by design.[363]

Whether the Minimum Period or the Maximum Period applies, it is important to remember that an FPAA is still required to adjust partnership items.[364] Nothing in the partner-by-partner application of the Maximum Period changes the requirement to issue an FPAA to adjust a partner's TEFRA partnership items.

If the Minimum Period is closed when the FPAA is issued, however, the timeliness of the FPAA will have to be determined partner-by-partner based on each partner's Maximum Period. The result of this analysis may vary by partner. The FPAA will be timely for all partners whose Maximum Period was open when the FPAA was issued, but will be untimely for all partners whose Maximum Period was closed when the FPAA was issued.

To make matters even more complicated, the analysis of each partner's Maximum Period is not limited only to the year in which the partnership items arise. Therefore, an FPAA can be timely issued to adjust partnership items in Year 1 (even if

[359] 114 T.C. 533 (2000), *appeal dismissed*, 249 F.3d 175 (3d Cir. 2001). *See also In re G-I Holdings, Inc.*, 2004-1 USTC ¶ 50,152 (D.N.J. 2003) (*Rhone* ruling collaterally estopped challenge to partnership statute of limitations in partner's bankruptcy case); *Curr-Spec Partners, LP v. Commissioner*, 579 F.3d 391 (5th Cir. 2009), *cert. denied*, 560 U.S. 924 (2010).

[360] *Bedrosian v. Commissioner*, 940 F.3d 467 (9th Cir. 2019); *Omega Forex Group, L.C. v. United States*, 906 F.3d 1196 (10th Cir. 2018); *Gail Vonto LLC v. United States*, 595 Fed. Appx. 170 (3d Cir. 2014); *Curr-Spec Partners, LP v. Commissioner*, 579 F.3d 391 (5th Cir. 2009); *AD Global Fund, LLC v. United States*, 481 F.3d 1351 (Fed. Cir. 2007); *Andantech LLC v. Commissioner*, 331 F.3d 972 (D.C. Cir. 2003). *See also* CCA 201402009, CCA 201439002 (Section 6229 operates only to extend partner's §6501 period, not shorten it; if partner's §6501 period is open for partnership items, IRS may issue an FPAA that is binding on that partner).

[361] The date the Form 1065 is received is the filing date. *See Natalie Holdings, Ltd. v. United States*, 2003-1 USTC ¶ 50,233 (W.D. Tex. 2003).

[362] *Seaview Trading LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023) (partnership return filed with the wrong IRS office did not start the Minimum Period).

[363] IRM 8.19.1.7.6.

[364] *See* FSA 200102043.

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both the Minimum Period and the Maximum Period is closed for every partner's Year 1) so long as the Maximum Period is open for any partner for Year 2 and the Year 1 partnership item adjustments have a tax effect in Year 2. This can occur if the Year 1 partnership item adjustments affect the basis of an asset sold in Year 2.[365] The rule also applies if the Year 2 tax deficiency results from the effect of the Year 1 partnership item adjustments on a net operating loss carryover from Year 1 to Year 2.[366] Accordingly, issuance of the FPAA will not be barred so long as a timely assessment of tax can be made against any partner for any year as a result of the partnership item adjustments.

> *Example:* Z, an individual, is a pass-through partner in PTP, and PTP is a partner in "source parternship" SP. SP allocated a loss claimed on its 2015 tax return to PTP, which passed this loss through to Z, who claimed it on Z's 2016 individual tax return. On October 14, 2020, less than three years after Z filed her 2016 individual tax return, the IRS issued an FPAA disallowing the loss that SP had claimed for 2015. Since the losses claimed on Z's 2016 tax return are attributable to the loss claimed on SP's 2015 tax return, Z's 2016 limitations period was suspended by the FPAA.[367]
>
> Another complication of the Maximum Period is the need to recognize the return that starts the period. For example, even though the partnership withholding obligation is a partnership item to be adjusted in an FPAA, the return that starts the Maximum Period is the withholding tax return not the partnership return.[368]

2. *The Scope of the Statute of Limitations Inquiry in the Partnership Proceeding*

Even though there is a clear consensus that the two-part Minimum Period and Maximum Period analysis controls the partnership item statute of limitations determination, the case law is less clear about the scope of the inquiry into these periods in the partnership proceeding. *Rhone-Poulenc* and many other cases suggest both the Minimum Period and the Maximum Period should be determined in the partnership proceeding.[369]

Most of the statute of limitations cases suggest that both the Minimum Period and Maximum Period issues must be addressed in the partnership proceeding because they are partnership items. Under a literal reading of §6231(a)(3), however, this is probably incorrect. Section 6231(a)(3) defines partnership items as items determined under Subtitle A. Neither the §6229 Minimum Period, nor the §6501 Maximum Period, is an item under Subtitle A and the partnership item regulation does not include the partnership item statute of limitations as an item more appropriately determined at the partnership level.[370]

The Minimum Period (which is based on §6229 and applies equally to all partners) is most appropriately characterized as an affirmative defense that must be raised in the partnership proceeding or is waived. That is consistent with the treatment of the statute of limitations issue in both TEFRA and non-TEFRA contexts.[371] No matter how it is characterized, however, the Minimum Period must be addressed in the partnership proceeding.

It is less clear that the Maximum Period (which applies differently to each partner based on the partner's specific circumstances) should be viewed as a mandatory affirmative defense in the partnership proceeding. A procedure does exist to raise a partner's Maximum Period in the partnership proceeding. Pursuant to §6229(d)(1), each partner may participate in the partnership proceeding to contest that partner's period of limitations. This provides a forum for a partner to have that

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[365] *See, e.g.*, *Kligfield Holdings v. Commissioner*, 128 T.C. 192 (2007) (FPAA may be issued to adjust partnership items in a closed year to allow assessment of deficiency in partner's later year return; reading §6229 and §6501 together, court concluded that differences in statutory language indicated that Congress anticipated that tax year in which assessment was made would not always be the same as the tax year in which the adjustment was made); *Russian Recovery Fund Ltd. v. United States*, 101 Fed. Cl. 498 (2011), *aff'd*, 851 F.3d 1253 (Fed. Cir. 2017). *See also* CCA 200414045.

[366] *Wilmington Partners, LP v. Commissioner*, 495 Fed. Appx. 173 (2d Cir. 2012) (unpub.); *Curr-Spec Partners v. Commissioner*, 579 F.3d 391 (5th Cir. 2009); *G-5 Inv. P'ship v. Commissioner*, 128 T.C. 186 (2007). *See also* CCA 201402007 (IRS may issue FPAA to prevent partners from carrying loss forward from closed year(s) to later years, so long as partners' carryfoward year is open), CCA 201402011 (when TMP signs Form 872-P, it extends period for assessing tax "attributable to" disallowed partnership loss, regardless of which return a partner claimed the loss on; thus, when TMP extends assessment period for tax attributable to partnership loss for Year 1, he is extending assessment period for all partner returns claiming such loss, including carryforward years), CCA 201509036 (although statute of limitations for assessing tax expired for particular tax year, IRS can still examine that TEFRA partnership for such tax year in order to disallow partner's net operating loss carryforward that resulted from partnership or affected item during that barred year).

[367] *Russian Recovery Fund Ltd. v. United States*, 851 F.3d 1253 (Fed. Cir. 2017).

[368] *YA Global Investments, LP v. Commissioner*, 161 T.C. 173 (2023).

[369] *See Baxter v. United States*, 48 F.4th 358 (5th Cir. 2022) (partner's refund action claiming untimely assessment under §6501 requires determining whether FPAA was timely assessed under §6229, which is partnership item; given that §7422(h) bars refund claims involving partnership items, district court lacked jurisdiction over partner's refund case); *Foster v. United States*, 801 Fed. Appx. 210 (5th Cir. 2020) (unpub. op.) *Bedrosian v. Commissioner*, 940 F.3d 467 (9th Cir. 2019); *Rodgers v. United States* 843 F.3d 181 (5th Cir. 2016); *Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013); *Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004), *cert. denied*, 125 S. Ct. 2312 (2005) (district courts lack jurisdiction to consider claim that expiration of FPAA statute of limitations prevented assessment as statute of limitations is a partnership item that must be litigated in a partnership-level proceeding); *Davenport Recycling Assocs. v. Commissioner*, 220 F.3d 1255 (11th Cir. 2000); *Chimblo v. Commissioner*, 177 F.3d 119 (2d Cir. 1999), *cert. denied*, 120 S. Ct. 1159 (2000) (taxpayer may not raise a statute of limitations defense for the first time in the affected items proceedings, after failing to raise it at the earlier partnership-level proceedings); *Kaplan v. United States*, 133 F.3d 469 (7th Cir. 1998) (district court lacks subject matter jurisdiction in individual tax partner's refund challenge to consider statute of limitations argument); *Kercher v. United States*, 539 Fed. Appx. 517 (5th Cir. 2013) (unpub.); *Klein v. United States*, 86 F. Supp. 2d 690 (E.D. Mich. 1999); *Prati v. United States*, 603 F.3d 1301 (Fed. Cir. 2010); *Keener v. United States*, 551 F.3d 1358 (Fed. Cir. 2009); *Conway v. United States*, 50 Fed. Cl. 273 (Fed. Cl. 2001), *aff'd on other grounds*, 326 F.3d 1268 (Fed. Cir. 2003); *BLAK Invs. v. Commissioner*, 133 T.C. 431 (2009); *Crowell v. Commissioner*, 102 T.C. 683 (1994); *McConnell v. Commissioner*, T.C. Memo 2008-167; *Overstreet v. Commissioner*, T.C. Memo 2001-13; *Isler v. United States*, 129 Fed. Cl. 67 (Fed. Cl. 2016) (citing *Keener* and *Prati*; Court of Federal Claims lacks jurisdiction in individual partner's refund suit to consider statute of limitations issue which is a partnership item).

[370] Reg. §301.6231(a)(3)-1.

[371] *Columbia Bldg., Ltd. v. Commissioner*, 98 T.C. 607 (1992); *Genesis Oil & Gas v. Commissioner*, 93 T.C. 562 (1989) (TEFRA); *Abeles v. Commissioner*, 91 T.C. 1019 (1988); *Robinson v. Commissioner*, 57 T.C. 735 (1972) (non-TEFRA).

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partner's Maximum Period determined in the partnership proceeding.[372]

Requiring the determination of the Maximum Period to be in the partnership proceeding is consistent with cases analyzing penalty issues. These cases essentially treat the partnership proceeding as a declaratory relief action with respect to the components of determinations that are more appropriately considered at the partnership level.[373]

Creating an opportunity for each partner to participate in the partnership proceeding probably means the partner must raise the partner's Maximum Period defenses in the partnership proceeding or the defenses will be considered waived.

A potential problem exists, however, when no FPAA has been issued. For example, the IRS could take the position that the partnership's return was filed late but make no adjustments to the ostensibly late-filed return and therefore issue no FPAA. The IRS then issues an affected item notice of deficiency to a partner based on the Minimum Period. If the Minimum Period is a partnership item, there is an argument that the partner cannot challenge the filing date of the partnership return in the affected item proceeding. This is the wrong result because there was no partnership proceeding in which any partner could have challenged the filing date. If the Minimum Period is treated an affirmative defense, however, there could have been no waiver resulting from the nonexistent partnership proceeding. That would presumably allow the partner to raise the filing date issue in the affected item proceeding. This is not a perfect solution as it would potentially involve litigating the common partnership return filing date issue in multiple partner-level proceedings. Nevertheless, this result is preferable to having no forum in which to raise the issue at all.

In sum, there is no statute or regulation that requires or suggests that the Minimum Period or the Maximum Period is a partnership item. The applicable cases do, however. Whether the determination of these periods is treated as a partnership item or an affirmative defense which is waived if not raised at the earliest opportunity, however, the Minimum Period and Maximum Period typically must be raised in the partnership proceeding.

3. Suspension from Issuing the FPAA

The issuance of an FPAA triggers a suspension of the partnership item statute of limitations. This suspension results from §6229(d), which suspends the partnership item statute of limitations from the date of the FPAA to the date the FPAA adjustments become final, plus one year. It is therefore important to determine the date the adjustments in the FPAA become final. If no petition is filed in any court, the adjustments become final 150 days after the FPAA is issued. If a petition is filed, the adjustments in the FPAA become final 90 days after the decision disposing of the adjustments is entered.[374] However the FPAA adjustments become final, the IRS has one year (plus any tacking period) from the finality date to make the computational adjustments to assess the tax.

There is some question concerning the effect of the §6229(d) suspension of the period of limitations in cases in which the IRS relies on the Maximum Period for the timeliness of the FPAA. A literal reading of §6229(d) suggests that the issuance of the FPAA suspends only the Minimum Period, not the Maximum Period. This would mean that if the Minimum Period expires before the FPAA is issued, the Maximum Period could expire while a petitioned FPAA case is pending even though the IRS is prohibited from making an assessment by §6225. The Tax Court addressed this problem by interpreting the "period" in §6229(a) that is referenced in §6229(d) as the overall statute of limitations which includes both the Minimum Period and the Maximum Period.[375] This analysis is suspect but necessary to make the Tax Court's interpretation of §6229 as a minimum period of limitations work.[376]

The suspension period of §6229(d) is a true suspension, i.e., the period of limitations stops running from the date the suspension period starts until the date it ends. The FPAA functions the same as a notice of deficiency in non-TEFRA cases in this analysis. Issuing a non-TEFRA notice of deficiency suspends the running of the nonpartnership item statute of limitations so that whatever time is left on the period of limitations when the notice is issued "tacks" onto the 60-day period after the notice of deficiency has become final in which the IRS may make a timely assessment.[377] The TEFRA rule is similar. The FPAA must be issued before the expiration of the applicable period of limitations. If there is time left on the period of limitations when the FPAA is issued, that time is added to the one-year period after the FPAA adjustments have become final.[378] Accordingly, in the case of adjustments that do not result from a settlement, there is the same "tacking" of a single statute of limitations as exists in non-TEFRA cases. As set forth more fully below, however, this tacking rule does not apply if the partnership item adjustments are resolved by settlement.

> *Example:* P Partnership and all of its partners filed their respective 2008 returns on April 15, 2009. The IRS issues an FPAA to P's TMP on April 2, 2012. P's TMP files a Tax Court petition on June 25, 2012. The Tax Court enters its decision concerning the partnership items included in the FPAA on October 20, 2013. There is no appeal from the Tax Court's decision. The IRS may assess the tax attributable to P's partnership items adjustments on or before January 31, 2015. This date is determined by adding to April 2, 2012: (1) the period from April 2, 2012, to January 18, 2014, the date the Tax Court decision becomes final (the Tax Court decision becomes final on January 18, 2014 —

[372] *MK Hillside Partners v. Commissioner*, 826 F.3d 1200 (9th Cir. 2016); *Full Circle Staffing LLC v. Commissioner*, T.C. Memo 2018-66 (§6501 Maximum Period considered in partnership proceeding), *aff'd per curiam on other issues*, 832 Fed.Appx. 854 (5th Cir. 2020).

[373] *United States v. Woods*, 571 U.S. 310 (2013); *NPR Invs. LLC v. United States*, 740 F.3d 998 (5th Cir. 2014) (overvaluation penalty); *Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013) (former §6621(c) penalty interest on tax-motivated transactions).

[374] See VII.H., below. *See Carroll v. United States*, 339 F.3d 61 (2d Cir. 2003) (decision entered without date still effective to start period of limitations).

[375] *Rhone-Poulenc Surfactants & Specialties, LP v. Commissioner*, 114 T.C. 533, 552 (2004), *appeal dismissed*, 249 F.3d 175 (3d Cir. 2001).

[376] *See also, AD Global Fund v. United States*, 132 AFTR2d 2023-6005 (Ct. Fed. Cl. 2023), *aff'd on other grounds*, (Fed. Cir. 2025).

[377] §6501(a).

[378] *Trust a/w/o v. Commissioner*, T.C. Memo 2018-182. §6501(a).

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90 days after entry of the decision (§7481(a), §7483)); plus (2) one year; plus (3) 13 days remaining on the original three-year limitations period from April 2, 2012, to April 15, 2012, when the FPAA was issued. The January 31, 2015 date in this example is also the final date for issuing an affected item notice of deficiency for any affected items related to those partnership item adjustments.[379]

The extension of the statute of limitations does not correlate exactly with the prohibition on assessment of the partnership items. In non-TEFRA cases, §6503(a)(1) generally suspends the non-TEFRA statute of limitations for the pendency of a Tax Court proceeding because the IRS is prohibited from assessing while that proceeding is pending. The corresponding provision contained in §6229(d), however, suspends the statute of limitations on assessment if a proceeding is commenced in any court. As is discussed in VII.A.3., below, however, the filing of a petition contesting an FPAA in a court other than the Tax Court does not prohibit the assessment of the tax attributable to the partnership item adjustments for any partner other than the petitioning partner. Accordingly, while the IRS is authorized to assess the tax of the nonpetitioning partners for U.S. district court and Court of Federal Claims cases, §6229(d) prevents the statute of limitations on assessment from expiring if the IRS does not assess these nonpetitioning partners. Because the IRS is relieved of the need to assess against these nonpetitioning partners, the IRS could allow the Court of Federal Claims or U.S. district court case to proceed to conclusion before the assessments are entered against the nonpetitioning partners. In practice, however, the IRS typically makes the assessments against the nonpetitioning partners even though the partnership item adjustments are still being contested.

Under §6229(d), the statute of limitations in TEFRA cases is suspended by the filing of any petition under §6226, regardless of whether the petition is timely or valid.[380] Accordingly, if the statute of limitations is open at the time that an untimely petition is filed, the limitations period no longer continues to run and will not expire while the action is pending before the court.[381] A Tax Court petition filed by a TMP suspends the limitations period for assessment against the partners even if the Tax Court later vacates the decision and dismisses the case for lack of jurisdiction after the petition is nullified.[382] Also, the limitations period for assessing tax attributable to a partnership item is suspended for the period during which an action with respect to an FPAA is pending although that action is later dismissed by stipulation.[383]

4. Exceptions to General Rule

As the comparison table in the Worksheets indicates, the TEFRA procedures retain many of the historic exceptions to the general statute of limitations. The following section discusses the incorporation of these traditional exceptions into the TEFRA procedures.

Several events extend or suspend the partnership item and affected item statute of limitations. These events are typically cross-referenced to the §6229(a) period of limitations. The Tax Court held in *Rhone-Poulenc* that the reference to the §6229(a) period of limitations means both the Minimum Period and the Maximum Period. Therefore, these extension and suspension events should be analyzed as extending both periods of limitation.

a. Six-Year Statute for Omitted Income

Section 6229(c)(2) extends the normal three-year Minimum Period for partnership items and affected items to six years if the partnership "omits" from gross income in excess of 25% of the amount of gross income stated in the return.[384] For this purpose, reporting an incorrect amount is not an omission if the transaction is reported on the partnership return.[385]

For purposes of §6229(c)(2), the regulations provide that "gross income," as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.[386]

Although there is no express adequate disclosure provision under §6229(c)(2), the regulations provide that an amount is not considered to be omitted from gross income if information sufficient to apprise the IRS of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.[387]

Section 6229(c)(2) extends the normal three-year Minimum Period for partnership items and affected items to six years if there is an omission from gross income exceeding $5,000 and the omitted income is attributable to an asset with respect to which information returns are required under §6038D, applied without regard to the dollar threshold, the statutory exception for nonresident aliens, and any exceptions provided by regulation.[388]

Over the years, the IRS and the courts disagreed as to whether an overstatement of an asset's basis resulted in an omission from gross income that extended the assessment statute of limitations from three years to six years under

[379] *See Simek v. United States*, 96-1 USTC ¶ 50,169 (W.D. Wis. 1995) (assessments made against partner were timely because suspension of limitations period for period "during which an action may be brought" by partners was lengthened by fact that last day fell during a weekend).

[380] *See McElroy v. Commissioner*, T.C. Memo 2014-163 (validity of petition by TMP under criminal investigation irrelevant to suspending statute of limitations because a validly petition is statutorily unnecessary under §6229(d)).

[381] §6229(d).

[382] *O'Neil v. United States*, 44 F.3d 803 (9th Cir. 1995).

[383] *Miller v. Commissioner*, 104 T.C. 378 (1995).

[384] *CNT Investors v. Commissioner*, 144 T.C. 161 (2015). *See also Highwood Partners v. Commissioner*, 133 T.C. 1 (2009), where the Tax Court held that an omission from income occurred for purposes of §6501(e) where the partnership failed to separately report gain and loss from long and short options as required under §988. The court stated that the fact that the partnership accurately calculated the amount of the net loss arising from the offsetting options did not preclude application of the six-year limitations period if the partnership or the partners were required to compute and report any gain from the short options separately from any loss from the long options.

[385] *Beverly Clark Collection, LLC v. Commissioner*, 851 Fed. Appx 1 (9th Cir. 2021), *aff'g*, T.C. Memo 2019-150. *But See*, *Pragias v. Commissioner*, T.C. Memo 2021-82 (omission of item not always required).

[386] Reg. §301.6229(c)(2)-1(a)(1)(ii).

[387] Reg. §301.6229(c)(2)-1(a)(1)(iv).

[388] *See* §6229(c)(2) and §6501(e)(1)(A)(ii).

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§6501(e)(1) and §6229(c)(2). The issue seemingly was settled by the U.S. Supreme Court in *United States v. Home Concrete & Supply, LLC*, in which the Court ruled that an overstatement of an asset's basis is not an omission from gross income that triggers the extended six-year assessment period.[389] In 2015, Congress stepped in to legislatively overrule the Supreme Court's decision in *Home Concrete*. Thus, effective for returns filed after July 15, 2015 (and returns filed before such date if the period specified in §6501 for assessment of the taxes with respect to which such return related had not expired as of July 31, 2015), §6501(e)(1)(B)(ii) provides that an understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission from gross income subject to a six-year state of limitations on assessment.[390]

b. Extended Statute for Fraud

The unlimited statute of limitations for fraudulent returns is incorporated into the TEFRA procedures with one significant modification. Section 6229(c)(1) applies the unlimited Minimum Period statute of limitations only to partners who sign the partnership return or who participate in preparation of the return.[391] The Minimum Period for all other partners is six years when the partnership return is fraudulent.[392] This distinction results in the partnership item statute of limitations remaining open for the "signing" partner while the statute of limitations for adjustment of the partnership items of the "nonsigning" partners closes after six years.

Interestingly, §6229(c)(1) does not apply the unlimited assessment period to a partner even if that partner knows of the fraudulent position taken on the partnership return, so long as that partner does not sign the return and does not participate, directly or indirectly, in the preparation of the return. This "knowing but nonsigning" partner, however, may in fact be committing fraud on his individual return by reporting the fraudulent partnership distributive share. Even if the Minimum Period is extended to only six years, the fraud on the individual return may cause the Maximum Period to apply. Section 6229(c)(1) does not pre-empt §6501(c)(1) if there is fraud on the partner's return as a result of either the partnership fraud or unrelated fraud.[393]

c. Extended Statute for Unidentified Partners

A partner is an unidentified partner if the name, address, and taxpayer identification number of the partner are not disclosed on the partnership return.[394] There are two circumstances in which the partner's status as unidentified partner will result in an extension of the Minimum Period. First, the statute is extended if the partner has not been identified by submitting the required information to the IRS at least one year before the issuance of the FPAA.[395] Second, the statute is extended if the unidentified partner files inconsistently with the partnership's return and does not file a notice of inconsistent treatment (Form 8082).[396] In both of these situations, the Minimum Period of the unidentified partner is extended until one year after the unidentified partner is identified to the IRS. To identify the partner, a written identification statement must be filed with the IRS submission processing center where the partnership return is filed, or (if known) with the IRS office that has issued the NBAP. This statement must: (1) identify the partnership, the partner, and the taxable year; and (2) be signed by the person supplying the information.[397]

Comment: This provision was apparently enacted in response to a perceived practice of filing a partnership return without attaching the K-1s. Unless the partnership return otherwise identifies the partners by name, address, and taxpayer identification number, failing to file K-1s is not effective in frustrating the audit of the partners.

It is not clear whether an indirect partner is an unidentified partner under this definition. An indirect partner fits the statutory definition because an indirect partner is a "partner" within the meaning of §6229(a) whose name, address, and taxpayer identification number are not furnished on the "source" partnership return. In addition, Reg. §301.6229(e)-1 indicates that an indirect partner can be an unidentified partner for this purpose. In contrast, however, the legislative history for §6229(e) indicates that the unidentified partner rule was intended to apply to information required on the source partnership return which is not furnished.[398] Identifying information concerning an indirect partner is not required to be shown on the source partnership return. Accordingly, an argument could be made that an indirect partner should not automatically be considered as an unidentified partner for purposes of extending the statute of limitations. However, most federal courts have held that an indirect partner

[389] See *United States v. Home Concrete & Supply LLC*, 566 U.S. 478 (2012), in which the Supreme Court invalidated Reg. §301.6501(e)-1(a)(1)(iii) because it contradicted *The Colony Inc. v. Commissioner*, 357 U.S. 28 (1958), in which the Court interpreted the predecessor to §6501(e)(1)(A) as excluding a basis overstatement from the meaning of omission from gross income. Note that the Court's invalidation of Reg. §301.6501(e)-1(a)(1)(iii) similarly invalidated identical language as used in Reg. §301.6229(c)(2)-1(a)(1)(iii). In so ruling, the Court disposed of nine cases addressing issues resolved in *Home Concrete*, denying certiorari to the cases that reached the same conclusion and granting certiorari and then vacating those that did not. Cases vacated included *Salman Ranch Ltd. v. Commissioner*, 647 F.3d 329 (10th Cir. 2011); *Intermountain Ins. Serv. of Vail LLC v. Commissioner*, 650 F.3d 691 (D.C. Cir. 2011); and *Grapevine Imports Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir. 2011) — all were remanded to the circuits from which they originated for further consideration. The four cases denied certiorari were *United States v. Burks*, 633 F.3d 347 (5th Cir. 2011); *Equip. Holding Co. v. Commissioner*, 439 Fed. Appx. 368 (5th Cir. 2011); *DSDBL Ltd. v. Commissioner*, 436 Fed. Appx. 384 (5th Cir. 2011); and *R & J Partners v. Commissioner*, 441 Fed. Appx. 271 (5th Cir. 2011). Cases for which certiorari was granted and then vacated were *Beard v. Commissioner*, 633 F.3d 616 (7th Cir. 2011) and *UTAM Ltd. v. Commissioner*, 645 F.3d 415 (D.C. Cir. 2011).

[390] *See* §6501(e)(1)(B)(ii).

[391] §6229(c)(1)(A).

[392] §6229(c)(1)(B). *See River City Ranches v. Commissioner*, 313 Fed. Appx. 935 (9th Cir. 2009) (unpub.).

[393] *Omega Forex Group, LC v. United States*, 906 F.3d 1196 (10th Cir. 2018). It appears the fraud on the partner's return must be that of the partner, not the partner's agent or advisor for the partner-level fraud to trigger the extended §6501(c)(1) statute of limitations. *BASR Partnership v. United States*, 795 F.3d 1338 (Fed. Cir. 2015); *but see Murrin v. Commissioner*, 158 F.4th 527 (3d Cir. 2025) (non TEFRA proceeding holding §6501(c)(1) applies to extend statute of limitations where taxpayer's return preparer had fraudulent intent; intent to evade tax attaches to the false or fraudulent return).

[394] §6229(e)(1).

[395] *See* §6229(e); *Walthall v. United States*, 911 F. Supp. 1275 (D. Alaska 1995), *aff'd*, 131 F.3d 1289 (9th Cir. 1997); *Taylor v. Commissioner*, T.C. Memo 1992-219.

[396] *See* CCA 201502009.

[397] Reg. §301.6229(e)-1(a), §301.6223(c)-1.

[398] H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 606 (1982), *reprinted in* 1982-2 C.B. 600, 666.

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who was not identified to the IRS, either in the partnership return or pursuant to Reg. §301.6223(c)-1T, is an "unidentified partner" within the meaning of §6229(e).[399]

d. No Partnership Return

If no partnership return is filed, there is no limit on the Minimum Period. This rule is actually the product of two provisions. First, the Minimum Period does not start under §6229(a) because the beginning of the three-year period is triggered by the later of the date the partnership return is due or the date the return is filed. Second, any confusion in the application of this general rule is resolved by §6229(c)(3), which states that there is no statute of limitations "[i]n the case of a failure by a partnership to file a return." The partnership can start the three-year period running by filing a delinquent return if no return has previously been filed. If a partnership does not file a return at a designated filing place, no return has been filed.[400] A §6020(b) return executed by the IRS when the partnership has not filed a return does not count as a return for purposes of starting the three-year period.[401] For further discussion of what constitutes a return and whether a return has been filed, see 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation.*

e. Extensions by Agreement

The IRS frequently does not conclude the audit of all of the partnership items before the normal three-year statute of limitations expires. Accordingly, it is very common for the IRS to solicit extensions of the three-year statute of limitations to conclude the audit and/or the administrative appeal of the Revenue Agent's conclusion. As with non-TEFRA statute extension agreements, agreements to extend the partnership item statute of limitations are generally subject to contract principles. The confusing nature of a TEFRA proceeding can make these interpretation issues even more complicated.[402] As discussed in V.C.2., above, the bar of the statute of limitations probably must be raised in the partnership proceeding. For this reason, any attack on the validity of an extension agreement should be brought in the partnership proceeding.

(1) Authority of TMP to Extend Minimum Period

One of the major benefits to the IRS that was implemented as part of the TEFRA procedures was §6229(b)(1)(B), which allows the TMP or other authorized person[403] to extend the partnership item statute of limitations on behalf of all partners, i.e., the Minimum Period. This statute of limitations extension agreement may be obtained by the IRS on Form 872-O. Form 872-O provides an open-ended extension of the statute of limitations similar to Form 872-A for nonpartnership items. Form 872-N is used to terminate this open-ended extension. If the TMP wishes to limit the extension to a specified date, the TMP should request and sign Form 872-P.[404]

Practical Comment: When a partnership merges into another entity, the extension agreement probably remains valid, according to the Chief Counsel's Office, but the designation of the tax matters partner terminates upon merger (CCA 200245002).

By obtaining one of these statute extension agreements, the IRS may "control" the Minimum Period with respect to all partners' partnership items and affected items. The extension of the statute of limitations at the source partnership level applies to all tier and indirect partners.[405] This is of enormous benefit to the IRS in monitoring and coordinating the administrative aspects of the partnership audit.

The TMP must inform all notice partners of the extension within 30 days after the extension is given.[406] The TMP's authority is not statutorily limited, however. The statute extension cannot be withdrawn even if the notice partners object.

Because of the importance of the TMP's extension of the statute of limitations, it becomes absolutely critical for the IRS to correctly identify the partnership's TMP. If the IRS obtains a statute extension agreement from a person who is not the TMP of the partnership, that statute extension agreement does not operate to extend the Minimum Period.[407] In addition, if the TMP is compromised by a conflict of interest, an otherwise validly executed statute extension agreement may be invalidat-

[399] *See Gaughf Props. v. Commissioner*, 139 T.C. 219 (2012) (indirect partners not required to be listed on partnership return but their assessment period remains open until one year after IRS received identifying information), *aff'd*, 738 F.3d 415 (D.C. Cir. 2013) (IRS may use information in its possession that was provided for other purposes but is not obligated to search its records); *Costello v. United States*, 765 F. Supp. 1003 (C.D. Cal. 1991). *See also* Hamel v. Commissioner, T.C. Memo 2025-19 (Reg. §301.6229(e)-1 still valid interpretation of ambiguous statute); reconsidering T.C. Memo 2024-62 (Gaugh still binding precedent) *Taylor v. Commissioner*, T.C. Memo 1992-219. *But See*, *American Milling LP v. Commissioner*, T.C. Memo 2023-83 (Partner in tiered partnership not an indirect partner because operative issue a partnership item of the second-tier partnership).

[400] *Seaview Trading LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023). *See* Reg. §1.6031(a)-1(e)(1) (designating proper place to file federal partnership income tax return); *Winnett v. Commissioner*, 96 T.C. 802 (1991) (return must be filed at designated filing place). *See also Seaview Trading, LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023) (en banc) (partnership return faxed to IRS agent not considered "filed" because agent not designated place for filing and return never forwarded to proper place for filing), *aff'g* T.C. Memo 2019-122.

[401] §6229(c)(4).

[402] *See Candyce Martin 1999 Irrevocable Trust v. United States*, 739 F.3d 1204 (9th Cir. 2014).

[403] *See* FAA 20161801F (TMP or any other person with written authorization from partnership may execute consent to extend assessment period under §6229(b)(1)(B)).

[404] The forms used for S corporations, before repeal of application of these audit procedures to them by the 1996 Small Business Job Protection Act, were Form 872-R (general extension), Form 872-Q (open-ended extension), and Form 872-S (extension to specific date).

[405] CCA 201028037.

[406] Reg. §301.6223(g)-1(b)(1)(v), §301.6223(g)-1(b)(3).

[407] *Barbados #7 Ltd. v. Commissioner*, 92 T.C. 804 (1989). *But see Modern Computer Games, Inc. v. Commissioner*, 96 T.C. 839 (1991) (in absence of different designation by corporation, consent to extend limitations period signed by largest shareholder was valid, despite later appointment of different shareholder to serve as TMP); *Monetary II LP v. Commissioner*, 47 F.3d 342 (9th Cir. 1995) (extension valid where it was executed by former general partner who qualified as TMP under §6231(a)(7)); *Consol. Ltd. v. Commissioner*, T.C. Memo 1993-571 (extension of limitations period signed by corporate TMP not voidable by corporation even though corporation's president signed it while corporate powers were suspended for failure to file state franchise tax return); *Summit Vineyard Holdings, LLC v. Commissioner*, T.C. Memo 2015-140 (extension valid where signor had apparent authority; TMP had changed, but same individual controlled both former and present TMP such that the correct natural person, but wrong TMP, signed). *See also Phillips v. Commissioner*, 272 F.3d 1172 (9th Cir. 2001), *aff'g* 114 T.C. 115 (2000) (limitations period was extended and did not expire when taxpayer filed a voluntary petition in bankruptcy; TMP executed extension agreements for the years in issue).

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ed.[408] Accordingly, the TMP issues discussed in III.A.1., above, should be thoroughly analyzed in each case in which a TMP executes a statute extension agreement and any appropriate challenge should be made in the partnership proceeding.

Note that if the TMP is an entity, the statute extension is signed by whoever has the authority, under state law, to sign for the TMP.[409]

If the TMP files an individual bankruptcy petition, the TMP's status is automatically terminated. Uncertainty arose in some cases where a bankrupt TMP executed consents to extend the statute of limitations for the partnership. In these situations, an agreement by the TMP to suspend the statute of limitations is valid and binding on all of the partners in the partnership unless the IRS is notified of the TMP's bankruptcy.[410]

(2) Authority of Other Partners to Extend Minimum Period

There are two separate situations in which partners other than the TMP may execute agreements to extend the Minimum Period. First, the partnership may authorize someone other than the TMP to execute statute extension agreements for the partnership items of all partners.[411] The Regulations set forth one method for establishing this authorization. Under the Regulations, the partnership may authorize a person to extend the statute of limitations by filing a written statement with the IRS submission processing center where the partnership return was filed that:

- states that the statement is an express authorization for the person to extend the partnership item statute of limitations for all partners;
- specifies the identity of the partnership and the authorized person by name, address and taxpayer identification number;
- lists the partnership taxable years for which the authorization is effective; and
- is signed by all persons who were general partners in the partnership at any time during the year for which the authorization is effective.[412]

Comment: The specificity of this procedure for authorizing a person other than the TMP to extend the TEFRA partnership statute of limitations may actually hurt the IRS. If the IRS improperly identifies a partner as TMP, the IRS could argue that the person was nevertheless authorized by the partnership to extend the Minimum Period for all partners. A partnership's failure to follow the express provisions of the regulations, however, would seem to enable it to refute this argument.[413]

The Tax Court has recognized a second manner in which the partnership can authorize a person to execute the Minimum Period extension agreement. In *Cambridge Research & Dev. Group v. Commissioner*,[414] the Tax Court held that a signed partnership agreement giving general partners power of attorney for each limited partner was a writing within the meaning of §6229(b)(1)(B) sufficient to authorize the non-TMP general partner to extend the limitations period for all partners. The court stated that the authorization procedure set out in the regulations is permissive and does not constitute the only way to authorize a non-TMP to extend the statute on behalf of all partners. In addition, even if the partnership agreement is insufficient to grant authority, the partnership may be estopped by its conduct from challenging the authority of the partner to bind the partnership.[415]

(3) Extension of Maximum Period

The second situation in which a person other than the TMP may extend the partnership item and affected item statute of limitations applies on only an individual partner basis. Each partner may extend the Maximum Period with respect to that

[408] *Transpac Drilling Venture 1982-12 v. Commissioner*, 147 F.3d 221 (2d Cir. 1998), in which the Second Circuit reversed a Tax Court ruling that allowed a TMP who had been under criminal investigation by the IRS to execute extensions of the §6229 statute of limitations after the limited partners had refused to grant the extensions. The court stated that a TMP who was subject to pressure by the IRS labored under a conflict of interest and was thereby disqualified from binding the partnership. *Leatherstocking 1983 Partnership v. Commissioner*, 296 Fed. Appx. 171 (2d Cir. 2008) (unpub.), *rev'g* T.C. Memo 2006-164. Most cases hold that a TMP who was under criminal investigation for tax fraud was authorized to extend the period in which the IRS could assess against the partnership, because there was no evidence that the TMP was pressured to or did abandon his fiduciary duties. In *Phillips v. Commissioner*, 272 F.3d 1172 (9th Cir. 2001), *aff'g* 114 T.C. 115 (2000), the Ninth Circuit affirmed the Tax Court's ruling distinguishing *Transpac* and holding that the TMP (who was also the TMP in the bankruptcy court case mentioned above and was under a criminal tax investigation) executed valid extension agreements for the years in issue, and that the limitations period for those years had not expired when the taxpayer filed a voluntary petition in bankruptcy. *See also BCP Trading & Invs., LLC v. Commissioner*, 991 F.3d 1253 (D.C. Cir. 2021) *aff'g* T.C. Memo 2017-151 (extension signed by TMP after giving partners ample opportunity to object was valid; no undue influence where TMP did not dominate the other partners and no conflict of interest where TMP was not concerned about his potential criminal liability until after extensions were signed); *Mercado Global Opportunities Fund v. Commissioner*, T.C. Memo 2011-220 (criminal investigation of TMP not proved); *Madison Recycling Assocs. v. Commissioner*, T.C. Memo 2001-85 (criminal investigation did not create conflict), *aff'd*, 295 F.3d 280 (2d Cir. 2002); *Agri-Cal Venture Assocs. v. Commissioner*, T.C. Memo 2000-271 (same); *Shasta Strategic Investment Fund LLC v. United States*, 2014-2 USTC ¶ 50,383 (N.D. Cal. 2014) (same); *In re Olcsvary*, 240 B.R. 264 (Bankr. E.D. Tenn. 1999). Note that a conflict of interest may exist even without a criminal investigation. *See, e.g.*, *River City Ranches #1 Ltd. v. Commissioner*, 401 F.3d 1136 (9th Cir. 2005) (disabling conflict of interest may exist by TMP's ongoing fraud and theft committed against partners as TMP would have interest in extending statute to delay discovery of fraud or to curry favor with government; case remanded for further discovery). *But see Twenty-Two Strategic Investment Funds v. United States*, 859 F.3d 684 (9th Cir. 2017) (alleged duress by IRS did not invalidate partner's consent); *In re Martinez*, 564 F.3d 719 (5th Cir. 2009) (may have to prove that the IRS had reason to know the partners did not want the TMP to extend the statute of limitations).

[409] *See, e.g.*, CCA 201710028.

[410] §6229(b)(2).

[411] §6229(b)(1)(B).

[412] Reg. §301.6229(b)-1(a). Reg. §301.6229(b)-1(a)(4) addresses the signature requirement in the case of an LLC.

[413] *But see Madison Recycling Assocs. v. Commissioner*, T.C. Memo 1992-605.

[414] 97 T.C. 287 (1991). *See also Amesbury Apartments, Ltd. v. Commissioner*, 95 T.C. 227 (1990); *Agri-Cal Venture Assocs. v. Commissioner*, T.C. Memo 2000-271; TAM 200123010 (person authorized to act on behalf of partnership in power of attorney executed by general partner may execute consent to extend time to assess tax attributable to partnership items on behalf of partnership). *But see Med. & Bus. Facilities Ltd. v. Commissioner*, 60 F.3d 207 (5th Cir. 1995) (assessments against partnership were time-barred since general partner who executed consents extending limitations period was not authorized by partnership to act under §6229(b)).

[415] *Montelius v. Commissioner*, 145 F.3d 1339 (9th Cir. 1998) (unpub.); *Doyle v. Commissioner*, T.C. Memo 1997-396, *aff'd*, 202 F.3d 253 (3d Cir. 1999); *Georgetown Petroleum-Edith Forrest v. Commissioner*, T.C. Memo 1994-13; *Iowa Investors Baker v. Commissioner*, T.C. Memo 1992-490.

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partner by a separate written agreement which expressly states that the agreement applies to the tax attributable to the partner's partnership items and affected items.[416] An extension for a partner's tax year covers all TEFRA partnership tax years ending during the partner's tax year.[417]

One question that exists under the two-part statute of limitations rule is whether an ordinary Form 872 extends the Maximum Period. Formerly, Form 872 did not extend the Maximum Period. This is because §6229(b)(3) requires specific language in the statute extension agreement that makes the agreement expressly applicable to partnership items. The standard Form 872 now contains the language necessary to extend the Maximum Period for all of the partner's partnership items in all TEFRA partnerships.

f. Suspensions from IRS Summons

Suspension events can occur if the IRS issues a summons. These events impact only the Maximum Period, not the Minimum Period.[418]

The first suspension event occurs if a partner intervenes in a summons enforcement proceeding or petitions to quash a third-party summons for summonses relating to that partner. The Maximum Period is suspended for the entire time (including appeals) the summons case is pending.[419] This suspension arises only if the partner takes some affirmative act to challenge the summons. It does not appear, however, that the summons must relate to the partnership items in any way. The language of §7609(e)(1) is nonspecific. Therefore, petitioning to quash any summons for the partner's tax year would appear to suspend the Maximum Period for the partnership items in all of the partner's TEFRA partnerships for that year.

The second suspension event can occur even if the partner takes no action at all to resist the summons. Pursuant to §7609(e)(2), if a third party is served with a summons that is issued with respect to the partner's liability and does not provide a complete response within six months, the Maximum Period will be suspended from the date six months after the summons is served until the summons case is resolved. This rule applies in the case of a John Doe summons. Accordingly, if the IRS has a summons issued to a promoter or other third party to learn the identity of the investors, the Maximum Period will be suspended from the date six months after the summons is served until the promoter complies with the summons as required.[420] As with the other summons suspension event, it appears that the existence of one such event suspends the Maximum Period for all TEFRA partnerships as well as the partner's nonpartnership item statute of limitations.

g. Mitigation

Mitigation applies to TEFRA adjustments and would open the statute of limitations for making the correlative adjustments.[421]

h. Notable "Nonexceptions"

Section 6503 provides a list of events which suspend the nonpartnership item statute of limitations on assessment. With one exception, these §6503 suspension events are not incorporated as suspension events for the Minimum Period. The principal item in this category of "nonexceptions" is the suspension provided by §6503(h) when the taxpayer has filed a petition in bankruptcy. There is no corresponding provision which directly extends the partnership item, affected item or converted item statute of limitations in the event that the partnership files a bankruptcy petition.

The theoretical basis for the suspension provided in §6503(h) is that the automatic stay provided in 11 U.S.C. §362 prohibits the IRS from making an assessment for the period beginning on the bankruptcy petition date and ending on the date the debtor is discharged. Because the IRS may not assess during this period, the statute of limitations on assessment is correspondingly suspended. In the partnership context, however, the partnership proceeding does not result in an assessment against the partnership. Any assessment as a result of this proceeding occurs at the partner level. The automatic stay does not come into play and there is no reason to suspend the partnership proceeding because the assessment will not be made against the partnership.

A more problematic statute of limitations issue arises when a partner files a bankruptcy petition. The filing of the bankruptcy petition converts the partner's partnership items to nonpartnership items. See V.E., below, for further discussion of these bankruptcy issues.

i. Assessment for Returns with §965 Issues

The §965 net tax liability generally applies to tax years 2017 and/or 2018. Section 965(k) generally provides that the statute of limitations on assessment does not expire before six years after the tax return for the tax year is filed. The six-year statute is limited to assessment of the §965 net tax liability. A taxpayer may elect under §965(h) to pay the net tax liability in installments over an eight-year period. The amounts deferred under §965(h) are liabilities for and assessed in the original year of inclusion and not the year of payment. Thus, the §965(k) limitation period applies only to the §965(k) inclusion year, i.e., the six-year statute does not apply to years after the initial calculation of the net tax liability in which only the §965(h) installment payment is reported.

In PMTA 2020-008 (May 26, 2020), the IRS addressed the issue of the applicable period of limitations for making adjustments relating to §965 for TEFRA partnerships. The IRS Chief Counsel's Office concluded that provided no other extensions

[416] §6229(b)(3). *See Foam Recycling Assocs. v. Commissioner*, T.C. Memo 1992-645; *Candyce Martin 1999 Irrevocable Trust v. United States*, 739 F.3d 1204 (9th Cir. 2014) (where Son-of-Boss transaction resulted in upper-tier partnership having inflated basis in lower-tier partnership, FPAA adjustments made to lower-tier partnership are within confines of Form 872-I extension agreement that limited assessment to upper-tier partnership items because adjustments made to lower-tier partnership originated with upper-tier partnership); CCA 201418050 (Form 872 from individual partners meets requirement of §6229(b)(3); IRS need not get a consent from TMP because partnership is not a party to TEFRA proceeding).

[417] *WHO515 v. Commissioner*, T.C. Memo 2012-316, *aff'd*, 784 Fed. Appx. 790 (D.C. Cir. 2019) (unpub.).

[418] Section 7609(c) only expressly applies to the periods of limitation in §6501 and §6531 (relating to criminal prosecutions).

[419] §7609(e)(1).

[420] §7609(e)(2). *See Kligfield Holdings v. Commissioner*, 128 T.C. 192 (2007); *Epsolon v. United States*, 78 Fed. Cl. 738 (2007).

[421] CCA 201024061. *See* §1311.

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or suspensions of the limitations period on making assessments or adjustments apply, (1) assessments for all partners and all partnership items must be made within three years from the date the partnership return is filed (or the due date, if later), and (2) assessments for a specific partner who has a net tax liability described in §965(h)(6) must be made within six years from the date the partner's return was filed (or due date, if later).[422]

5. Partner-Level Proceeding

The general design of the TEFRA statute of limitations scheme is to have a period of time to reach a final resolution of the partnership proceeding then have at least a one-year period as provided by §6229(d) or §6229(f) in which to take the necessary action to assess the tax attributable to the partnership item adjustments. There are two ways that the partnership item adjustments become final as to the partner: (1) by a final determination at the conclusion of the partnership proceeding or (2) by a settlement with the partner. The procedures and periods of limitations which apply to assess the tax differ for each of these two types of resolution.

a. Computational Adjustments from Final FPAA

The partnership item adjustments become final as to a partner at the conclusion of a partnership proceeding in one of two ways. First, the adjustments become final 150 days after the FPAA is issued if no §6226 petition is filed contesting the FPAA. Second, if a §6226 petition is filed, the adjustments become final when the decision of the court becomes final (including expiration of applicable appeal periods). In either event, there is no conversion of partnership items to nonpartnership items, and the tax attributable to the partnership item adjustments is assessed as a computational adjustment.

This computational adjustment assessment must be made within the partnership item period of limitations. This period is the longer of the Minimum Period or the Maximum Period, as suspended by §6229(d). The tacking rules discussed in the preceding section apply to this period for making the computational adjustment. Accordingly, the assessment of tax must generally be made by the date one year after the determination in the partnership proceeding becomes final plus the tacking of the period remaining on the applicable period of limitations when the FPAA was issued.

b. Computational Adjustments from Settlement

The second way partnership item adjustments can result from a partnership proceeding is as a result of a settlement between the partner and the IRS. This can occur at the administrative stage or the litigation stage of the partnership proceeding.

When the IRS and the partner execute a settlement agreement for the partner's partnership items, the partner's partnership items convert to nonpartnership items.[423] Because the deficiency procedures do not apply to this type of converted item, the assessment is made by a computational adjustment without the prior issuance of a notice of deficiency.[424] The statute of limitations for assessment of these converted items apparently expires on the later of: (1) one year after the date on which the partnership items are converted to nonpartnership items or (2) the expiration of the partner's nonpartnership item statute of limitations.[425] The hallmark of the type of settlement agreement contemplated by §6231(b)(1)(C) is one that expressly addresses the individual partner's liability and/or conversion of partnership items into nonpartnership items.[426]

Under §6231(b)(1)(C), partnership items become nonpartnership items as of the date a partner enters into a settlement agreement with the IRS with respect to such items. The date the IRS signs the settlement agreement is generally considered the date of the conversion.[427] In the case of a partial settlement agreement, the assessment period for the items covered by the settlement agreement may be different than the assessment period for the remaining items. To avoid a fractured statute of limitations and the relating tracking problems, Congress in 1997 excluded partial settlements from the one-year limitations period. Thus, if a partner and the IRS enter into a settlement agreement for some but not all partnership items, the period for assessing any tax attributable to the settled items is determined as if the agreement had not been made.[428] As a consequence, the limitations period for the last partnership item to be resolved is controlling for all disputed partnership items for that taxable year. In addition, the partner remains subject to the unified audit procedures regarding the nonsettled items.[429] The conversion starts the running of the one-year period. The IRS and the part-

[422] *See* LB&I-04-0821-0010 (Aug. 20, 2021) (affecting IRM 4.31.2).

[423] A partner's settlement with the U.S. Attorney General (or a delegate) entered into after March 9, 2002, also creates converted items from settlement. §6231(b)(1)(C). The IRS does not enter into a settlement agreement with a partner when it enters into a settlement agreement with a tax matters partner. *See Davis v. United States*, 811 F.3d 335 (9th Cir. 2016).

[424] §6230(a)(2)(A)(ii). See VIII.B., below, for a discussion of the procedures for contesting a computational adjustment.

[425] §6229(f). Section 6229(f)(1) provides that the statute of limitations for assessing converted items "shall not expire before" one year after the conversion date. This is the same language which in §6229(a) was interpreted to create only a minimum partnership statute of limitations (see V.C.1., above). The conversion of partnership items merges the converted items with the partner's nonpartnership items. In theory, one notice of deficiency could be issued to assert deficiencies with respect to both nonpartnership items and converted items. Any interpretation of §6229(f) as creating a separate converted item statute of limitations does not make sense in this situation. *See also Crnkovich v. United States*, 202 F.3d 1325 (Fed. Cir. 2000) (stipulation of settlement entered in Tax Court case was a "settlement agreement" under §6231(b)(1)(C), converting the tax items from partnership to nonpartnership items, and triggering applicable limitations period in §6229(f); IRS did not timely assess the tax within one year of executing the settlement agreement, so court held for a taxpayer in the refund suit); *Aufleger v. Commissioner*, 99 T.C. 109 (1992) (where items become non-subchapter-S items, statute is extended for one year from date of conversion).

[426] *Compare Crnkovich v. United States*, 202 F.3d 1325 (Fed. Cir. 2000) (partnership items were converted into nonpartnership items because some partners had entered into Form 906 closing agreements and other partners had entered into stipulation agreements that were the product of the IRS's decision to resolve certain issues at the individual partner level) *with Mathia v. Commissioner*, 669 F.3d 1080 (10th Cir. 2012) (agreement and stipulation at issue by their express terms dealt only with treatment of partnership items and were entered into by and with partnership alone and made no mention of plaintiff's individual liability).

[427] *See Estate of Ray v. Commissioner*, T.C. Memo 1995-561, *aff'd*, 112 F.3d 194 (5th Cir. 1997); *Gingerich v. United States*, 77 Fed. Cl. 231 (2007).

[428] §6229(f)(2); Reg. §301.6229(f)-1. In addition to partnership items, under the final regulations, "partnership-level determinations of penalties, additions to tax or additional amounts" are also items to which this provision applies. The corresponding temporary regulations were limited to partnership items.

[429] *See* Reg. §301.6229(f)-1(b).

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ner may agree to an extension of the §6229(f) one-year period after conversion by executing Form 872-F.[430]

D. Affected Items

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Section 6229(a) specifically applies the partnership item statute of limitations to all affected items. The extension of the partnership item statute of limitations to these affected items is necessary by definition. Because the affected items are affected by partnership items, those affected items cannot be properly determined until after the final determination of the partnership items.

Because the affected item adjustments piggyback on the partnership item adjustments, the affected item statute of limitations is in most instances identical to the partnership item statute of limitations. Accordingly, the same analysis of the Minimum Period and the Maximum Period must be made in determining the affected item statute of limitations.

One of the key issues in determining the affected item statute of limitations is often the suspension caused by the issuance of the FPAA. Because the prevailing rule dictates that the timeliness of the FPAA is an issue that must be litigated in the partnership proceeding, it appears that any challenge on this issue will be barred by the time the affected item notice of deficiency is issued.[431] While the partner generally may not challenge the timeliness of the FPAA in the context of challenging the timeliness of the affected item notice of deficiency, however, the partner can challenge the timeliness of the affected item notice of deficiency based on events occurring after the Tax Court decision is entered.[432]

Comment: This apparent bar from challenging the timeliness of the FPAA in an affected item notice of deficiency proceeding is troubling. Historically, the IRS has done a much better job of issuing affected item notices of deficiency to a good address than they have with copies of the FPAA. This is because there appears to be no "last known address" obligation for issuing copies of the FPAA to notice partners. If the FPAA is not received, barring the partner from raising the validity and timeliness of the FPAA as it impacts the affected item statute of limitations might violate due process.

Even though the affected item statute of limitations is the same as the partnership item statute of limitations, different actions are required before the assessment of certain affected items. As discussed in III.B.2., above, there are two different types of affected items. Each type of affected item differs in the application of the affected item statute of limitations and in the nature in which affected item adjustments are made.

The affected items that are purely "computational" can be assessed without the prior issuance of a notice of deficiency. These "computational affected items" can be assessed as part of the computational adjustment process within the same time period as the partnership item computational adjustments discussed in the preceding section.[433]

Certain affected items, however, require a substantive determination at the partner level.[434] This second type of "substantive affected item" requires the issuance of an "affected item notice of deficiency" before adjustment. This causes two relevant statute of limitations periods to apply: (1) the statute of limitations for issuing the affected item notice of deficiency and (2) the period of limitations in which to assess the tax after the affected item statute of limitations is issued.

The period in which the IRS may issue the affected item notice of deficiency is the same as the period of limitations for making computational adjustments of partnership items and computational affected items. Accordingly, this statute of limitations is the same as the partnership item statute of limitations determination in the preceding section.[435] It is not necessary for the IRS to conduct a partnership proceeding to issue an affected item notice of deficiency, however, so long as the basis of the affected item notice of deficiency does not require partnership item determinations.[436]

Once it has been determined that the affected item notice of deficiency is timely, the validity of the affected item notice of deficiency and its effect on the ultimate period of limitations for assessing substantive affected item adjustments must be examined. The affected item notice of deficiency is treated as a normal notice of deficiency in most respects.[437] The recipient of an affected item notice of deficiency is given the opportunity to file a petition in Tax Court before assessment of the affected items. There appear to be two slightly different statute of limitations rules depending on whether the IRS is relying on the Minimum Period or the Maximum Period as the applicable period of limitations, however.

If the IRS is relying on the Maximum Period, the period of limitations should be subject to the suspensions set forth in §6503. The two major suspensions are: (1) the suspension in §6503(a)(1) that starts when the affected item notice of defi-

[430] *See* FSA 200125014.

[431] *Bedrosian v. Commissioner*, 940 F.3d 467 (9th Cir. 2019) (partner's statute of limitations challenge to FPAA must be raised at partnership level).

[432] *Ghase v. Commissioner*, T.C. Memo 2008-80; *Hirshfield v. United States*, 177 F. Supp. 2d 220 (S.D.N.Y. 2001).

[433] §6229(d).

[434] *See N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987); *Maxwell v. Commissioner*, 87 T.C. 783 (1986).

[435] *Ochsner v. Commissioner*, T.C. Memo 2010-122.

[436] §6229(a), §6229(d); *Meruelo v. Commissioner*, 691 F.3d 1108 (9th Cir. 2012) (IRS may issue a notice of deficiency during the normal period of limitations applicable to a TEFRA entity when at the time of such issuance the IRS has accepted the TEFRA entity's return as filed); *Roberts v. Commissioner*, 94 T.C. 853 (1990); CCA 202020001 (IRS may adjust affected item at partner level without opening partnership-level examination if partnership return is accepted as filed; in adjusting basis, IRS cannot change any of the partnership-item components of outside basis without opening a TEFRA proceeding; IRS may adjust overall computation of outside basis and any nonpartnership item components of outside basis); CCA 201447031 (IRS cannot dispute Tier 1 partnership items on Form K-1 it issued to Tier 2 that Tier 2 used to compute its outside basis in Tier 1; IRS must open TEFRA proceeding for Tier 1 in order to dispute Tier 1's partnership items).

[437] To avoid the "no second notice of deficiency" rule of §6212(c), it was necessary to specify in §6230(a)(2)(C) that the affected item notice of deficiency does not count as a notice of deficiency for purposes of §6212(c).

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ciency is issued and ends 60 days after the determination in the notice of deficiency becomes final; and (2) the suspension in §6503(h) from the date a bankruptcy petition is filed until 60 days after the automatic stay is lifted.

If the IRS relies on the Minimum Period, the result is largely the same but the analysis is slightly different. The same two major suspensions exist. The §6503(a) suspension from issuing the affected item notice of deficiency is made expressly applicable to the §6229(d) period of limitations.[438] In addition, the bankruptcy suspension is for the same period but results from §6229(h), not §6501(h).

E. Converted Items

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Converted items are discussed more fully in III.B.4., above. One major type of converted item occurs when the partner enters into a partnership item settlement with the IRS. The statute of limitations for this type of converted item is more appropriately considered as part of the partnership item statute of limitations. See V.C.5.b., above, for further discussion of these issues. The remaining converted items have special deficiency procedures that apply after conversion. These items are partnership items which have been converted to nonpartnership items either automatically or by election upon the occurrence of certain specified events. The two types of these converted items are: (1) deficiency converted items and (2) special enforcement area converted items. While these two types of converted items are distinct, the statute of limitations rules are the same for each type.

Both types of converted items are subject to a special deficiency procedure. This procedure requires that the IRS issue a converted item notice of deficiency to assess the tax resulting from the converted item adjustments.

The same two-part statute of limitations analysis exists for deficiency converted items as is discussed above for converted items from a settlement: (1) a one-year minimum period of limitations, and (2) if longer, the partner's nonpartnership item statute of limitations.

The one-year minimum period of limitations is provided in §6229(f)(1). This section contains the same "shall not expire before" language as exists in §6229(a) for partnership and affected items. Accordingly, this should be construed as a minimum period in which the converted item notice of deficiency can be issued. Section 6229(f)(1) expressly provides that this one-year minimum period can be extended by agreement. The issuance of a converted item notice of deficiency suspends the §6229(f)(1) limitations period if the §6501 statute of limitations for asserting nonpartnership item adjustments has expired on the conversion date.[439]

If the one-year minimum period of limitations has expired, the IRS can still issue a timely converted item notice of deficiency if the nonpartnership item partner statute of limitations is still open. Accordingly, the nonpartnership item statute of limitations must be analyzed if the various minimum periods of limitation set forth in §6229 have expired.

As with the affected item notice of deficiency, §6230(a)(2) circumvents the "no second notice of deficiency" rule of §6212(c) for converted item notices of deficiency. Without this provision, the partner could have received a §6212 notice of deficiency, petitioned the Tax Court and had the adjustments resolved by entry of a decision before the conversion of certain partnership items to nonpartnership items. In this situation, §6212(c) would prohibit the issuance of a notice of deficiency with respect to these converted items. Section 6230(a)(2) avoids this unintended prohibition by effectively not counting the converted item notice of deficiency as a notice of deficiency for this purpose. The converted items in separate partnerships need not be aggregated into one converted item notice of deficiency. Section 6230(a)(2)(B) states that §6230(a)(2) applies separately to the converted items from each partnership. Accordingly, each partnership's converted items may be included in a separate converted item notice of deficiency, and the issuance of a second converted item notice of deficiency for a second partnership is not barred by §6212(c).

Because of their nature, special enforcement area converted items will typically be included in a nonpartnership item notice of deficiency that is issued within the nonpartnership statute of limitations. Nevertheless, the same one-year extension provided in §6229(f) applies to special enforcement area converted items (within the meaning of §6231(c)) because such items are incorporated into §6229(f) by virtue of §6231(b)(1)(D).

The bankruptcy special enforcement area presents a special issue in determining which partnership items are converted by the filing of a bankruptcy petition by a partner. The following example illustrates this issue.

> *Example:* X is a partner in P Partnership. Both X and P Partnership file their respective 2009 returns on April 15, 2010. On April 1, 2012, the TMP for P Partnership executes Form 872-P extending the Minimum Period to Dec. 31, 2014. X does not extend X's nonpartnership item statute. On September 28, 2014, X files a bankruptcy petition.
>
> There are two possible answers to the problem presented in this example. First, a literal reading of the applicable regulations seems to indicate that X's 2009 P Partnership items would convert only if the IRS could file a claim in X's bankruptcy for X's 2009 tax year.[440] Because the IRS can file a claim for X's 2009 tax year only if X's nonpartnership item statute of limitations is open (which is not the case in the example), it would appear that X's 2009 P Partnership items would not convert.

[438] §6503(a), §6230(a)(2)(A)(i).

[439] §6503(a), §6230(a)(2)(A), §6231(b)(1)(A), §6231(b)(1)(B), §6231(b)(1)(D), §6231(e)(1)(B).

[440] Reg. §301.6231(c)-7(a).

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It appears, however, that this literal interpretation is not correct. One of the principal purposes of the bankruptcy conversion provision is to immediately drop the partner out of the partnership proceeding as of the filing of the bankruptcy petition. This avoids any question of whether the automatic stay of 11 U.S.C. §362 suspends the partnership proceeding for the duration of the bankruptcy.

To accomplish this purpose under the facts presented by the example, Reg. §301.6231(c)-7 must be construed as incorporating the special one-year limitations period of §6229(f)(1) into the definition of "the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding." Section 6229(f)(1) gives the IRS one year from the date of conversion to issue a notice of deficiency for the converted items. Therefore, on the facts presented, the IRS could file a claim for X's 2009 converted items from P Partnership any time on or before September 29, 2015. This interpretation of the provisions allows partnership items to convert in any open TEFRA proceeding and prevents the bankruptcy automatic stay of one partner from tying up the entire TEFRA proceeding.

Another bankruptcy issue arises when only one spouse files for bankruptcy. It appears in this situation that the partnership items of the spouse who does not file for bankruptcy do not convert.[441]

There is one additional limitation on the conversion of special enforcement area converted items based on the status of the partnership items before conversion. The partnership items do not convert if an FPAA has been issued and the FPAA adjustments have become final either because no partner filed a petition to contest the FPAA or because there has been a final decision in a contested case.[442] A conversion may still occur, however, if no FPAA has been issued and the Minimum Period has expired.

Example: X (a partner in P Partnership) and P Partnership (a TEFRA partnership) file their respective 2013 returns on April 15, 2014. P Partnership is not audited. On June 14, 2017, the IRS notifies X that he is under criminal investigation for suspected fraud on his 2013 return unrelated to P Partnership. Even though the Minimum Period has expired, a conversion will occur. The P Partnership items would become nonpartnership items and, if the IRS could establish a 25% omission of income or fraud with respect to X, the nonpartnership item statute of limitations would allow an adjustment of the converted P Partnership items.

F. Nonpartnership Items

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The nonpartnership item statute of limitations is not affected by the TEFRA partnership audit procedures. Accordingly, the general non-TEFRA rules illustrated in the Worksheets apply to the nonpartnership item adjustments on the partner's tax return. As discussed above, however, difficulties sometimes arise concerning which items are partnership items, affected items and nonpartnership items.[443] Because separate statute of limitations rules apply to each of these three categories, this classification issue is critical.

G. Refund Statutes

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The statutes of limitation rules for refunds vary depending on the procedural context in which the refund claim arises. There are at least seven separate situations in which a refund claim can arise:

- the TMP files a "substituted return" AAR under §6227(c)(1),
- the TMP files a "claim for refund" AAR under §6227(c)(2),
- any partner files an AAR with respect to that partner's partnership items under §6227(d),
- the IRS and a partner enter into a settlement agreement which results in a refund,
- the IRS issues an FPAA which results in a refund to the partners,
- a court proceeding contesting an FPAA or AAR determines a refund to the partners, and
- the partner's items are converted to nonpartnership items and a nonpartnership item claim for refund is filed.

In each of the first three situations, the AAR constitutes the claim for refund. See IX.B., below, for the statute of limitation rules for filing these AARs. In addition, if the AAR is filed before the IRS mails the FPAA, a special statute of limitations

[441] *First Blood Assocs. v. Commissioner*, T.C. Memo 1998-138, *appeal dismissed sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002) (binding closing agreement precluded appeal).

[442] Reg. §301.6231(c)-3(a).

[443] For example, SCA 1998-013 addressed the extent to which changes to the base year income of a partner who had elected income averaging could be taken into account, even though the §6501 limitations period for that tax year had run, in computing the partner's share of partnership adjustments determined by the Tax Court after the partnership had extended its period for assessment. The National Office advised that adjustments otherwise barred by §6501 could not be asserted when making computational adjustments to the partner's tax liability under §6231(a)(6), but they could be taken into account to compute the tax arising from the partnership adjustments even though only tax attributable to the partnership adjustments could be assessed.

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for filing an AAR applies to deductions by a partnership that are related to worthless securities or bad debts.[444]

The claim for refund that arises from a settlement agreement, FPAA, or court proceeding is necessary only if the IRS does not properly process the case. In each of these situations, the IRS is supposed to compute the effect of the partnership-level determination on the partners and issue a notice of computational adjustment and refund to the partners.[445] If the IRS fails to issue the refund or incorrectly computes the amount of the refund, however, the partner can file a claim for refund. If the refund is incorrectly computed, or if the IRS fails to issue the notice of computational adjustment and refund altogether, the partner's claim must be filed within two years after: (1) the date the settlement agreement is executed; (2) the date on which the period to petition from the FPAA expires; or (3) if a petition contesting the FPAA or the denial of an AAR is filed, the date on which the court's decision becomes final.[446]

Comment: This provision appears to cover any situation in which the IRS has not made a refund in an amount equal to the overpayment attributable to the partnership item adjustments.

If the claim for refund is not allowed in full, the partner may file a refund suit at any time from the date six months after the claim is filed to the date one day less than two years after the notice of claim disallowance is mailed by the IRS.[447]

The final claim for refund situation arises after the partner's partnership items have been converted to nonpartnership items. After a partner's partnership items are converted to nonpartnership items, any claim for refund of those items is subject to the non-TEFRA refund procedures. These procedures generally require the refund claim to be filed within the later of three years after the date the partner's return was filed or two years after the tax was paid.[448] If the partner enters into a statute of limitations extension agreement for nonpartnership items, the nonpartnership item refund claim statute does not expire until six months after expiration of the period of extension under the agreement.[449]

Note: It is not clear, however, whether a nonpartnership item extension agreement would cover partnership items which are converted to nonpartnership items after execution of the agreement.

A potential problem arose if the partner's partnership items were converted to nonpartnership items after expiration of the §6511 refund claim period. This could easily happen if the TMP granted an extension of the partnership item statute of limitations under §6229(b)(1)(B). While the partner was protected by the special rules provided for the settlement agreement, FPAA, and court proceeding situations discussed above, if the partner remained in the partnership proceeding to its conclusion, or if the partner's partnership items were converted before conclusion of the partnership proceeding, the partner could not file a claim for refund. This was true because: (1) an extension agreement for partnership items under §6229(b)(1)(B) did not extend the §6511 nonpartnership item refund statute and (2) the automatic one-year converted item extension in §6229(f) did not apply to refund claims. The partner also could not file an AAR under §6227(c) because the AAR applied only to partnership items. The partner had no partnership items after conversion. Even if the partner could file an AAR under §6227(c) before conversion of the partnership items to nonpartnership items, the partner could not file a suit contesting the AAR disallowance unless the IRS had not issued an NBAP to the partnership.[450] Because this statute of limitations problem typically arose only when the partnership item statute of limitations had been extended (an event that usually occurred after the NBAP had been issued), the §6227(c) AAR rarely provided relief to the partner in this situation. The only apparent way for a partner to protect potential converted item refund claims under former law was for the partner to file a protective claim for refund within the §6511 period of limitations. This would be a protective claim because, at the time the claim was filed, the conversion was only a potential future event. This procedure required altogether too much foresight on the partner's behalf. The Taxpayer Relief Act of 1997 remedied this situation by adding §6227(b), which provides that if an agreement is entered into concerning a TEFRA statute of limitations, that agreement also extends the statute of limitations for filing a refund claim attributable to converted items or affected items until six months after the expiration of the §6229 statute of limitations on assessments.[451]

[444] §6227(e).
[445] §6231(a)(6).
[446] §6230(c)(2)(B).
[447] §6230(c)(3), §6532(a).
[448] §6511(a).
[449] §6511(c)(1).
[450] §6228(b)(1), §6231(b)(3), §6228(b)(2)(c).
[451] *See* §6227(b).

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VI. Administrative Stages of Partnership Proceeding

A. Overview

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

As illustrated in the Worksheets, below, the administrative phase of the TEFRA partnership audit has many similarities to the audit procedures in non-TEFRA cases. Certain procedural differences arise, however, due to the unified nature of a TEFRA partnership audit. These unified audit procedures are discussed in this Chapter and Chapter VII. This section discusses the administrative stages in a typical partnership audit. Chapter VII. focuses on the procedures for judicial proceedings at the conclusion of the administrative stage.

The primary administrative stages in a partnership proceeding are:

- issuance of the NBAP by the IRS,
- the audit conducted by the IRS Examining Agent,
- the 60-day letter issued at the conclusion of the audit,
- the conference with IRS Appeals,
- the administrative settlement (if any), and
- the issuance of the FPAA.

In addition to these stages of the partnership proceeding, it is important to have an understanding of the manner in which the administrative phase of the partnership proceeding is handled both by the TMP and by the IRS. This section explores these issues as well as discusses the administrative stages in the partnership proceeding.

B. Role of the TMP

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TMP is charged with full administrative responsibility for the partnership's participation in the partnership proceeding. The TMP is the focal point for IRS contact and is responsible for keeping the other partners informed of the status of the proceeding. The TMP may execute an agreement to extend the statute of limitations for all partners' partnership and affected items. The TMP also has the authority to execute settlement agreements in the administrative phase of the partnership proceeding which bind certain non-notice partners. The issues concerning the appointment, replacement, duties, and practical problems for the TMP are discussed more fully in III.A.1., above.

C. Right of Other Partners to Participate or Waive Rights

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The rights of partners other than the TMP to participate in the partnership proceeding have two components: (1) the right to information concerning the status of the proceeding and (2) the right to attend certain important administrative conferences. The partners can also waive these rights and most of the partners' other rights under the TEFRA procedures.

1. Right to Information

The Code and regulations establish a mechanism to ensure that the partners other than the TMP are adequately informed of the status of the partnership proceedings. This mechanism provides for the following information to be provided from the sources indicated:

Item of Information	Provider
NBAP (Notice Partners)	IRS
NBAP (Non-notice Partners)	TMP
Time and place of closing conference with examining agent	TMP
60-day Letter (Notice Partners)	IRS
60-day Letter (Non-notice Partners)	TMP
Time and place of IRS Appeals conference	TMP
IRS acceptance of settlement offer	TMP
TMP's consent to statute extension	TMP
FPAA (Notice Partners)	IRS
FPAA (Non-notice Partners)	TMP
Filing a petition contesting the FPAA	TMP
Judicial redetermination of an FPAA	TMP
Filing a judicial appeal	TMP
Filing an AAR on behalf of the partnership	TMP
Filing a petition contesting denial of an AAR	TMP[452]

In addition, if the partner is an indirect partner who has not filed the §6223(c) identification statement, the above information is provided to the pass-thru partner. The pass-thru partner is then obligated to forward the information to the indirect partner.[453]

[452] §6223(a); Reg. §301.6223(g)-1(a), §301.6223(g)-1(b), §301.6227(c)-1(b).

[453] Reg. §301.6223(h)-1(a).

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As can be seen from this table, the TMP is charged with substantial responsibilities concerning the dissemination of information to the other partners. The other partners have little recourse, however, if the TMP fails to fulfill these obligations. A failure by the TMP to inform the other partners of the events occurring in the partnership proceeding does not allow the uninformed partners to "drop out" of the proceeding and resolve the issues separately with the IRS.[454] While the other partners may have legal grounds for an action against the TMP for any failure to provide them with information, the Code provides no recourse to recover any losses the partners may sustain by reason of such failure.

Comment: While in theory the other partners are entitled to participate fully in the partnership proceeding, the lack of any recourse for their de facto exclusion by reason of the TMP's malfeasance is an extremely troublesome feature of the TEFRA partnership audit procedures. The absence of any procedural options for the TMP's failures may be vulnerable to challenge on constitutional grounds.

2. Right to Attendance

In addition to the right to be informed of key events in the administrative proceeding, all partners have a right to attend certain important conferences. The right to participate is not limited to notice partners.[455] The first important conference is the closing conference with the examining agent. The TMP is obligated to inform the other partners of the time and place of this meeting and all partners are allowed to attend the conference.[456] The partners' attendance must be coordinated through the TMP, however, and arrangements will not generally be changed for the convenience of partners other than the TMP.[457] Unless the TMP provides detailed information during the audit, this is the first stage in the partnership proceeding where the other partners receive substantive information concerning the IRS's position in the proceeding. Attendance at this conference also allows the other partners the opportunity to ascertain which information has been provided to the IRS by the TMP.

The second significant administrative conference is the conference with IRS Appeals after issuance of the 60-day letter. While the notice partners receive a copy of the 60-day letter directly from the IRS, the TMP is responsible for informing all partners of the time and place of the Appeals conference. All partners are entitled to attend this appellate conference.[458] This conference is typically the first opportunity for the partnership and the IRS to engage in settlement negotiations. Whether the partners attend this conference or not, however, all partners will be given the opportunity to accept the same settlement terms as are agreed to by the TMP and the partners who attend the conference.[459]

3. Waiver of Rights

The partner may also waive any rights granted by the TEFRA procedures. Section 6224(b) authorizes the partner to waive any right and any restriction imposed on the IRS. This waiver power presumably extends to: (1) notice provisions, (2) information requirements, and (3) restrictions on assessment. The partner cannot, however, "waive out" of the TEFRA procedures altogether and have all partnership items treated as nonpartnership items. The TEFRA procedures establish a detailed framework which binds both the partner and the IRS to a consistent treatment and a unified proceeding unless one of the specific statutory exceptions applies. Section 6224(b) is not one of these express exceptions.

To waive the partner's waivable rights under TEFRA, the partner must file a form with the IRS. The form must: (1) be identified as a §6224(b) waiver; (2) identify the partner and the partnership; (3) specify the rights or restrictions being waived and the taxable years for which the waiver is effective; and (4) be signed by the partner. The form is filed with the IRS where the partnership return was filed unless the partner knows that an NBAP has already been sent to the TMP. In this case, the form must be filed with the IRS office which issued the NBAP. A waiver between partners (e.g., in the partnership agreement) will not be recognized as a §6224(b) waiver because the waiver form must be filed with the IRS.[460]

D. IRS Case Handling

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The manner in which the IRS processes TEFRA partnership cases has two significant aspects: (1) the mechanical case processing, and (2) the statutory requirements concerning the "information base."

1. Case Processing

See the Worksheets, below, for a timeline presentation of the stages in a typical partnership audit proceeding and a flowchart of TEFRA key case procedures.

Partnership returns are generally selected for audit by the IRS submission processing center where the partnership return is filed. The partnership return is sent for initial review by an IRS Tax Examiner or Revenue Agent. The Revenue Agent issues an NBAP to the TMP typically accompanied by a request for certain items of information. Within 45 days after issuing the NBAP to the TMP, the Revenue Agent must make a preliminary determination as to whether an audit should be pursued, as required by Reg. §301.6223(a)-2(a). If no audit is pursued, the Revenue Agent informs the TMP of this determination and forwards the case file through the appropriate channels for the

[454] §6230(f).

[455] §6224(a).

[456] §6223(g); IRM 8.19.10.5.6. See VI.F., below, for further discussion of this conference.

[457] Reg. §301.6224(a)-1(a).

[458] §6224(a); IRM 8.19.10.5.6.

[459] §6224(c)(2). See IV.B., above, for further discussion of the consistent settlement requirement.

[460] Reg. §301.6224(b)-1.

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issuance of a letter withdrawing the NBAP.[461] If the Revenue Agent determines that a partnership audit should be pursued, the Agent completes Form 14090, *TEFRA Electronic Linkage Check Sheet (LB&I)*, or Form 14091, *TEFRA Electronic Linkage Check Sheet (SBSE)*. This package is designed to institute the controls on the partners' returns through the Partnership Control System (PCS).[462] The PCS contains flow-through entity and related investor records, establishes linkage between the entity and investors nationwide, and generates the various TEFRA notices and letters.[463]

A partner's return can have issues unrelated to the partnership audit. These are handled by the non-TEFRA Area. If the non-TEFRA Area resolves the unrelated issues before the TEFRA issues are resolved, the non-TEFRA Area closes the non-TEFRA issues using the normal closing procedures. Any assessments or refunds are processed as a partial assessment.[464] If the TEFRA partnership audit is concluded before resolution of the audit of the unrelated items, different procedures apply depending on whether Joint Committee review is required.[465]

The Flow-Through Area is responsible for completing the TEFRA partnership audit. The Revenue Agent gathers the necessary information and makes determinations which are incorporated into the proper notice package explaining the proposed adjustments. The notice package is issued to the TMP.[466] The TMP is given the opportunity to attend a closing conference with the Revenue Agent. After the closing conference, the Agent finalizes and forwards the Revenue Agent's Report (RAR) to Technical Services for review. Closing procedures differ depending on whether a Tax Court petition is filed.[467]

2. Information Base

The second significant aspect of the processing of the TEFRA partnership audit case is the partnership's "information base." The information base is essentially the body of information that the IRS must incorporate into the processing of the partnership case. The IRS maintains its record of the information base on Form 886-Z(C).

The IRS uses the information base to determine which partners are entitled to receive the notices provided by the TEFRA procedures. Section 6223(c)(1) specifies that the principal information base is the names, addresses, and profits interests shown on the partnership return. The partnership return typically discloses all of the information that the IRS needs to make the determination as to which partners are entitled to the TEFRA notices.

In certain situations, however, the information disclosed in the partnership return is not sufficient for the IRS to make the necessary notice determinations. In these situations, the TMP is required to provide a list containing the name, address, profits interest, and taxpayer identification number of all persons who were partners during the year under examination. In addition, if the TMP becomes aware that any of the information on the partnership return or previously provided to the IRS is inaccurate or incomplete, the TMP must inform the IRS of the correct information within 15 days.[468]

The notification procedures set out in §6223 in connection with TEFRA's unified audit provisions are calculated to apprise all partners of tax adjustments and administrative proceedings involving the partnership.[469] Court have held that the TEFRA notice procedures sufficiently assure partners the notice and opportunity to be heard that is due under the Constitution before their property rights may be adjusted.[470]

Reg. §301.6223(c)-1 specifies the manner in which information may be submitted to the IRS to correct or supplement the IRS information base. Any person may furnish additional information to the IRS by filing a written statement which:

- identifies the partnership, each affected partner, and the person supplying the information by name, address, and taxpayer identification number;
- explains that the statement is furnished to correct or supplement earlier information;
- specifies the taxable year to which the information relates;
- sets out the correct or additional information; and
- is signed by the person supplying the information.

The written statement must be self-contained and cannot incorporate by reference previously furnished information such as a pass-thru partner's previously filed partnership return.[471] However, the person may make reference to a prior general notification to the IRS that the purported TMP is a bankruptcy debtor or has had a receiver appointed in a receivership proceeding if a copy of the notification document referenced is attached.[472]

The statement must be filed with the IRS submission processing center where the partnership return was filed unless the person filing the statement knows that an NBAP has been issued to the TMP. In this event, the statement must be filed with the IRS office that mailed the NBAP. If the statement is filed by the TMP, the IRS must incorporate the information into the information base within 30 days after receipt. If the statement is furnished by someone other than the TMP, however, the IRS is not required to incorporate the information until 30 days after appropriate verification of the information has been

[461] IRM 4.31.2.3.9.1.

[462] IRM 4.31.2.1.1 (4-10-23); IRM 4.31.2.1.6. Beginning June 1, 2018, all LB&I TEFRA partnership examinations require a linkage plan. LB&I 04-0518-010 (May 30, 2018).

[463] IRM 4.29.1.2.

[464] IRM 4.31.3.5.8.3(1).

[465] IRM 4.31.3.5.8.1.

[466] *See* IRM 4.31.3.6. *et seq.*

[467] IRM 4.31.3.7.2.1. *See also* IRM 4.31.3.7.2.4.

[468] Reg. §301.6230(e)-1.

[469] *See Kaplan v. United States*, 133 F.3d 469 (7th Cir. 1998) (TEFRA's unified audit provisions did not violate the equal protection and due process rights of partners who were not notice partners and who, without having been notified by tax matters partner, were assessed deficiencies resulting from disallowance of their distributive share of partnership deductions).

[470] *Camacho v. United States*, 195 B.R. 114 (D. Alaska 1996) (because taxpayer's name was not listed on tax returns of top-tier partnerships as an indirect partner of pass-through partnerships, or in any other capacity, and since neither top-tier partnerships, nor anyone else, furnished IRS with separate notice of the taxpayer's interest in top-tier partnerships, taxpayer was not entitled to notice of administrative proceedings affecting top-tier partnerships); *Walthall v. United States*, 911 F. Supp. 1275 (D. Alaska 1995), *aff'd*, 131 F.3d 1289 (9th Cir. 1997).

[471] Reg. §301.6223(c)-1(b), §301.6223(c)-1(c).

[472] Reg. §301.6223(c)-1.

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furnished.[473] For partnership proceedings commenced on or after January 2, 2002, the IRS accepts information from a properly designated power of attorney in the same manner as if the information were submitted by the TMP.[474]

The IRS is also authorized (but not required) to incorporate other information in its possession into the information base.[475] For example, the IRS may use a change of address reflected on a partner's return in mailing a TEFRA partnership notice. The IRS is not obligated, however, to search its records for information that is not furnished by means of the written statement discussed above.[476] As a routine practice, however, the IRS will typically perform a search of its computer records for the partnership's address before issuance of an FPAA to ensure that the FPAA is issued to the last known address of the partnership. The IRS does not typically perform such a search to ensure that the FPAA is sent to a notice partner's last known address, however. Because the FPAA is such a critical document, the partners should follow these notification procedures any time there is a change of address to ensure that the IRS utilizes the most accurate mailing address for the TEFRA notices.

E. Notice of Beginning of Administrative Proceeding (NBAP)

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

As the name implies, the Notice of Beginning of Administrative Proceeding (NBAP) constitutes the formal notice by the IRS that a partnership audit has been commenced. The primary purpose of the NBAP is to inform all of the notice partners and notice groups of the commencement of the partnership audit. Because of the various notice periods and case processing requirements, the IRS will not generally commence a partnership proceeding when less than one year remains on the statute of limitations Minimum Period.[477]

1. NBAP to TMP and Preliminary Review

The first formal contact between the IRS and the partnership occurs when the IRS issues an NBAP to "The Tax Matters Partner" at the partnership address.[478] This "generic" NBAP will be issued by the IRS even if there is a formal designation of the TMP on the partnership return. The IRS may, however, issue a duplicate NBAP to the partner designated as TMP at that partner's address.

Within 45 days after the issuance of the NBAP to the TMP, the IRS makes a preliminary review and investigation of the partnership return to determine whether to pursue a full-fledged partnership proceeding.

Note: The internal IRS procedures give the Revenue Agent 30 of these 45 days to make a preliminary determination. The remaining 15 days are apparently for review of the Agent's determination and issuance of the withdrawal letter.

During this 45-day period, the IRS will not issue an NBAP to the other partners. The IRS attempts to obtain sufficient information from the TMP to make a determination about the audit potential of that partnership return.

Information is usually solicited from the TMP in this 45-day period. In many cases, this step is merely an extension of the IRS's "classification" function. The classification units in the Flow-Through campus make initial determinations as to whether an audit will be commenced. This classification is frequently based on the information contained on the partnership return. If the information contained on the partnership return is insufficient to make an informed audit classification, the Flow-Through campus may then refer the case to the Flow-Through Area office for further development by a Revenue Agent.

If the TMP can satisfy the Revenue Agent that no substantial audit issues exist in the 45-day period, the IRS withdraws the NBAP and discontinues the partnership proceeding.[479] The IRS will issue the appropriate letter following case review.[480] However, even if the IRS does not withdraw the NBAP, the IRS is not required to issue an FPAA.[481] After the NBAP has been withdrawn, a second NBAP may not be issued unless: (1) there is evidence of fraud, concealment, or misrepresentation; (2) the first proceeding involved a clearly defined substantial error with respect to an established IRS position; or (3) the failure to reissue the NBAP would be a serious administrative omission.[482] In light of this difficulty in reopening a partnership proceeding after the initial NBAP has been withdrawn, this 45-day "mini-examination" period can be strategically important.

2. NBAP to Notice Partners and Notice Groups

If the IRS decides to continue with the partnership proceeding after the 45-day period, the IRS issues NBAPs to all notice partners and five-percent notice group representatives.[483]

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[473] Reg. §301.6223(c)-1(b)(1), §301.6223(c)-1(d).

[474] Reg. §301.6223(c)-1(e).

[475] *Block Developers, LLC v. Commissioner*, T.C. Memo 2017-142 (IRS's actual knowledge of indirect partners does not entitle indirect partners to notices if notification procedures are not followed).

[476] *Gaughf Props., LP v. Commissioner*, 139 T.C. 219 (2012) (information must be affirmatively furnished for IRS to be required to acknowledge it), *aff'd*, 738 F.3d 415 (D.C. Cir. 2013) (IRS is not required to use information already in its possession); *Hamel v. Commissioner*, T.C. Memo 2024-62, reconsideration denied, T.C. Memo 2025-19 (even IRS use of information is not binding if regulatory process not followed); *Triangle Investors LP v. Commissioner*, 95 T.C. 610 (1990); Reg. §301.6223(c)-1(f). The IRS's general procedures explaining how a taxpayer should inform the IRS of a change of address expressly do not apply to notices under §6221 through §6234. Rev. Proc. 2010-16, §6.01, *superseding* Rev. Proc. 2001-18. *But see* CCA 202501009 (Although Rev. Proc. 2010-16, §6.01, indicates that it does not apply to the notice requirements under §6221 through §6234, it is clear from the publication date of the revenue procedure and the scope of the reference that its limitation relates to those sections as in effect before amendment by the Bipartisan Budget Act of 2015, Pub. L. No. 114-74.).

[477] IRM 4.31.2.3.7.

[478] Reg. §301.6223(a)-1.

[479] Reg. §301.6223(a)-2(a); IRM 4.31.2.3.7.4.

[480] IRM 4.31.2.3.9.3.

[481] Reg. §301.6223(a)-2(a).

[482] Reg. §301.6223(a)-2(b).

[483] See III.A.2. and 3., above, for the definitional rules concerning notice partners and five-percent notice groups.

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Note: In CCA 201125027, the IRS Chief Counsel's Office concluded that there is no legal requirement to include a partner's full TIN on an NBAP.

The representative of a five-percent notice group, however, is entitled to receive the NBAP only if the representative has notified the IRS of the existence of the five-percent notice group and the designation of the representative at least 30 days before the NBAP is mailed to the TMP.[484] Notice groups should probably be designated when the partnership is formed to ensure receipt of the NBAP.

The TMP is obligated to forward a copy of the NBAP to all non-notice partners within 75 days after the date the original NBAP was issued to the TMP. If the non-notice partners have joined a five-percent notice group as of the date the NBAP was mailed, however, the TMP is not responsible for forwarding the NBAP to these notice group members.[485]

The NBAP is important to each partner for two reasons. First, the NBAP notifies the partner of the commencement of the IRS audit. The TMP is not obligated under the Code or regulations to provide status reports to the other partners during the audit phase of the proceeding, so the NBAP effectively informs the other partners of their potential interest in obtaining information from the TMP informally. Second, the issuance of the NBAP commences the running of a 120-day period which restricts the issuance of an FPAA. If the IRS issues an FPAA to the TMP during this 120-day period, the partner becomes entitled to limited procedural rights to be removed from the unified partnership proceeding.[486] These procedural rights are discussed in more detail in VI.E.4., below.

3. NBAP to Pass-thru and Indirect Partners

The rules concerning the right to receive a NBAP are modified for pass-thru and indirect partners. In the absence of notice to the contrary, only the pass-thru partner is entitled to receive the NBAP. There are two ways, however, for an indirect partner to become entitled to receive a copy of the NBAP.[487] First, if the indirect partner files a written identification statement with the IRS in accordance with Reg. §301.6223(c)-1 at least 30 days before the date the NBAP is mailed to the TMP and the indirect partner qualifies as a notice partner in the "source partnership," the indirect partner is entitled to receive the NBAP directly from the IRS.[488] Second, if the indirect partner is identified to the TMP, the TMP is required to forward the information to the IRS. The information is then incorporated by the IRS in the information base.[489] If the TMP fails to forward the information to the IRS, however, the indirect partner is not entitled to receive the NBAP.[490] Even if the TMP fails to forward the information, the indirect partner is entitled to receive a copy of the NBAP from the TMP if the indirect partner is identified to the TMP within 45 days after the NBAP is mailed to the TMP (i.e., at least 30 days before the TMP is required to forward the NBAP to each partner not entitled to notice from the IRS).[491]

These notice rules concerning pass-thru and indirect partners are rather complicated and can be best illustrated by example:

> *Example (1):* B Partnership is a partner in BCD Partnership. B Partnership has three partners, X, Y, and Z. BCD Partnership is the "source partnership;" B Partnership is the pass-thru partner; and X, Y, and Z are the indirect partners. Z is identified to the IRS more than 30 days before the NBAP is mailed to the TMP. If the IRS mails the NBAP to B Partnership, the NBAP will be deemed to constitute notice to X and Y, but not Z. The IRS must mail the NBAP separately to Z to effect proper notice on Z.

> *Example (2):* Assume the same facts as in *Example (1)*, except that Z is identified to BCD Partnership's TMP, not to the IRS. The TMP fails to forward Z's identification statement to the IRS and fails to provide a copy of the NBAP to Z. Because Z was not identified to the IRS, the NBAP will be deemed given to X, Y, and Z if it is mailed to B Partnership.[492]

These notice rules should be examined in each case involving pass-thru and indirect partners.

4. Effect of Failure to Provide NBAP

The first question in determining whether there has been a failure to provide a NBAP is to determine whether a particular partner is entitled to receive the NBAP. This issue is discussed more fully in VI.E.2. and 3., above. If the partner is not entitled to receive an NBAP, no rights accrue if the IRS does not send one to that partner.[493] The NBAP must be issued to each partner entitled to receive an NBAP at least 120 days before issuance of the FPAA. Accordingly, the IRS may fail the NBAP requirement either by not issuing an NBAP at all or by issuing the NBAP within the 120-day period preceding the date the FPAA is mailed to the TMP.

The partner's remedy is the same in either event. If the IRS fails to properly mail the NBAP to a partner, the partner may elect out of the partnership proceeding and may resolve the partnership item issues separately. A partner may make only one election with respect to all partnership interests, even if the partner holds both direct and indirect interests in the part-

[484] Reg. §301.6223(e)-1(a). See III.A.3., above, for further information concerning the formation of a five-percent notice group.

[485] Reg. §301.6223(g)-1(a).

[486] The premature issuance of the FPAA does not, however, invalidate the notice. *Wind Energy Tech. Assocs. III v. Commissioner*, 94 T.C. 787 (1990). *See* Reg. §301.6223(e)-2(a).

[487] *Block Developers LLC v. Commissioner*, T.C. Memo 2017-142 (IRS not required to issue NBAP to indirect partners absent notification per regulations even if IRS actually knows identity of indirect partners).

[488] §6223(c)(3). See III.A.6., above, for further discussion of the determination as to whether the indirect partner can become a notice partner in the "source partnership."

[489] Reg. §301.6230(e)-1(b) and §301.6223(c)-1.

[490] §6230(f).

[491] Reg. §301.6223(g)-1(a)(1), §301.6223(g)-1(a)(3)(ii).

[492] *See* Reg. §301.6223(e)-1(b)(2). §6230(f).

[493] *Kearney Partners Fund, LLC v. United States*, 946 F. Supp. 2d 1302 (M.D. Fla. 2013). However, note that §6223(d) requires the issuance of NBAPs to notice partners only if the IRS ultimately issues an FPAA to the TMP, so even if an NBAP is issued to the TMP and is not withdrawn within 45 days as required by Reg. §301.6223(a)-2(a), the IRS may delay issuing NBAPs to notice partners until 120 days before an FPAA is issued to the TMP and the IRS may completely forego issuing NBAPs to the notice partners if no FPAA is ultimately issued. PMTA 2014-06 (May 9, 2014).

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nership. Thus, a partner may not opt out of the partnership proceeding with respect to an indirect interest but participate in the partnership proceeding with respect to a direct interest.[494]

Comment: As there is seldom a significant tactical advantage to electing out, and the alternative is likely to be expensive in terms of separate payment for professional services, the partner will probably not choose to opt out of the partnership proceeding even when the NBAP has not been properly provided, unless the partnership proceeding was not conducted effectively by the TMP or other partners.

The procedure for electing out of the partnership proceeding varies depending on when the partner receives notice of the proceeding from the IRS. It is not clear what constitutes "notice of the proceeding" as contemplated by §6223. If an NBAP is not received but the FPAA is, the FPAA probably constitutes notice of the proceeding.[495] In practice, the IRS issues an "untimely notice letter" when the IRS identifies a violation of the NBAP requirements. This letter advises the partner of the procedures available as a result of the untimely NBAP.[496]

If the IRS mails the partner notice of the proceeding after (1) an FPAA has been issued and no petition was filed, or (2) the decision of the court reviewing an FPAA has become final, the partner may elect to obtain the benefit of the court's decision or any settlement agreement offered by the IRS with respect to that partnership taxable year. If the partner does not elect to join in the decision or the settlement agreement, the partner's partnership items convert to nonpartnership items. The election must be filed with the IRS office which provided the notice concerning the proceedings within 45 days after the notice of the proceeding. The election must:

- be identified as an election;
- specify that the election is being made;
- set forth the partner's and the partnership's name, address, and taxpayer identification numbers;
- specify the partnership taxable year for which the election is made; and
- be signed by the partner making the election.[497]

If the adjustments in the FPAA have not become final, the partner becomes a party to the partnership proceeding unless the partner makes one of two elections. First, the partner may elect to obtain the benefit of any settlement agreement offered by the IRS for that partnership taxable year. Second, the partner may drop out of the partnership proceeding by electing to convert the partner's partnership items to nonpartnership items. Either of these elections is made in the same manner as the election specified in the preceding paragraph.[498]

As can be seen, the consequences to the IRS of a failure to provide a timely NBAP are not severe. The most drastic consequence is that the partner is provided the opportunity to drop out of the partnership proceedings by converting the partnership items to nonpartnership items. Section 6229(f) preserves the statute of limitations for one year after the partner's election so long as the partnership item statute of limitations is open when the partnership items are converted to nonpartnership items. Accordingly, a failure to provide a timely NBAP does not present a partner with an opportunity to argue that adjustments based on an FPAA are barred by the statute of limitations.

The IRS does not run the risk of having adjustments barred by the statute of limitations for at least one year after the conversion which results from the failure to issue an NBAP. Therefore, in exceptional cases, the IRS may not even attempt to mail the NBAP in a timely manner before issuing an FPAA. This practice does not invalidate the FPAA and does not run afoul of the Minimum Period.[499] The procedural option that allows the partners to elect out of the partnership proceeding is the partners' exclusive remedy. Accordingly, the NBAP requirement should not be viewed as creating a significant additional statute of limitations protection.

A partner that has received an NBAP or FPAA and who fails to make a §6223(e)(2) or §6223(e)(3) election (as discussed above) cannot later contest their partnership tax liability in a Collection Due Process (CDP) hearing.[500]

F. Audit and Area-Level Conference

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TEFRA partnership audit is conducted by the Revenue Agent for the Flow-through Area. The Revenue Agent typically forwards all information requests and makes all contact with the partnership's TMP. This generally includes the advance notice required by §7602(c) when the IRS may make

[494] *JT USA, LP v. Commissioner*, 131 T.C. 59 (2008), *rev'd and rem'd*, 771 F.3d 654, (9th Cir. 2014), *cert. denied*, 136 S. Ct. 120 (2015). The Ninth Circuit reasoned that, according to the clear and unambiguous language of §6223(e)(3)(B), unless a partner elects to have all of his or her partnership items treated as nonpartnership items, the partner cannot elect out of a TEFRA proceeding.

[495] *See Camacho v. United States*, 195 B.R. 114 (D. Alaska 1996), *appeal dismissed sub. nom. Walthall v. United States*, 131 F.3d 1289 (9th Cir. 1997).

[496] *See* IRM 4.31.2.7.2.5.

[497] Reg. §301.6223(e)-2(d). *Bedrosian v. Commissioner*, 940 F.3d 467 (9th Cir. 2019) (challenge of partnership disallowance deductions in individual deficiency proceeding did not substantially comply with §6223(e)(3)(B) election requirements because no clear intention to make election and not filed in designated IRS office).

[498] §6223(e)(3); Reg. §301.6223(e)-2.

[499] *Wind Energy Tech Assocs. III v. Commissioner*, 94 T.C. 787 (1990); *Bedrosian v. Commissioner*, 143 T.C. 84 (2014), *aff'd* 940 F.3d 467 (9th Cir. 2019); *Pacific Management Group v. Commissioner*, T.C. Memo 2018-131; *Green Gas Statutory Trust v. Commissioner*, T.C. Memo 2015-168; *In re Raihl*, 94-2 USTC ¶ 50,404 (Bankr. D. Alaska 1994). However, in FSA 199938016, the National Office indicated that the IRS should not intentionally issue an untimely NBAP, because such an action would be contrary to the legislative policies underlying the enactment of TEFRA.

[500] *See* §6330(c)(4)(C). *See also, e.g., Goldberg v. Commissioner*, T.C. Memo 2021-119, *aff'd* 73 F.4th 537 (7th Cir. 2023) (when an NBAP or FPAA is properly furnished to the partner, the only venue for the partner to challenge their partnership tax liability is a TEFRA proceeding unless a timely §6223(e)(2) or §6223(e)(3) election is made; the partners' attempted TEFRA statute of limitations challenge in a CDP hearing in the case at bar was an improper attempt to appeal their underlying partnership tax liability).

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contacts with third parties related to the determination of the TEFRA partnership adjustments.[501] In situations in which the identity of the TMP is uncertain or where the TMP has limited access to the partnership books and records, the IRS may contact the possessor of these records either informally or by use of an administrative summons to obtain the necessary information. There is no requirement that the Revenue Agent contact only the TMP to obtain the information necessary to complete the audit.[502]

At the conclusion of the partnership audit, the Revenue Agent contacts the TMP to schedule a closing conference.[503] The TMP is required to inform the other partners of the details concerning this closing conference.[504] These other partners apparently have a right to attend the closing conference with the Revenue Agent. There is no such right provided in the Code or regulations. The Internal Revenue Manual, however, seems to indicate that notice partners may be present at the conference.[505] A partner's representative may also attend if the representative has a valid power of attorney from the partner.[506] In practice, it is likely that the Revenue Agent will allow the attendance of notice partners at the closing conference but will not reschedule the conference for the notice partners' benefit. If the TMP fails to inform the other partners of the time and place of the closing conference, however, the other partners lose their opportunity to attend the conference and acquire no additional procedural rights to compensate for this loss.[507]

G. 60-day Letter

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The key case Campus Pass-through Function (CPF) is responsible for issuing the 60-day letter. The 60-day letter is the TEFRA partnership equivalent of the 30-day letter in non-TEFRA cases. Each notice partner receives the 60-day letter from the IRS.[508] The non-notice partners receive notification of the 60-day letter from the TMP.[509]

The 60-day letter informs the partners of the Revenue Agent's conclusions and notifies the partners of their right to an administrative appeal with the IRS Appeals office. A copy of the RAR is also attached to the 60-day letter sent to the TMP. Each partner's copy of the 60-day letter is accompanied by Form 870-PT or Form 870-LT. Form 870-PT discloses the adjustments proposed at the partnership level. Form 870-LT is included instead if the proposal includes affected items. Form 870-PT does not disclose the partner's distributive share of those partnership adjustments and does not state the tax deficiency which would be due from the partner for those adjustments. The partner must compute the tax effect from the proposed partnership-level adjustments contained in Form 870-PT in determining whether or not to accept the proposal. See the Worksheets, below, for an example of the 60-day letter and Form 870-LT.

The 60-day letter should not be confused with the FPAA. The 60-day letter is the notification that allows the partners the opportunity to attend a conference with IRS Appeals. The 60-day letter does not give the partners the opportunity to file a Tax Court petition.[510] The 60-day letter is also not a statutorily required procedural step. No provision in the Code or regulations requires the IRS to issue a 60-day letter. While the 60-day letter is clearly incorporated in the Internal Revenue Manual provisions, the IRS's failure to issue a 60-day letter is not fatal and does not give the partners any basis for arguing that a subsequent FPAA is invalid because of the IRS's procedural failure to issue a 60-day letter.[511]

The IRS will not generally issue a 60-day letter and give an opportunity for a conference with Appeals before issuing the FPAA unless a year remains on the Minimum Period. The partnership generally cannot compel an Appeals conference without extending the Minimum Period.[512]

H. Appeals Conference

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The purpose of the 60-day letter is to give the partners the opportunity for a conference with IRS Appeals. This opportunity is provided if any partner files a written protest with the indicated office within the 60-day period from the date of the letter.[513]

When the case file is received in the key case Area Appeals office, the Appeals Officer assigned to the case schedules a conference with the TMP. Before the conference, the TMP must provide the names of all partners and their representatives

[501] CCA 200109047; Reg. §301.7602-2(c)(3)(ii) *Ex. 6(a)* and *Ex. 6(b).*

[502] *See, e.g., United States v. Clarke*, 816 F.3d 1310 (11th Cir. 2016) (summonses issued before FPAA not in bad faith and could be enforced).

[503] IRM 4.31.2.3.10.

[504] Reg. §301.6223(g)-1(b)(1)(i).

[505] IRM 4.31.2.3.10.

[506] IRM 4.31.2.3.10.

[507] §6230(f).

[508] IRM 4.31.3.6.2. *See also* IRM 4.31.3.6.1. Technical Services forwards the 60-day letter package to the key case CPF, which mails the package to the TMP and notice partners.

[509] Reg. §301.6223(g)-1(b)(1)(ii).

[510] *Clovis I v. Commissioner*, 88 T.C. 980 (1987).

[511] *See Luhring v. Glotzbach*, 304 F.2d 560 (4th Cir. 1962) (taxpayer not legally entitled to 30-day letter); Parnell, "The Internal Revenue Manual: Its Utility and Legal Effect," 32 *Tax Law.* 687 (1979).

[512] *Rocky Branch Timberlands LLC v. United States*, 132 AFTR2d 2023-5788 (11th Cir. 2023) (unpub.), *cert. denied*, 144 S. Ct. 812 (2024) (lawsuit to compel rescission of FPAA barred when partnership initially decided not to sign Form 872-P); *Hancock County Land Acquisitions, LLC v. United States*, 130 AFTR2d 2022-5529 (11th Cir. 2022) (unpub.), *cert. denied*, 143 S. Ct. 577 (2023) (action to compel administrative appeal barred).

[513] IRM 4.31.3.6.3. See IRM 4.31.2.3.8. *et seq.* for rules concerning the proper completion of a power of attorney form.

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who will be attending the Appeals conference. These other partners have the right to attend the Appeals conference, but must rely on the TMP to receive notice of the conference and coordinate the other partners' attendance. Even if one of the other partners has filed a separate protest, that partner is not generally provided the opportunity to have a separate conference with Appeals.

The Appeals conference is the partners' first real chance to engage in substantive settlement negotiations. Before this conference, the settlement negotiations are confined primarily to the TMP's discussions with the Revenue Agent about the positions the Agent will take in the RAR. These positions are then incorporated into Form 870-PT which is issued with the 60-day letter. Unless the partners wish to accept the Revenue Agent's conclusions, a written protest should be filed to obtain the opportunity for substantive settlement negotiation with an Appeals Officer. The Appeals Officer's stated goal is to determine whether the parties can obtain a fair administrative resolution of the audit issues. The Appeals conference is the best opportunity for the partners to negotiate a settlement of the audit issues at the administrative stage.

I. Administrative Settlement

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

An administrative settlement under §6224(c) causes the conversion of the settling partner's partnership items to nonpartnership items. This effectively drops the partner out of the partnership proceeding. The IRS then processes the settlement and makes the assessment of tax to reflect the settlement by means of a computational adjustment. The partner is bound by the settlement agreement as to the substantive partnership item adjustments and may contest the computational aspects of the assessment only through the §6230(c) refund procedures. See III.B.4.a. and V.C.5.b., above, and VIII.A., below, for further discussion of these assessment procedures.

1. Consistency Requirement

The consistent settlement requirement is designed to provide all partners with an opportunity to settle their partnership items on a consistent basis. This does not mean that all partners are required to settle in the same manner or that all partners will ultimately receive the same settlement offer. If the IRS settles the partnership items of one partner, however, that same settlement must be offered to any partner whose items are still partnership items who requests the same settlement. The mechanics of the consistent settlement procedures are discussed more fully in IV.B., above.

2. Authority of the TMP to Bind Other Partners

Before issuance of the FPAA, the TMP has a narrow and well-defined ability to bind certain non-notice partners to settlement agreements for partnership items. The TMP cannot bind any notice partners or any member of a 5% notice group. In addition, the TMP cannot bind any partner on a settlement of affected item issues.[514] The TMP may enter binding settlement agreements only for the partnership items of certain non-notice partners. Therefore, if the partnership has fewer than 100 partners, the TMP may not bind any other partners to an administrative settlement agreement.

Even in a partnership with more than 100 partners, the non-notice partners have two ways to avoid being bound by the TMP's authority to settle their partnership item adjustments. First, the non-notice partners are not bound if they have joined a 5% notice group at least 30 days before the TMP's execution of the settlement agreement.[515] Second, even if the non-notice partner is unable to join a five-percent notice group, the non-notice partner may file a written "no settlement" statement negating the TMP's settlement authority. The no-settlement statement must be filed more than 30 days before the TMP's settlement agreement is executed and must:

- be identified as a statement to deny the TMP settlement authority under §6224(c)(3)(B);
- identify the partner and partnership by name, address, and taxpayer identification number;
- specify the taxable years to which the statement applies;
- be signed by the partner filing the statement; and
- be filed with the submission processing center where the partnership return was filed or with the Area office that issued the NBAP if the partner knows that an NBAP was issued.[516]

Comment: The TMP's ability to bind non-notice partners to administrative settlements may be less significant as a practical matter. While the TEFRA partnership audit procedures do not require the issuance of the critical notices and settlement agreements to non-notice partners, the IRS nevertheless may provide them.[517] Despite the IRS guidelines, it is not clear what happens if the IRS mails Form 870-PT to a non-notice partner who elects not to accept the settlement reflected in that document. If the TMP elects to accept the settlement and purports to accept on behalf of all non-notice partners, it would appear that this settlement is binding on the non-notice partners. This conclusion is consistent with the case law which holds that the actual mailing of an FPAA to a non-notice partner does not confer on such partner the legal rights and status of a notice partner.[518]

Observation: A procedural gap exists which may adversely affect the non-notice partners if the TMP and all notice partners accept the settlement, but the TMP does not or cannot accept the settlement for the non-notice partners because they have elected not to be bound. If the IRS issues an FPAA and the

[514] Section 6224(c)(1) defines a settlement agreement as extending only to partnership items. *See Davis v. United States*, 811 F.3d 335 (9th Cir. 2016) (IRS does not enter into settlement agreement with partner when it enters into settlement agreement with TMP; if partner had entered into settlement with IRS, such partner's partnership items would be converted to nonpartnership items).

[515] Reg. §301.6224(c)-1(a)(1), §301.6223(b)-1(c)(4).

[516] Reg. §301.6224(c)-1(c).

[517] *See, e.g., Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913, 914 n. 2 (1988).

[518] *Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913 (1988).

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TMP fails to file a petition in response, the FPAA adjustments become final as to the non-notice partners unless these partners can form a 5% litigation group to file a petition. The adjustments proposed in the FPAA may be less favorable to the non-notice partners than the settlement. Accordingly, the non-notice partners who do not want to be bound by the TMP should form a 5% notice and litigation group to preserve their procedural rights.

In contrast to the relatively well-defined rules which apply to an administrative settlement before issuance of the FPAA, the rules concerning the TMP's settlement authority in a court proceeding after issuance of the FPAA are somewhat confusing. These rules are discussed more fully in VII.F., below.

3. Authority of the Pass-thru Partner and TMP to Bind Indirect Partners

The TMP or the pass-thru partner can bind an indirect partner to a settlement in certain circumstances. These circumstances differ depending on whether or not the indirect partner has filed an identification statement pursuant to §6223(c)(3).

An indirect partner who has not filed an identification statement is bound by a settlement agreement entered into by the pass-thru partner.[519] To be binding, this settlement agreement must be executed for the pass-thru partner by: (1) the TMP if the pass-thru partner is a TEFRA partnership or S corporation; (2) any general partner or officer of a non-TEFRA partnership or S corporation; or (3) the authorized representative of a trust, estate, or nominee.[520]

If the pass-thru partner is not a notice partner or a member of a 5% notice group and has not filed a §6224(c)(3)(B) no-settlement statement, the pass-thru partner and each unidentified indirect partner can be bound by a settlement agreement executed by the TMP. Because the indirect partner in this situation is by definition a non-notice partner, and because the indirect partner cannot join a 5% notice group without first filing an identification statement, the indirect partner will be bound by the TMP's settlement unless the indirect partner has filed a §6224(c)(3)(B) no settlement statement at least 30 days before the TMP's settlement agreement is executed.

Example: P Partnership, which has not elected to be treated as an "electing large partnership," has over 100 partners. J Partnership is a partner in P Partnership with a profits interest of less than 1%. J Partnership has three partners, B, C, and D. B is a member of a 5% notice group with respect to P Partnership, but C and D are not. On July 3, Year 1, C filed a no-settlement statement declaring that C would not be bound by any settlement agreement entered into by the TMP of P Partnership. On August 3, Year 1, the TMP of P Partnership enters into a settlement agreement with the IRS and states that the agreement is binding on other partners as provided in §6224(c)(3). J Partnership is bound by the settlement agreement, so the pass-thru partner rule is applied separately to each of the indirect partners to determine whether the indirect partners are bound. B is not bound by the agreement because B was a member of a 5% notice group on the day the agreement was entered into. C is not bound because C filed the no-settlement statement at least 30 days before the agreement was entered into. D is bound by the settlement agreement.[521]

If the indirect partner has filed an identification statement, the pass-thru partner loses the authority to bind the indirect partner to a settlement.[522] The indirect partner is then treated as a "direct" partner. As a result, the TMP has the authority to bind the indirect partner after the identification statement is filed unless the indirect partner (1) is a notice partner, (2) becomes a member of a 5% notice group, or (3) has filed a §6224(c)(3)(B) no-settlement statement in the manner described in the preceding chapter.[523]

4. Forms and Procedures Used to Implement the Settlement

Form 870-PT is the form typically used to implement administrative settlements. Form 870-PT reflects the partnership item adjustments for the partnership as a whole. Form 870-PT does not reflect the individual partners' shares of the partnership item adjustments.[524]

If an individual partner filed a joint return, the IRS requires the signature of both spouses on Form 870-PT.[525]

In CCA 201723024, the IRS Chief Counsel's Office concluded that, in the case of a terminated trust that is a notice partner, the trustee must sign the Form 870-PT if signing on behalf of the trust and all beneficiaries (and individual beneficiaries may sign to bind themselves). If the trust has terminated, state law will determine who may act for an entity after dissolution.

Form 870-PT provides that "the treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no claim for an adjustment of partnership items or for a refund or credit based on any change in the treatment of partnership items may be filed or prosecuted" once the form is signed by the IRS. However, the parties may dispute what constitutes the "treatment of partnership items."[526]

Form 870-PT reflects only the settlement of partnership items. Because, prior to enactment of TRA 1997, many partnership item adjustments were accompanied by penalty proposals by the IRS, Form 870-PT often did not provide a total settlement of the partners' partnership issues. In the context of an administrative settlement it is usually possible to resolve the penalty issues as part of the overall partnership issue settlement with the Appeals office. Under prior law, the amount of the penalties could be ascertained and settled in one of

[519] §6224(c)(1); CCA 201116020.

[520] Reg. §301.6224(c)-2(b).

[521] Reg. §301.6224(c)-1(b)(2).

[522] §6224(c)(1); Reg. §301.6224(c)-2; CCA 201041041.

[523] See III.A.5. and III.A.6., above, for a discussion of the means for determining the indirect partner's interest in the "source" partnership.

[524] IRM 4.31.1.3.

[525] See IRM Exhibit 4.31.2-4 for a summary of the required signatures.

[526] *Browning-Ferris Indus., Inc. v. United States*, 233 F. Supp. 2d 1223 (D. Ariz. 2002) (IRS failed to establish that an agreement to fix the amount of the partnership's ITCs at the specific amounts listed on the Form 870-P constituted the "treatment of partnership items" that is made binding by Form 870-P). *See Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995).

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two ways. First, the penalties could be incorporated into Form 870-L(AD), which could be executed to allow the partners to accept the settlement of the penalty issues. Second, the partner and the IRS could execute the two-part Form 870-LT, which contains both the Form 870-PT agreement and a Form 870-like agreement in one document. Separate signatures are required to consent to the settlement of the partnership items and the penalties.[527] As with the partnership item adjustments contained in a Form 870-PT, the penalty section of Form 870-LT would typically not state the dollar amount of the penalty, but rather would state the applicable percentage of the respective penalties.

Partial settlements present their own issues. If a partner and the IRS enter into a settlement agreement for some but not all partnership items, the period for assessing any tax attributable to the settled items is determined as if the agreement had not been made. As a consequence, the limitations period for the last partnership item to be resolved is controlling for all disputed partnership items for that taxable year.[528]

A final issue that arises in connection with a settlement through any form of agreement is the effect of the settlement on the interest suspension rules of §6601(c). Section 6601(c) provides generally that, if a waiver of the restriction on assessment of a deficiency is executed, interest on the deficiency stops running from the date 30 days after the waiver's effective date and until the taxpayer is billed for the deficiency. Section 6229(f) gives the IRS at least one year after the settlement agreement is executed to assess and bill the partner for the deficiency attributable to the partnership item adjustments. The IRS typically uses most of this one-year period.

A settlement agreement constitutes a waiver within the meaning of §6601(c). Therefore, interest stops running 30 days after the date of the settlement agreement until the partner is actually billed for the resulting deficiency. This is frequently a very substantial period of time. Section 6601(c) suspends interest from the date one month after the settlement agreement is executed until the date of assessment.[529] The IRS's position is that under §6601(c), the Form 870-PT is equivalent to a waiver under §6601(c), such that interest is suspended under §6601(c) if the IRS does not send notice and demand within 30 days after the IRS co-signs the Form 870-PT. Similarly, in the case of a settlement under §6224(c), where a partner signs a Form 906 rather than a Form 870-PT, Form 906 is equivalent to a waiver under §6213(d), and interest would be suspended if the IRS fails to send notice and demand within 30 days after the IRS co-signs the Form 906.[530]

The administrative settlement often contemplates simultaneous resolution of affected items. If the affected items are not resolved in the settlement, however, affected item procedures also will be implemented (if applicable) when the settlement is processed. See IX.B., below, for further discussion of these procedures.

The settlement will be applied to the partner's return by means of a computational adjustment. See III.D.1., above, and IX.A., below, for further discussion of the computational adjustment procedures.

5. *Alternative Events Constituting a Settlement Agreement*

Typically, the IRS implements a settlement agreement by means of the standardized forms discussed in VI.I.4., above. This does not appear to be the exclusive means to implement a settlement agreement, however. For example, a judicial settlement is subject to general contract principles.[531] In *Treaty Pines Invs. P'ship v. Commissioner*,[532] the Fifth Circuit held that general contract principles (e.g., offer and acceptance) applied to the determination of whether a settlement agreement exists. In response to *Treaty Pines*, the IRS has attempted to be much more specific about the requirements to consummate a settlement agreement. As a result, most attempts to argue that correspondence between a partner and the IRS created a settlement agreement have not been successful.[533]

Comment: The consequences of consummating a binding settlement agreement are considerable. Not only will the IRS be bound to the settlement terms, but the existence of a settlement converts the partner's partnership items to nonpartnership items and starts the one-year period of limitations in which the

[527] *See* FAA 20124201F (Chief Counsel Notice CC-2009-011 does not apply to allow deficiency procedures necessary to determine loss or gain on sale of partnership interest where taxpayer waived deficiency procedures on Form 870-LT as to agreed items; penalties under §6651 (failure to file return) and §6654 (failure to pay estimated tax) are normally not subject to deficiency procedures unless attributable to deficiencies subject to deficiency procedures; therefore, where taxpayer did not file return but signed Form 870, §6654 penalties, but not §6651 penalties, are subject to deficiency procedures). The IRS indicated that it would revise Forms 870-LT and 870-L(AD) for tax years ending after August 5, 1997.

[528] *See* §6229(f)(2); Reg. §301.6229(f)-1. The same procedures apply if a partner and the U.S. Attorney General (or a delegate) enter into a partial settlement agreement after Mar. 9, 2002. §6229(f)(2). Under prior law, if, for example, the IRS and the partners agreed to settle one of three issues in a particular year and executed a closing agreement for that issue, that issue became a converted item and had to be assessed within the §6229(f) one-year converted item statute of limitations period. The potential multiplicity of this procedure could have been problematic. Thus, the IRS submitted to Congress a proposal that would allow the assessment of the converted items for a partial settlement but would not trigger the §6229(f) limitations period until all issues are settled. The 1997 TRA amended §6229(f) to adopt this proposal.

[529] §6601(c).

[530] *See* PMTA 2012-09. Some cases decided before the amendment of §6601(c) held that the partnership item settlement agreement was not treated as a §6601(c) waiver for interest suspension purposes. *See, e.g.*, *Pack v. United States*, 992 F.2d 955 (9th Cir. 1993) (§6601(c) not applicable to taxpayer's deficiency where tax dispute and closing agreement relate to TEFRA partnership).

[531] *Dorchester Indus., Inc. v. Commissioner*, 108 T.C. 320 (1997).

[532] 967 F.2d 206 (5th Cir. 1992). *See generally Haiduk v. Commissioner*, T.C. Memo 1990-506; *Smith v. United States*, 328 F.3d 760 (5th Cir. 2003) (although taxpayer gave up right to file prepayment action in Tax Court, signing of Form 870 did not preclude taxpayer from filing post-payment refund action in district court, as there was no meeting of minds whereby taxpayer agreed to waive right to file a refund action).

[533] *Mathia v. Commissioner*, 669 F.3d 1080 (10th Cir. 2012); *Estate of Ray v. Commissioner*, 112 F.3d 194 (5th Cir. 1997); *Varnum v. United States*, 2000-2 USTC ¶ 50,617 (S.D. Tex. 2000); *Gregory v. United States*, 111 F. Supp. 2d 851 (S.D. Tex. 2000); *Transpac Drilling Venture 1982-21 v. Commissioner*, T.C. Memo 1996-208, *aff'd*, 210 F.3d 355 (2d Cir. 2000) (unpub.); *Gingerich v. United States*, 54 Fed. Cl. 222 (2002), *vac'd and rem'd*, 82 Fed. Appx. 35 (Fed. Cir. 2003) (tax settlements for issues before the Tax Court do not require any method or form; genuine issues of material fact existed regarding the need for a closing agreement to effectuate settlement of issues before the Tax Court). *But see Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002) (partner's intent to settle not defeated by unstated IRS requirement for closing agreement).

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IRS may assess the resulting tax.[534] The existence of a settlement agreement also gives other partners in the partnership the right to request a consistent settlement under §6224(c).[535] The importance of the characterization of events as a binding settlement agreement dictate that the circumstances surrounding efforts to settle the partnership items be examined in detail.

6. Coordination with Non-TEFRA Years

As discussed in II., above, a partnership may be governed by the TEFRA procedures in one year but may be classified as non-TEFRA in the succeeding year. Due to the fundamentally different processing of TEFRA and non-TEFRA cases by the IRS, the coordination of settlement covering TEFRA years with non-TEFRA years can present logistical problems. The partner should obtain Form 870-PT to resolve the TEFRA years, obtain Form 870 to resolve the non-TEFRA years, and also enter into a closing agreement (Form 906) to provide the degree of certainty and coordination necessary to avoid confusion in the application of the settlement in the different years.[536]

The processing of multiple-year settlements is made simpler by the IRS interpretation of the effect of a closing agreement and the amendment of §6230(a)(2)(A)(ii). The IRS considers a closing agreement to be a settlement agreement under §6224(c). Section 6230(a)(2)(A)(ii) excepts converted items resulting from settlements from the deficiency procedures. Accordingly, if a closing agreement is executed which establishes the appropriate reporting pursuant to the settlement for a later TEFRA year, the closing agreement (as a settlement agreement) converts that item to a nonpartnership item. If the later year's return already has been filed when the closing agreement is executed, the later-year conversion occurs and the IRS can assess any additional tax due via the computational adjustment procedure. If the later year's return has not been filed when the closing agreement is executed, the items which are the subject of the agreement are never treated as partnership items and, therefore, cannot become converted items. If the items are reported inconsistently with the closing agreement, an adjustment to these items can be made through the normal non-TEFRA deficiency procedures.

Comment: While this expansive use of the closing agreement provides a vehicle to resolve these coordination issues, the implementation of this device creates significant administrative problems for the IRS. In practice, the IRS has had some difficulty assessing the partnership item adjustments within the one-year period provided by §6229(f) for years for which the TEFRA case processing has been established from the start of the audit. These difficulties will only be compounded if the closing agreement covers years for which the case processing procedures have not even been established.

7. Advance Payments

Often in the administrative or judicial phase of a partnership proceeding a partner may wish to make an advance payment to stop the running of interest or (in the case of a corporate taxpayer) obtain the benefit of an interest deduction for the interest paid on the deficiency. The rules governing these advance payments are frequently complicated in non-TEFRA audits. These rules are even more complicated in the context of TEFRA partnership adjustments.

Announcement 86-114 generally provides two mechanisms for the advance payment of tax and/or interest at the administrative stage of a partnership proceeding before issuance of the FPAA. First, if the IRS has issued Form 870-PT to the partner, the partner may execute the Form 870-PT and tender payment allocating the entire payment to the interest amount. Execution of Form 870-PT, however, binds the partner to the settlement reflected in that form and may not be subsequently amended if the IRS later offers other partners more favorable settlements. Accordingly, this alternative should be pursued only when the partner is certain that the settlement reflected in Form 870-PT is the settlement which the partner wishes to accept.

If the partner does not wish to accept an IRS settlement offer, Announcement 86-114 directs the partner to file an Administrative Adjustment Request (AAR) by filing Form 8082 and Form 1040X, *Amended U.S. Individual Income Tax Return.* Form 8082 identifies the partner's inconsistent treatment with the partnership return. Form 1040X computes the effect of the partner's inconsistent treatment on the partner's individual income tax return. If the AAR is filed before the IRS issues a Notice of Beginning of Administrative Proceedings (NBAP) to the partnership, the AAR allows the IRS the option of converting that partner's partnership items to nonpartnership items by mailing the notice of conversion to the partner. If this notice of conversion is not mailed, the partner will remain a part of the TEFRA partnership proceeding. If an NBAP has already been issued to the partnership, however, the partner filing the AAR remains part of the partnership proceeding.

Comment: In this circumstance, it is apparently the IRS's position that the IRS has already elected to conduct a partnership proceeding pursuant to §6227(d)(4) and therefore a notice to convert the partnership items to nonpartnership items will not be issued.

Note: One potential problem in connection with advance payments concerns claims for refund if the partnership ultimately prevails. If the advance payment was submitted as a payment of tax, the only way to recover an excess payment is by filing a claim for refund (unless the IRS automatically refunds the excess). It is unclear, however, whether such a refund claim is authorized. The only refund claim expressly authorized after an FPAA has been issued is the §6230(c) refund claim for challenging computational adjustments. It is unclear whether the refund of an excess advance payment constitutes

[534] §6231(b)(1)(C), §6229(f)(1). *Gingerich v. United States*, 77 Fed. Cl. 231 (2007) (parties did not require closing agreement to effectuate settlement of partnership item as Acceptance Forms approved in advance by IRS counsel and signed and submitted by plaintiffs were valid acceptance of government's offer to resolve partnership item, binding both government and taxpayers; IRS assessments were time barred as it failed to assess applicable taxes within statutorily prescribed one-year period under §6229(f)).

[535] *See H Graphics/Access LP v. Commissioner*, T.C. Memo 1992-345.

[536] At one time an issue was raised over whether the closing agreement could override the TEFRA partnership procedures and allow the conversion of the TEFRA year to non-TEFRA or the non-TEFRA year to TEFRA. The conversion of a TEFRA year to non-TEFRA was arguably supported by §6224(b), which provides that a partner may waive any right provided under the TEFRA partnership audit proceeding. In view of the specific means provided in §6231(b) for converting partnership items to nonpartnership items, however, it does not appear that §6224(b) would allow the partner to waive out of the TEFRA procedures altogether.

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the challenge of a computational adjustment.[537] This issue may require legislative clarification.

As interest on a tax deficiency is no longer deductible for an individual taxpayer, the potential problems associated with a payment of tax probably dictate that an alternative payment procedure be used.[538] If the 60-day letter has been issued, the partner should be eligible to make a deposit on a disputed tax which does not constitute a payment of tax until the tax is assessed, and is returnable before that point on demand with interest.[539]

The partner submitting an advance payment may also seek to protect the partner's rights to contest the proposed adjustments by simultaneously filing a protection claim recouping the amount paid. If the IRS allows this protective claim, however, the liability is effectively revived and will be subject to penalties if the adjustments are ultimately upheld.[540]

The rules for making advance payments are modified after issuance of the FPAA. See VII.G.7., below, for further discussion of these advance payment rules.

J. Notice of Final Partnership Administrative Adjustment (FPAA)

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The issuance of the FPAA reflects the final stage in the administrative phase of the TEFRA partnership audit proceeding. The FPAA is issued after the Revenue Agent has completed the examination of the partnership return and typically after the 60-day letter has been issued and the Appeals office has attempted an administrative settlement of the partnership item and affected item adjustments.[541] A TEFRA partnership cannot compel the IRS to grant an Appeals conference before an FPAA is issued.[542]

1. Persons Entitled to Receive the FPAA

Section 6223(d)(2) provides a two-step process for the mailing of the FPAA. First, the IRS mails the FPAA to the TMP. Second, the IRS mails the FPAA to all notice partners and five-percent notice group representatives within 60 days after the date on which the FPAA was mailed to the TMP.

Section 6229(d) suspends the statute of limitations on the assessment of partnership items from the date the FPAA is mailed to the TMP. As discussed below, if the FPAA has been properly mailed to the TMP, a failure to properly mail the FPAA to other notice partners does not terminate the suspension of the statute of limitations. Accordingly, the IRS pays a great deal of attention to proper mailing of the FPAA to the TMP. It does not matter whether the TMP receives the FPAA, only that it is properly mailed.[543]

In practice, the mailing to the TMP typically involves two forms of mailing. First, the IRS attempts to determine the identity of the TMP and mail an original FPAA specifically addressed to that TMP at the TMP's address. A duplicate original FPAA (commonly called a "generic" FPAA) is also issued to the "Tax Matters Partner" at the partnership's address. This is a protective measure designed to ensure that adequate notice has been given under the Code. The use of this generic FPAA is authorized by TEFRA's legislative history and the regulations and has been approved by the Tax Court.[544]

Within 60 days after the FPAA is issued to the TMP, the IRS must issue a duplicate FPAA to the notice partners and the five-percent notice group representatives.[545] In practice, the IRS frequently mails copies of the FPAA to even non-notice partners who are not members of a five-percent notice group. Nevertheless, non-notice partners who receive an FPAA do not thereby become entitled to all of the administrative and judicial rights and remedies which apply to notice partners.[546] While indirect partners that have not been formally identified to the IRS are not entitled to receive a copy of the FPAA, if the IRS does send a copy to the indirect partner, the IRS obligation to issue a copy to the pass-thru partner is deemed satisfied as to that indirect partner.[547]

If the IRS fails to mail a duplicate FPAA to a notice partner or a five-percent notice group representative within the 60-day period after the FPAA is mailed to the TMP, certain procedural options become available to the partner entitled to receive the FPAA. These same procedural options also become available if an NBAP has not been properly mailed to a notice partner or five-percent notice group representative at least 120 days before the FPAA is mailed to the TMP. These procedural

[537] *See* PLR 9112005.

[538] See Rev. Proc. 2005-18, for further explanation of the distinction between an advance payment of tax, a cash bond, and a deposit on a disputed tax.

[539] §6603.

[540] *Greer v. United States*, 557 F.3d 688 (6th Cir. 2009).

[541] §6223(a)(2); IRM 4.31.2.7.2.5.; *See also*, *NPR Invs. LLC v. United States*, 732 F. Supp. 2d 676 (E.D. Tex. 2010) (district court concluded that indicating on tax return that entity was not subject to TEFRA provisions when in fact it was, although not necessarily intentional or fraudulent, nevertheless was a material misrepresentation that related directly to the proper audit procedures that should have been applied and thus justified the issuance of a second FPAA), *aff'd on this issue*, 740 F.3d 998 (5th Cir. 2014).

[542] *See Rocky Branch Timberlands LLC v. United States*, 132 AFTR2d 2023-5788 (11th Cir. 2023) (unpub.), *cert. denied*, 144 S. Ct. 812 (2024); *Hancock County Land Acquisitions, LLC v. United States*, 130 AFTR2d 2022-5529 (11th Cir. 2022) (unpub.), *cert. denied*, 143 S. Ct. 577 (2023). *See also* CCA 201025061 (no legal requirement to grant closing conference); thus, IRS can proceed directly to issuing FPAA if statute is about to expire.

[543] *Crowell v. Commissioner*, 102 T.C. 683 (1994); *Biomage, LLC v. Commissioner*, T.C. Memo 2013-202.

[544] H.R. Conf. Rep. No. 760, 97th Cong., 2d. Sess. 601 (1982), *reprinted in* 1982-2 C.B. 600, 663; Reg. §301.6223(a)-1; *Barbados #7 Ltd. v. Commissioner*, 92 T.C. 804 (1989); *Seneca, Ltd. v. Commissioner*, 92 T.C. 363 (1989); *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988); *Utah Bioresearch 1984, Ltd. v. Commissioner*, T.C. Memo 1989-612.

[545] §6223(b), §6223(d)(2).

[546] *Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913, 914 n.2 (1988). *See also Hoyt & Sons Ranch Props. Ltd. NV v. Commissioner*, T.C. Memo 2001-282 (prior year issuance of FPAA to non-notice partner does not create right to receive subsequent year FPAA).

[547] *Murphy v. Commissioner*, 129 T.C. 82 (2007).

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options are discussed more fully in VI.E.4., above. The options generally allow the partner to elect out of the partnership proceedings by converting the partner's partnership items to nonpartnership items.[548] However, the IRS's failure to issue a timely FPAA or NBAP to a notice partner or five-percent notice group representative does not cause the statute of limitations on the assessment of these converted items to expire before the IRS has the opportunity to assess the adjustments with respect to these items by issuing a converted item notice of deficiency. The partnership statute of limitations is preserved so long as the FPAA is mailed to the TMP within the statutory period.

2. Last Known Address Issue

Because the FPAA is the TEFRA partnership equivalent of the notice of deficiency, a question arises as to whether the notice of deficiency "last known address" requirement applies to FPAAs.[549] There is clearly some notion of a last-known address issue with respect to the mailing of the FPAA to the partnership or the TMP even though there is no express statutory requirement.[550] The IRS has attempted to provide certainty to this address determination by issuing regulations. Reg. §301.6223(a)-1, issued in 2001, specifies which information must be considered in making the address determination. The regulations provide generally that the notice is deemed given as of the earlier of (1) the date on which the generic FPAA is mailed to "The Tax Matters Partner" at the partnership address contained in the IRS's information base, or (2) the date on which the FPAA is mailed to the TMP at the TMP's address as determined by the IRS's information base. The information base is discussed more fully in VI.D.2., above. This information base is generally limited to the information contained on the partnership return under audit as supplemented by information provided to the IRS in written statements received at least 30 days before the FPAA is mailed to the TMP.[551]

This address scheme of the regulations has been upheld by the Tax Court.[552] The scheme was also found to satisfy Constitutional due process requirements when the FPAA was actually received by the TMP.[553] The result is less clear, however, if no partner has received a copy of the FPAA. There is clearly a notion that the FPAA must provide adequate notice to the partners to be valid (i.e., some partner must be put on notice of the need to file a petition).[554] Absent a situation in which no partner has received a copy of the FPAA, however, it does not appear that the IRS will be required to search its computer data base to find the most recent address of either the partnership or the TMP. The IRS is required to incorporate only the information which is properly included within the IRS information base.[555]

The absence of a true last known address requirement is even more pronounced with respect to the notices mailed to the notice partners. In addition to the information base limitation specified in §6223(c), the TEFRA procedures focus on the mailing of the FPAA to the TMP as the critical act. So long as the FPAA is timely mailed to the TMP, the partnership item statute of limitations is preserved and the §6225 restriction on assessment of partnership item deficiencies is lifted. Neither of these key issues is in any way dependent on mailing the FPAA to the notice partners. Even an intentional failure by the IRS to mail the FPAAs to the notice partners would only give those partners the opportunity to elect out of the partnership proceeding pursuant to §6223(e).[556] In addition, as with most IRS notices, the focus is on mailing not actual receipt. As a result, if the IRS mails the FPAA to the information base address of the notice partner, the notice partner will not have the opportunity to elect out of the partnership proceeding even if the FPAA is not received.[557]

Finally, Reg. §301.6212-2, which defines the phrase "last known address," provides further support for the notion that the notice of deficiency last known address requirement does not apply to FPAAs because there is no statutory or regulatory requirement that the FPAA be sent to the last known address of the partnership or the TMP.[558] Similarly, the IRS's procedures explaining how a taxpayer is to inform the IRS of a change of address expressly do not apply to notices under §6221 through §6234.[559]

3. Contents of the FPAA

While the case law concerning the necessary address for notices of deficiency is not liberally incorporated for FPAAs, the law concerning the contents of the notice of deficiency does apply in determining the required contents of the FPAA.

As with notices of deficiency, the Tax Court has held that the FPAA need not be in any particular form so long as it gives minimal notice to the taxpayer that the IRS has finally determined adjustments to the partnership return.[560] Accordingly, the Tax Court has held that the FPAA need not identify a specific

[548] *Blum v. Commissioner*, T.C. Memo 2025-18.

[549] *See* §6212(b); *Wallin v. Commissioner*, 744 F.2d 674 (9th Cir. 1984); *Abeles v. Commissioner*, 91 T.C. 1019 (1988).

[550] *See Summerland Partnership v. Commissioner*, T.C. Memo 1988-548.

[551] Reg. §301.6223(c)-1. *See Taurus FX Partners, LLC v. Commissioner*, T.C. Memo 2013-168 (even if more current information is supplied on subsequent return, IRS is not required to search for information other than supplied on return at issue if not provided information according to regulations); *Stone Canyon Partners v. Commissioner*, T.C. Memo 2007-377, *aff'd sub nom. Bedrosian v. Commissioner*, 358 Fed. Appx. 868 (9th Cir. 2009) (IRS use of new address does not constitute required notification); *Hamel v. Commissioner*, T.C. Memo 2024-62, reconsideration denied T.C. Memo 2025-19.

[552] *Taurus FX Partners, LLC v. Commissioner*, T.C. Memo 2013-168; *Stone Canyon Partners v. Commissioner*, T.C. Memo 2007-377, *aff'd sub nom. Bedrosian v. Commissioner*, 358 Fed. Appx. 868 (9th Cir. 2009); *Utah Bioresearch 1984, Ltd. v. Commissioner*, T.C. Memo 1989-612.

[553] *Byrd Invs. v. Commissioner*, 89 T.C. 1 (1987), *aff'd*, 853 F.2d 928 (11th Cir. 1988) (unpub.).

[554] *See Seneca, Ltd. v. Commissioner*, 92 T.C. 363 (1989), 899 F.2d 1225 (9th Cir. 1990) (unpub.).

[555] *SNJ Ltd. v. Commissioner*, 28 F.4th 936 (9th Cir. 2022).

[556] *See Fox v. United States*, 133 F.3d 926 (9th Cir. 1998) (unpub.); *Crowell v. Commissioner*, 102 T.C. 683 (1994).

[557] *McClaskey v. Commissioner*, T.C. Memo 2008-147.

[558] *See* Reg. §301.6212-2(c).

[559] Rev. Proc. 2010-16, §6.01, *superseding* Rev. Proc. 2001-18, §6.01. *But see* CCA 202501009 (Although Rev. Proc. 2010-16, §6.01, indicates that it does not apply to the notice requirements under §6221 through §6234, it is clear from the publication date of the revenue procedure and the scope of the reference that its limitation relates to those sections as in effect before amendment by the Bipartisan Budget Act of 2015, Pub. L. No. 114-74.).

[560] *Clovis I v. Commissioner*, 88 T.C. 980 (1987); *Meserve Drilling Partners v. Commissioner*, T.C. Memo 1996-72, *aff'd*, 152 F.3d 1181 (9th Cir. 1998). *See also Natalie Holdings, Ltd. v. United States*, 2003-1 USTC ¶ 50,233 (W.D. Tex. 2003) (FPAA that was issued without examination of partnership's return, but that contained information relating to partnership, properly identified tax shelters associated with partnership and related entities, and explained reasons for adjustments, held a considered determination, as required by §6212, and therefore valid).

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TMP. Rather, the generic FPAA addressed to "The Tax Matters Partner" complies with the minimal notice requirement.[561] Similarly, the IRS's omission on a duplicate FPAA mailed to a notice partner of the date that the original FPAA was mailed to the TMP has not been held to be a fatal defect. The court concluded that the notice partner received notice of the mailing of the FPAA and could have independently determined the date the FPAA was mailed to the TMP to compute the time limits for filing a petition contesting the FPAA.[562] In addition, a typographical error concerning the tax year covered by the FPAA is not fatal if the partners are not misled by the error.[563]

Only partnership item adjustments can be included in the FPAA. Any affected items may not be included in the FPAA.[564] Therefore, the determination of these items cannot be made a part of the court proceeding which contests the FPAA. See VI-II.B., below, for further discussion of the problems in coordinating these FPAA and affected item determinations. Even if improper information is included in the FPAA, it does not appear that the affected partners can successfully recover damages for improper disclosure of tax return information or get the court to reform the FPAA.[565] The IRS takes the position that an FPAA can be issued to recover erroneous refunds made with respect to partnership items so long as the period of limitations remains open.[566]

The FPAA is the partnership equivalent of a notice of deficiency, and courts typically analyze an FPAA the same way notices of deficiency are analyzed.[567] Generally, a notice of deficiency, and thus also an FPAA, must (1) set forth the deficiency amount, and (2) provide the applicable year.[568] The deficiency amount must be a "thoughtful and considered determination" and not "a mere formal demand for an arbitrary amount as to which there … [is] substantial doubt."[569] The Commissioner must consider information specific to the taxpayer before determining a deficiency, rather than arbitrarily denying the entire amount of the taxpayer's deductions.[570] There may be a different standard with respect to disallowed deductions, however. Even an arbitrary determination may not invalidate the FPAA or cause the burden of proof to shift to the IRS in a deduction case.[571]

The IRS is not typically required to explain the basis of the proposed adjustments in the FPAA in detail. After the FPAA case is filed, the IRS can add new issues in a timely answer or permitted amended answer but bears the burden of proof for this "new matter."[572] An issue not raised in the FPAA or in a timely answer or permitted amended answer will not be considered, however.[573] This is particularly true if the IRS commits to a position in discovery or otherwise.[574] Even if the IRS abandons the position in the FPAA and adopts a new position, however, the Tax Court retains jurisdiction to consider the new argument.[575]

There is one significant difference between an FPAA and a notice of deficiency. A notice of deficiency cannot be issued unless the IRS determines a deficiency under §6211. This means that additional tax must be due. An FPAA, on the other hand, can be issued if no adjustments are being made or if the IRS has determined that the partnership overreported its taxable income and, therefore, refunds are due to the partners. The IRS is not required to issue an FPAA in these circumstances.[576] Nevertheless, if an examination has been conducted and there are no adjustments, the IRS typically issues Letter 2064, no change FPAA, if the TMP disagrees or there are inconsistencies among the partners. Even if there are no adjustments or the adjustments reduce partnership items, the partners may still file a petition so long as an FPAA is actually issued.[577]

4. Restriction on Assessment

Section 6225(a) provides that no assessment of any deficiency attributable to the partnership items of a TEFRA partnership may be made until: (1) 150 days after the FPAA is mailed to the TMP, or (2) if a Tax Court petition is filed within the 150-day period, until the decision in the Tax Court case has become final.[578] If an assessment is made in violation of §6225(a), §6225(b) authorizes the issuance of an injunction against assessment and collection notwithstanding the Anti-Injunction Act provisions of §7421(a). These provisions parallel the restriction and injunction provisions of §6213(a) for non-TEFRA deficiency cases. Thus, like §6213(a), §6225(b) expressly states that the Tax Court has jurisdiction to enjoin any IRS action during the 150-day period for filing a petition.[579]

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[561] *Triangle Investors LP v. Commissioner*, 95 T.C. 610 (1990); *Seneca, Ltd. v. Commissioner*, 92 T.C. 363 (1989), *aff'd*, 899 F.2d 1225 (9th Cir. 1990) (unpub.); *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988).

[562] *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988); *Byrd Invs. v. Commissioner*, 89 T.C. 1 (1987), *aff'd*, 853 F.2d 928 (11th Cir. 1988) (unpub.).

[563] *Petaluma FX Partners, LLC v. Commissioner*, T.C. Memo 2007-254.

[564] *N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987); *Maxwell v. Commissioner*, 87 T.C. 783 (1986).

[565] *See Abelein v. United States*, 323 F.3d 1210 (9th Cir. 2003); *Austin Inv. Fund v. United States*, 2009-1 USTC ¶ 50,173 (Fed. Cl. 2009). *Note:* To avoid disclosure issues, generally a separate FPAA is required for each tax year when partners are not the same; however, under §6103(h)(4)(B), if tax year 1 resolution conclusively establishes tax year 2 treatment, then the IRS can address those multiple years in a single FPAA. CCA 201509032.

[566] CCA 201125028 (audit termination letter).

[567] *See, e.g., Green Gas Del. Statutory Tr. v. Commissioner*, T.C. Memo 2015-168 (2015), *citing Sealy Power, Ltd. v. Commissioner*, 46 F.3d 382, 385–386 (5th Cir. 1995), *aff'g in part, rev'g and remanding in part* T.C. Memo 1992-168; *Bedrosian v. Commissioner*, 143 T.C. 83, 107 (2014), *aff'd on other grounds*, 940 F.3d 467 (9th Cir. 2019).

[568] *Sealy Power, Ltd. v. Commissioner*, 46 F.3d at 386.

[569] *Scar v. Commissioner*, 814 F.2d 1363, 1369 (9th Cir. 1987).

[570] *Meserve Drilling Partners v. Commissioner*, 152 F.3d 1181, 1183 (9th Cir. 1998), *aff'g* T.C. Memo 1996-72.

[571] *Beaverdam Creek Holdings, LLC v. Commissioner*, T.C. Memo 2025-53.

[572] Tax Court Rule 142; *Marfam Enterprises LLC v. Commissioner*, T.C. Memo 2023-73.

[573] *Anaheim Arena Management, LLC v. Commissioner*, T.C. Memo 2025-68; *Clark Raymond & Co. PLLC v. Commissioner*, T.C. Memo 2022-105; *Genecure, LLC v. Commissioner*, T.C. Memo 2022-52.

[574] *5630 LakePoint Land II, LLC v. Commissioner*, T.C. Memo 2023-111.

[575] *Surk, LLC v. Commissioner*, T.C. Memo 2024-99.

[576] §6230(c)(2), §6230(c)(3); CCA 201115020. *See Atl. Richfield Co. v. United States*, 97-1 USTC ¶ 50,170 (D.D.C. 1996) (TEFRA audit procedures do not require the IRS to issue FPAA at conclusion of every audit; IRS required to mail FPAA to TMP only if one is issued); Reg. §301.6223(a)-2(a) (explicitly informing taxpayers that the IRS does not have to issue an FPAA notwithstanding the issuance of (and failure to withdraw) an NBAP).

[577] Former IRM 4.31.2.3.9.9.

[578] See VII.A., below, for the importance of filing a Tax Court petition on the restriction on assessment. See V.C.3., above, for the importance of filing a timely petition on the suspension of the partnership item statute of limitations.

[579] §6225(b).

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Comment: In non-TEFRA deficiency cases, some case law indicates that the taxpayer's ability to pay the wrongfully assessed tax and sue for refund provides an adequate remedy at law. Therefore, injunctive relief is not appropriate.[580] This argument should not deny injunctive relief in TEFRA partnership cases where an FPAA has been issued, however, because no similar refund remedy exists. See VII.B., below, for a further discussion of this issue. The IRS may still attempt to use this non-TEFRA argument, however, if the allegedly wrongful assessment was made without the issuance of a valid FPAA and, therefore, the refund-like procedures of §6227 and §6228 are available.

5. No Second FPAA

The IRS may not issue a second FPAA to the partnership for the same taxable years absent fraud, malfeasance, or misrepresentation of a material fact.[581] This rule parallels §6212(c) for non-TEFRA notices of deficiency. If no petition is filed and no fraud, etc., exists, the IRS is limited to assessing the computational adjustments based on the original FPAA.[582] If a petition is filed in response to the FPAA, however, the IRS can raise additional adjustments as affirmative issues in the resulting proceeding.[583]

For non-TEFRA notices of deficiency, §6212(d) gives the IRS the authority to rescind the notice with the consent of the taxpayer without running the risk of violating the "no second notice of deficiency" rule for a subsequently issued notice of deficiency. However, the IRS has taken the position that this authority does not allow the IRS to rescind an FPAA under any circumstances.[584]

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[580] *See Cool Fuel, Inc. v. Connett*, 685 F.2d 309 (9th Cir. 1982).

[581] §6223(f). *See, e.g., NPR Invs. LLC v. United States*, 732 F. Supp. 2d 676 (E.D. Tex. 2010) (indicating on a tax return that an entity was not subject to the TEFRA provisions when in fact it was a material misrepresentation that related directly to the proper audit procedures that should have been applied and, thus, justified the issuance of a second FPAA), *aff'd on this issue*, 740 F.3d 998 (5th Cir. 2014); *Am. Milling LP v. Commissioner*, T.C. Memo 2023-83 (*American Milling II*) (period of limitations for assessing tax attributable to partnership items flowing to partnership items or affected items with respect to indirect partner of the same partnership had expired under §6223(e) as the adjustments were made to the same partnership entity and the limitations period was not held open). *But see Am. Milling LP v. Commissioner*, T.C. Memo 2015-192 (*American Milling I*) (earlier holding that second TEFRA partnership was pass-through partner of first TEFRA partnership that had received FPAA for prohibited tax shelter transactions; FPAA issued to second partnership for later tax years for related basis issues was to a different partnership; though some adjustments were related, they were not identical; its TMP unsuccessfully argued that second FPAA was barred by §6223(f)). *See also Wise Guys Holdings LLC v. Commissioner*, 140 T.C. 193 (2013) (second FPAA was invalid and thus disregarded because §6223(f) precluded IRS from issuing second FPAA to TMP; court lacked jurisdiction because petition, although timely filed following receipt of second FPAA, was not timely filed with respect to original FPAA). CCA 202007017 (IRS agrees with general prohibition on issuing second FPAA but explains that if a TEFRA partnership (TP2) is a partner in another TEFRA partnership (TP1) and partner-level factual determinations are needed at the TP2 level to apply the results of the final determination in the TP1 TEFRA proceeding, another FPAA may be issued to TP2 to make those partner-level factual determinations).

[582] §6225(c).

[583] *See* Tax Court Rules 240(a), 241.

[584] Rev. Proc. 98-54, §4.01, *superseding* Rev. Proc. 88-17, §3.01.

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VII. Judicial Stages of Partnership Proceeding

A. Filing the Petition to Contest the FPAA

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

It is critical for the partners to file at least one valid petition in response to the FPAA unless the partners agree with the adjustments contained in the FPAA. The rules concerning the time, manner, and place for filing petitions in response to the FPAA are significantly different from the rules concerning petitions filed in response to a notice of deficiency.

1. Jurisdictional Issues

If the administrative stages of the TEFRA partnership audit proceeding do not result in resolution of the partnership item dispute, the IRS issues the FPAA. The FPAA transforms the partnership proceedings from the administrative phase to the judicial phase because the issuance of the FPAA compels the partners to commence an action in the Tax Court, the district court or the Court of Federal Claims to avoid having the adjustments set forth in the FPAA become final. The principal issues in the judicial phase of the partnership proceeding are:

- the filing rules for the petition;
- the role and participation of the TMP and the other partners in the judicial proceeding;
- the conduct of the judicial proceeding;
- the settlement of the litigation;
- the appeal of adverse determinations.

The application of the partnership adjustments are then applied to the partners in partner-level computational adjustment or affected item proceedings.

The jurisdictional requirements for filing a §6226 action contesting the FPAA differ from the non-TEFRA deficiency rules in several significant respects. The principal jurisdictional requirements are: (1) a validly issued FPAA; (2) a timely petition; and (3) if the petition is filed in the Court of Federal Claims or a U.S. district court, the deposit of an amount equal to the proposed adjustment of tax for the petitioning party.

a. Valid FPAA

The two jurisdictional prerequisites to commencing an action under §6226 in any court are a valid FPAA and a timely petition. Several issues arise concerning the requirement of a valid FPAA. First, a petition may not be filed in response to any of the correspondence received before the FPAA, such as the 60-day letter.[585] Any such petition would be subject to dismissal for lack of jurisdiction.

Second, for jurisdictional purposes it is important to distinguish a challenge to the FPAA based on untimeliness from a challenge that the FPAA is otherwise invalid. For example, if the FPAA is improperly mailed within 120 days from the mailing of the NBAP, the petitioner's motion to dismiss alleging the failure to issue a timely FPAA is properly viewed as a motion to dismiss for lack of jurisdiction rather than a motion to dismiss for failure to observe the limitations period.[586] Similarly, a challenge to the sufficiency of the content of the FPAA would be characterized as a jurisdictional motion.

A challenge based on whether the FPAA was issued within the applicable period of limitations, on the other hand, is not a jurisdictional motion. This statute of limitations issue is merely a defense which can be raised or waived in an otherwise timely filed action. The significance of this distinction is that if the §6226 action is not filed within the jurisdictional period, no action may be brought to challenge the timeliness of the FPAA. This issue is deemed waived and the adjustments in the FPAA become final.[587] If the §6226 action is timely filed, a challenge to the timeliness of the FPAA is properly raised as a motion for summary judgment.

Section 6226(d)(1) confers jurisdiction on the Tax Court to consider statute of limitation issues with respect to partners, thereby allowing a partner to participate in an action or file a petition for the sole purpose of asserting that the period of limitations has expired for that person.[588] This grant of jurisdiction to "consider" an assertion of a statute of limitations defense necessarily includes jurisdiction to reject it, at least for purposes of the partnership proceeding.[589]

b. Which Partners May File and When

The second jurisdictional issue which applies to all judicial actions contesting an FPAA is the requirement of a timely petition. The petition rules for FPAAs specify two separate periods in which different partners are eligible to file a petition. Only the tax matters partner (TMP) may file in the first 90 days after the issuance of the FPAA. Any notice partner or five-percent litigation group (including the TMP) may file in the 60-day period following the TMP's 90-day period.

A separate petition must be filed for each FPAA or AAR issued to separate partnerships.[590] However, if there is an FPAA and an AAR pertaining to the same partnership, a single petition for adjustment or for readjustment of partnership items may be filed.[591] Nevertheless, the Tax Court may order the case severed where it is based on multiple notices or requests.[592]

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[585] *Clovis I v. Commissioner*, 88 T.C. 980 (1987).

[586] *Wind Energy Tech. Assocs. III v. Commissioner*, 94 T.C. 787 (1990). *See also Green Gas Del. Statutory Tr. v. Commissioner*, T.C. Memo 2015-168 (FPAA was not invalid because of its issuance shortly after late NBAP).

[587] *Columbia Bldg., Ltd. v. Commissioner*, 98 T.C. 607 (1992); *Genesis Oil & Gas, Ltd. v. Commissioner*, 93 T.C. 562 (1989); *Cambridge Research & Dev. Group v. Commissioner*, T.C. Memo 1989-679. *See Crowell v. Commissioner*, 102 T.C. 683 (1994) (good-faith effort by IRS to send the FPAA to correct address is all that is required; validity of properly mailed FPAA is not contingent upon actual receipt by TMP or notice partner).

[588] §6226(d)(1).

[589] *MK Hillside Partners v. Commissioner*, 826 F.3d 1200 (9th Cir. 2016).

[590] Tax Court Rule 241(h).

[591] Tax Court Rule 241(h).

[592] Tax Court Rule 241(h).

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(1) Petition Filed by the TMP

The date that triggers the running of the 90-day period in which the TMP may file a petition is the date the FPAA is mailed to the TMP. As discussed in VI.J., above, this date is the earlier of the date the generic FPAA is mailed to "The Tax Matters Partner" or the date the FPAA is mailed to a specific TMP at the TMP's address as contained in the IRS's information base.

The Tax Court has adopted its own definition of a TMP for the jurisdictional purpose of filing a proper Tax Court petition in response to the FPAA. The Tax Court observes the TMP priority structure set forth in §6231(a)(7), which generally provides for the following order of priority: (1) the general partner designated as TMP by the partnership, (2) if there is no designation, the general partner with the largest profits interest, and (3) if there is no designation by the partnership and there are equal general partners, the partner whose name appears first in an alphabetical listing.[593]

In circumstances where this express Code priority does not work, however, the Tax Court has been unwilling to apply the former temporary regulations as the method for determining the proper TMP to file a Tax Court petition. The reasoning behind this position was that the temporary regulations did not establish the jurisdictional prerequisite for filing a Tax Court petition. The Tax Court will accept a petition as the TMP's petition so long as the petition is filed by a general partner who establishes that the filing of the petition was made with sufficient authorization by the partnership.[594] This authorization can be implied ratification.[595] Reg. §301.6231(a)(7)-1, adopted in 2001,[596] is substantially the same as the temporary regulations, so presumably the same result applies.

The Tax Court has also refused to hold that the mailing of an FPAA to a named partner constitutes IRS designation of that partner as TMP for the jurisdictional purpose of filing a Tax Court petition. The Tax Court has held that such mailing does not comply with the formal procedures established in the temporary regulations for IRS designation of a TMP.[597]

The rules concerning the bankruptcy of a TMP may also have an impact on that TMP's ability to file the Tax Court petition as TMP. Even though the filing of a bankruptcy petition by the TMP revokes the TMP's designation, a subsequent redesignation of that partner as TMP after the partner's discharge in bankruptcy apparently gives that redesignated partner sufficient authority to petition the Tax Court as TMP.[598]

If the TMP's 90-day period ends on a holiday, the normal §7503 rule applies and dictates that the 90-day period is extended through the end of the next business day in the District of Columbia.[599] The §7502 timely mailing as timely filing rule also apparently applies, allowing the TMP's petition to be mailed on the 90th day so long as the mailing is made by the U.S. Postal Service or other recognized courier.

(2) Petition Filed by Other Parties

The notice partners and any five-percent litigation group may file a petition contesting the FPAA in the 60-day period following the close of the TMP's 90-day period if the TMP does not file a petition.[600] This 60-day period applies whether or not the TMP receives the FPAA.[601] If the TMP files a timely petition in the 90-day period, all subsequent notice partner petitions are subject to dismissal. The fact that the readjustment petition filed by a notice partner or a five-percent litigation group relates to different partnership items from the partnership items addressed in the readjustment petition previously filed by the TMP for the same FPAA does not give the Tax Court jurisdiction to hear the petition by a notice partner or a five-percent litigation group.[602]

An extension of the TMP's 90-day period which results from the 90th day falling on a weekend or holiday will extend the commencement of the 60-day period for notice partners and five-percent litigation groups.[603] The §7503 weekend or holiday rule and the §7502 timely mailing as timely filing rule also appear to apply in determining the final date on which the petition may be filed by the notice partners or five-percent litigation groups.[604]

Generally, however, a petition filed after the statutory 150-day deadline will be considered untimely. In *N. Wall Holdings*, the Tax Court considered whether equitable tolling could apply to TEFRA petition deadlines. The court reasoned that given TEFRA's specific deadlines, technical rules, and clearly laid out exceptions, the regime leaves no room for flexibility, making it clear Congress did not intend for equitable tolling to apply. Thus, the court held that the 150-day deadline is jurisdictional, and the petition, which was filed more than

[593] *See Sierra Design Research & Dev. LP v. Commissioner*, T.C. Memo 1989-506.

[594] *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988); *Devonian Program v. Commissioner*, T.C. Memo 2010-153, *aff'd*, 2011-2 USTC ¶ 50,564 (2d Cir. 2011) (unpub.); *Modern Computer Games, Inc. v. Commissioner*, T.C. Memo 1989-483; *Summerland P'ship v. Commissioner*, T.C. Memo 1988-548.

[595] In *Mishawaka Props.*, the Tax Court petition was filed by a partner who, although not designated as the TMP, handled all of the partnership's dealings with the IRS. The court held that the principle of implied ratification applied in the TEFRA partnership proceeding; thus, the partners, including the actual TMP, were deemed to have ratified the petition filed by the non-TMP. The court stated that the partners, through their knowledge, action, and inaction, authorized the petition. *Mishawaka Props. Co. v. Commissioner*, 100 T.C. 353 (1993). In *Davenport*, the Tax Court again applied the principle of implied ratification to uphold extension and settlement agreements which the purported TMP had entered into with the IRS despite his having been restricted to administrative TMP services as part of a §7408 injunction settlement. *Davenport Recycling Assocs. v. Commissioner*, T.C. Memo 1998-347, *aff'd*, 220 F.3d 1255 (11th Cir. 2000).

[596] T.D. 8965, 66 Fed. Reg. 50541 (Oct. 4, 2001). The final regulation is effective for partnership tax years beginning on or after October 4, 2001. The former temporary regulation is effective for partnership tax years beginning before that date.

[597] *Sierra Design Research & Dev. LP v. Commissioner*, T.C. Memo 1989-506; *PAE Enters. v. Commissioner*, T.C. Memo 1988-222.

[598] *Barbados #7 Ltd. v. Commissioner*, 92 T.C. 804 (1989).

[599] *Transpac Drilling Venture 1982-22 v. Commissioner*, 87 T.C. 874 (1986).

[600] §6226(b)(1); *1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990), *aff'd*, 995 F.2d 235 (9th Cir. 1993) (unpub.).

[601] *Berkshire 2006-5 LLP v. Commissioner*, T.C. Memo 2016-25; *Han Kook LLC I-1 v. Commissioner*, T.C. Memo 2011-222; *Han Kook LLC I-D v. Commissioner*, T.C. Memo 2011-223.

[602] *Columbia/St. David's Healthcare Sys. LP v. Commissioner*, 264 F.3d 1140 (5th Cir. 2001) (unpub.).

[603] *Transpac Drilling Venture 1982-22 v. Commissioner*, 87 T.C. 874 (1986); *Sierra Design Res. & Dev. LP v. Commissioner*, T.C. Memo 1989-506; *Buzick v. United States*, 15 Cl. Ct. 289 (1988).

[604] *Sierra Design Research & Dev. LP v. Commissioner*, T.C. Memo 1989-506.

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150 days after the FPAA was mailed to the TMP, was untimely.[605]

A petition filed prematurely by notice partners or any five-percent litigation group during the 90-day period will not be immediately dismissed. If the TMP does not file a petition within the 90-day period but a notice partner or five-percent litigation group files a petition during the 90-day period, §6226(b)(5) treats the premature petition as if it were filed on the last day of the ensuing 60-day period. This measure preserves the opportunity for judicial review.[606]

One general requirement exists with respect to any notice partner or five-percent litigation group which attempts to file a petition in the 60-day period. Section 6226(d)(2) allows this notice partner or five-percent litigation group to file a petition only if the petitioning partner has an interest in the outcome of the proceeding. Specifically, §6226(d) provides that the partnership items for such petitioning partner must not have been converted to nonpartnership items and the statute of limitations for assessment of those partnership items must not have expired. Indirect partners do have a sufficient interest in the outcome of the proceeding to be recognized as members of a five-percent litigation group.[607]

Comment: The requirement that the partner have an interest in the outcome applies only to petitions filed by notice partners or five-percent litigation groups, and does not specifically apply with respect to the TMP. While the conversion of partnership items to nonpartnership items typically terminates a TMP designation, situations frequently arise in which the sole general partner has no profits interest in the partnership. While this TMP could not petition as a notice partner because of §6226(d), this section apparently does not prevent the TMP from petitioning as TMP in the initial 90-day period. However, a TMP with no profits interest in the partnership may be challenged by the IRS as not being a partner and, therefore, not being eligible to serve as TMP.[608]

Several technical issues apply to the determination of whether a partner is eligible to file a petition in the 60-day period. First, if the TMP does not file a petition within the 90-day period but does file a petition within the 60-day period, the Tax Court considers the petition as one filed by a partner other than the TMP. Therefore, the petition is valid if the TMP is entitled to petition as a notice partner during that 60-day period.[609] Second, the five-percent litigation group that is authorized to file in the 60-day period is not the same as the five-percent notice group that may receive the NBAP and FPAA through a group representative. All members of the five-percent litigation group must sign the petition before the group is recognized by the court.[610] Finally, if a partner is a non-notice partner but nevertheless receives the FPAA pursuant to the IRS's standard administrative practice, the receipt of this FPAA will not elevate this non-notice partner to the status of a notice partner for purposes of filing a petition.[611]

The Tax Court is apparently lenient in recognizing an imperfect petition filed by an authorized representative not admitted to practice before the Tax Court so long as the representative clearly has the authority and direction to act on behalf of a properly petitioning party.[612] This practice is consistent with the Tax Court's focus on the substantive authority of the person filing the petition rather than on the compliance with the formal procedures provided in the regulations or other administrative pronouncements.

c. District Court and Court of Federal Claims Petitions

Section 6226 authorizes litigation contesting the FPAA to be conducted in the Tax Court, U.S. district court, or the Court of Federal Claims. While this choice of courts is the same as in a non-TEFRA action, the rules concerning access to these various forums differ. In a non-TEFRA case, the taxpayer may petition before payment to the Tax Court or may pay the tax liability in full and sue for refund in the district court or Court of Federal Claims. The TEFRA rules modify the payment requirements for petitions to the district court or the Court of Federal Claims.

Section 6226(e)(1) allows a partner to petition to a U.S. district court or the Court of Federal Claims after that partner deposits an amount with the IRS which is approximately equal to the additional tax due with respect to that partner's share of the partnership item adjustments. Failure to pay the deposit deprives the court of jurisdiction.[613] It is not entirely clear whether the statute requires a deposit of the total tax liability for all affected years or just the liability for the year for which the FPAA was issued.[614] If the petition is filed by a five-percent litigation group, each group member must satisfy the deposit requirement. If a pass-thru partner files the petition, each indirect partner holding an interest through the pass-thru partner must meet the deposit requirement.[615]

The petitioning partner may contact the "contact person" identified in the FPAA for assistance in calculating the required deposit. The deposit is completely separate from any nonpartnership item liability which the petitioning partner may have, and, therefore, the partner need not pay any outstanding nonpartnership item liability for the deposit to be sufficient. The

[605] *N. Wall Holdings LLC v. Commissioner*, 165 T.C. No. 9 (Oct. 21, 2025).

[606] §6226(b)(5).

[607] *PCMG Trading Partners XX, LP v. Commissioner*, 131 T.C. 206 (2008).

[608] See III.A.1., above, for further discussion of this issue.

[609] *Barbados #6 Ltd. v. Commissioner*, 85 T.C. 900 (1985). *See MK Hillside Partners v. Commissioner*, 826 F.3d 1200 (9th Cir. 2016) (90-day period having expired, TMP filed petition as partner other than TMP).

[610] Reg. §301.6223(b)-1(e), Reg. §301.6226(b)-1(a).

[611] *Energy Resources, Ltd. v. Commissioner*, 91 T.C. 913 (1988). *See also Gov't Arbitrage Trading Co. v. Commissioner*, T.C. Memo 1994-136.

[612] *Montana Sapphire Assocs. v. Commissioner*, 95 T.C. 477 (1990); *Sente Inv. Club P'ship of Utah v. Commissioner*, T.C. Memo 1988-376. *But see Transpac Drilling Venture v. United States*, 16 F.3d 383 (Fed. Cir. 1994) (retroactive ratification not allowed).

[613] *See Riggle v. United States*, 131 Fed. Appx. 273 (Fed. Cir. 2005), *cert. denied*, 126 S. Ct. 586 (2005).

[614] *See Kislev Partners LP v. United States*, 84 Fed. Cl. 378 (2008) (deposit for all affected years required); *Russian Recovery Fund, Ltd. v. United States*, 90 Fed. Cl. 698 (2009) (same). *But see Prestop Holdings LLC v. United States*, 96 Fed. Cl. 244 (2010) (both *Kislev* and *Russian Recovery* are mistaken in requiring partner to pay total, multi-year tax liability associated with the adjustment made in the FPAA as a precondition to challenging that adjustment).

[615] Reg. §301.6226(e)-1(a); *Natalie Holdings, Ltd. v. United States*, 2003-1 USTC ¶ 50,233 (W.D. Tex. 2003) (because petitioning partner was an S corporation, pursuant to §1366–§1368, shareholders, not corporation, had to make tax deposits).

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deposit will not be offset against the nonpartnership item liability while the partnership case is pending.[616]

Courts have shown leniency in enforcing the deposit requirement. For example, where the TMP made a good faith effort to satisfy the deposit, the court allowed the TMP to make up the balance of the funds required to satisfy the shortfall to avoid dismissal for lack of jurisdiction.[617] In another case, the court declined to dismiss the petition for readjustment where the partnership made a prima facie showing of a good faith effort to calculate the deposit under §6226(e)(1).[618]

The jurisdictional deposit is not considered a payment of tax except with respect to the interest provisions in the Code.[619] Interest will be paid by the IRS if the deposit is refunded at the conclusion of the partnership proceeding. However, the refund of the deposit is not subject to Joint Committee review under §6405 because the deposit is not a payment of tax for other refund purposes.

Observation: This deposit mechanism represents a significant departure from the non-TEFRA rule. In a non-TEFRA proceeding, all partners would receive a separate notice of deficiency, and each partner would be required to pay that partner's full amount of the tax before contesting the adjustments in a district court or the Court of Federal Claims.[620] Only the petitioning partner is required to make the jurisdictional deposit in a §6226 district court or Court of Federal Claims action. While prepayment by all partners is not required under this deposit procedure, the IRS may assess and collect against all partners who do not make the deposit after a district court or Court of Federal Claims action is filed. See VII.A.3., below, for further discussion of this issue.

After the jurisdictional deposit is paid, the district court or Court of Federal Claims has jurisdiction so long as a timely petition is filed in response to a valid FPAA. So long as at least one partner continues to have an interest, however, nothing more is required. If no partner has an interest in the outcome or all known partners have settled, however, the petition may be subject to dismissal for lack of standing.[621] District court venue exists in the judicial district where the partnership's principal place of business is located on the petition date.[622] The principal place is the partnership's "nerve center" where major decisions are made.[623] The Court of Federal Claims has national jurisdiction so venue is not an issue.

2. Priority of Multiple Petitions

Section 6226 establishes a priority scheme for determining which case will go forward when multiple petitions have been filed. The first priority is afforded to a petition filed by the TMP in the initial 90-day period after the FPAA has been mailed to the TMP.[624] If the TMP does not file within this 90-day period, the next priority goes to the first Tax Court case filed by a notice partner or five-percent litigation group.[625] If no Tax Court petition is filed, the first petition filed in the Court of Federal Claims or the district court for the district where the partnership's principal place of business is located is entitled to priority.[626]

This priority scheme means that the TMP controls the choice of forum for the first 90-day period. If no petition is filed by the TMP in the 90-day period, one notice partner can then force litigation in Tax Court even if all other notice partners wish to file in the district court or Court of Federal Claims. Any additional petitions which are not entitled to the priority set forth above are dismissed.[627] If jurisdictional deposits (which are required in cases not filed in Tax Court) are made in cases which are ultimately dismissed, the deposit is refunded by the IRS upon request.[628] While this scheme seems simple on the surface, related questions concerning the identity of the TMP and the effects of bankruptcy and other events that convert partnership items to nonpartnership items can result in confused situations involving multiple petitions.[629]

Comment: The confusion in this area can create a substantial problem. If a petition is filed which appears to satisfy the jurisdictional requirements, the rules concerning the priority of multiple petitions may discourage other partners from filing additional petitions. If the initial petition is ultimately determined to be jurisdictionally deficient, however, that petition is subject to dismissal. If no other petition has been filed, the partnership may be deemed to have failed to file a timely petition in response to the FPAA.

As discussed in VII.B., below, the failure to file a petition has dramatically adverse consequences. The courts seem to allow liberal ratification of invalid petitions in these situations.[630] Partnerships that are unwilling to rely on the courts' good graces, however, should file a "backup" petition to ensure that at least one petition will be deemed timely and validly filed.

If the TMP does not file in the 90-day period and a notice partner or five-percent litigation group petition survives in the priority scheme, the TMP is given the opportunity to intervene in the case.[631] This intervention allows the TMP to be an active participant in the case.

3. Relative Merits of Alternative Forums

The partnership has the choice of three forums in which to litigate the adjustments asserted by the IRS in the FPAA: (1)

[616] Reg. §301.6226(e)-1(a), §301.6226(e)-1(c), §301.6226(e)-1(d).

[617] *See Kislev Partners LP v. United States*, 84 Fed. Cl. 378 (2008); *Span Hansa Mgmt. Co. v. United States*, 91-1 USTC ¶ 50,213 (W.D. Wash. 1991).

[618] *Maarten Investerings P'ship v. United States*, 2000-1 USTC ¶ 50,241 (S.D.N.Y. 2000).

[619] §6226(e)(3); Reg. §301.6226(e)-1(b), Reg. §301.6226(e)-1(c).

[620] See *Flora v. United States*, 362 U.S. 145 (1960), and 631 T.M., *Refund Litigation*, for further discussion of the payment requirement before conducting a non-TEFRA refund action.

[621] *SESCO Enters., LLC v. United States*, 450 Fed. Appx. 141 (3d Cir. 2011) (unpub.).

[622] §6226(a)(2); Reg. §301.6226(a)-1.

[623] *Kearney Partners Fund, LLC v. United States*, 814 F. Supp. 2d 1349 (M.D. Fla. 2011); *Uviado LLC v. United States*, 755 F. Supp. 2d 767 (S.D. Tex. 2010).

[624] §6226(a), §6226(b)(1); *Transpac Drilling Venture 1982-22 v. Commissioner*, 87 T.C. 874 (1986).

[625] §6226(b)(2). *See PCMG Trading Partners XX, LP v. Commissioner*, 131 T.C. 206 (2008) (subsequent petitions by indirect partners solely to raise statute of limitations issues are subject to dismissal).

[626] §6226(b)(3).

[627] §6226(b)(4).

[628] §6226(d)(2).

[629] *See Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987); *Gran Esperanzas P'ship v. Commissioner*, T.C. Memo 1989-113; *Summerland P'ship v. Commissioner*, T.C. Memo 1988-548.

[630] See VII.A.1.b., above.

[631] §6226(b)(6).

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Tax Court, (2) district court, and (3) Court of Federal Claims. The Tax Court and the Court of Federal Claims have national jurisdiction, and the petitions are filed with the court in Washington, D.C. The U.S. district courts do not have national jurisdiction, and the petition must be filed in the judicial district where the partnership's principal place of business is located.[632] For this purpose, the partnership's principal place of business is determined as of the petition date and not as of the date the return is filed or the date the FPAA is issued.[633] The "principal place of business" language is a venue provision, and objections to venue can be waived. Thus, if the IRS issues an FPAA to a dissolved partnership, a notice partner files a petition for readjustment in a judicial district other than the one in which the partnership's principal place of business was located before the dissolution, and the IRS agrees that venue is proper, the district court may not dismiss the action for a lack of jurisdiction.[634]

One critical distinction between a Tax Court petition and a district court or Court of Federal Claims petition is that if the partnership action is filed in U.S. district court or Court of Federal Claims and the petitioning partner makes the jurisdictional deposit, the restriction on assessment contained in §6225(a) does not apply to the other partners. Section 6225(a) restricts assessment of the tax attributable to the partnership item adjustments against all partners only if the petition contesting the FPAA is filed in Tax Court. Accordingly, the IRS is entitled to assess the tax attributable to the partnership item adjustments in the FPAA against all partners even if a U.S. district court or Court of Federal Claims petition is timely filed and the jurisdictional deposit is paid. Reg. §301.6226(e)-1(d) provides that if the §6225(a) restriction on assessment lapses during the pendency of a district court or Court of Federal Claims petition and the assessment is made against the petitioning partner, the jurisdictional deposit may be applied to pay the tax assessed.

Note: While a U.S. district court or Court of Federal Claims petition does not restrict assessment of the tax attributable to partnership items, a petition in either of these two courts does suspend the statute of limitations for assessment of partnership items.[635] Because this suspension of the statute of limitations applies, the IRS is not compelled to assess the tax attributable to the partnership item adjustments contained in the FPAA. It is unlikely the IRS as an administrative practice will withhold assessment of the tax attributable to the partnership item adjustments in these U.S. district court or Court of Federal Claims cases, however.

One tactical advantage to filing a non-TEFRA refund action in a U.S. district court is the availability of a jury trial. However, a refund action is based on the allegation that the tax paid exceeds the correct tax. Because the jurisdictional deposit is not treated as a payment of tax, 28 U.S.C. §1396 and 28 U.S.C. §1491 do not appear to apply and a jury trial does not appear to be available for a petition contesting the FPAA in district court.[636] With this potential benefit removed, and with the possibility of assessment of the tax if a district court or Court of Federal Claims petition is filed, there appears to be little benefit to filing the action contesting the FPAA in district court or Court of Federal Claims. If the district court or Court of Federal Claims is likely to be more receptive to the partnership's arguments or if the partnership desires a broader range of discovery, however, the district court or Court of Federal Claims alternative should be explored.

For discussion of the relative benefits of conducting a case in these alternative forums, see 630 T.M., *Tax Court Litigation*, and 631 T.M., *Refund Litigation.*

4. Contents of the Petition

The Tax Court Rules provide the most detailed requirements concerning the contents of a petition contesting an FPAA. The Court of Federal Claims subsequently enacted Appendix F to the Rules of the Court of Federal Claims which addresses TEFRA partnership proceedings. These rules are modeled after the Tax Court Rules.

Tax Court Rules 240(d) and 241 set the following required contents of a Tax Court petition:

- The name of the partnership and the full name of any partner filing the petition stated in the caption with an indication whether the petitioning partner is the "Tax Matters Partner" or is "A Partner Other Than the Tax Matters Partner" (the caption should also state that the petition is a "Petition for Readjustment of Partnership Items");
- The name and address of the petitioning partner;
- The name, taxpayer identification number, and principal place of business of the partnership at the time the petition is filed;
- The date the FPAA was mailed to the TMP;
- The taxable periods for which the FPAA was issued;
- Clear and concise statements of each and every error alleged to have been committed by the IRS in the FPAA;
- Clear and concise statements of the facts upon which the petitioner bases the assignments of error;
- A prayer for relief;
- The signature, mailing address, and telephone number of each petitioning partner or the petitioner's counsel;
- An attached copy of the FPAA including so many of the accompanying statements as are material;
- If the petition is filed by the TMP, a statement that the petitioning partner is the TMP; and
- If the petitioning partner is a partner other than the TMP:

  (i) a statement that the petitioning partner is a notice partner (groups of notice partners cannot file a joint petition) or a five-percent litigation group representative,

[632] A partnership with a principal place of business outside the United States is treated as being located in the District of Columbia. §6230(j).

[633] Reg. §301.6226(a)-1.

[634] *TransCapital Leasing Assocs., 1990-II, LP v. United States*, 398 F.3d 1317 (Fed. Cir. 2005).

[635] §6229(d).

[636] *RCL Props., Inc. v. United States*, 2009-1 USTC ¶ 50,351 (D. Colo. 2009); *Thomas v. United States*, 695 F. Supp. 1021 (E.D. Mo. 1988).

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(ii) a statement establishing facts sufficient to establish that the petitioning partner has an interest in the outcome of the proceeding as required by §6226(d),

(iii) a statement containing the name and current address of the TMP, and

(iv) a statement that the TMP has not filed a petition within the TMP's 90-day petition period after the FPAA was sent to the TMP.

Practical Comment: The petitioning partner should take some care in establishing sufficient facts; for example, if the §6229 statute of limitations is open as to the petitioning partner only if that partner participated in the fraud on the partnership return, the petitioning partner must be careful not to admit participation in the fraud in establishing that the statute of limitations is open as to that partner in order to establish an interest in the outcome of the proceeding under §6226(d)(1)(B).

Any party other than the petitioning partner may file an amendment to the petition to raise additional partnership item issues not raised in the original petition. This procedure does not allow the petitioning partner or any other partner to amend the petition to add years which were not timely petitioned, however.[637] An amendment by a nonpetitioning partner for a petitioned year must be filed within 90 days after the petition is served on the IRS.[638] This procedure allows all nonpetitioning partners to raise any partnership item issues for the taxable year contained in the FPAA.[639] Because the judicial action contesting an FPAA resolves all partnership item issues for the years petitioned with finality, it is important that all potential "refund" issues be raised in the petition or in an amendment to the petition to ensure that the issues will be addressed.[640] The amendment to the petition may be filed only with leave from the court after the 90-day period.[641]

Because §6226(f) provides that an FPAA action covers all partnership items for the years petitioned, the IRS may also amend its answer to raise issues which were not raised in the FPAA. As with a new matter raised by the IRS after issuance of a notice of deficiency in a non-TEFRA case, the IRS has the burden of proof on any new matter raised after issuance of an FPAA.[642]

While the Federal Rules of Civil Procedure do not contain detailed rules governing the contents of a petition filed in the district court, the Tax Court Rules provide guidance as to the contents of a U.S. district court petition. In addition to the contents specified by the Tax Court Rules, a district court or Court of Federal Claims petition or complaint should also allege the jurisdictional basis for the petition and the satisfaction of the deposit requirement. A district court complaint should also specify the basis for venue, i.e., the partnership's principal place of business as of the date the petition was filed.[643]

B. Effect of No Contest

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

If the partnership or any partner does not agree with the adjustments proposed in the FPAA, a petition must be filed by the TMP within the 90-day period or by a notice partner or five-percent litigation group in the ensuing 60-day period. If no petition is filed within these periods, the opportunity to contest the partnership item adjustments in the FPAA is lost. The IRS then makes a computational adjustment and bills the partner for the partner's distributive share of the adjustments contained in the FPAA. The partner's only recourse is to contest the computational issues (not the substantive FPAA adjustments) in a §6230(c) refund procedure. See VIII.B., below, for further discussion of the computational adjustment procedures.

The exclusivity of the 150-day "prepayment" forum as a means for contesting the FPAA represents a significant departure from the procedure that applies in non-TEFRA cases. In non-TEFRA cases, the taxpayer may pay the tax, file a claim for refund, and file a refund suit if the claim is denied. This procedure is available so long as the claim for refund is filed within two years after the date the tax is paid and the refund suit is filed within two years after the claim is denied.[644] In a TEFRA partnership proceeding, however, the equivalent of the claim for refund is an AAR. Section 6227(a)(2) provides that an AAR may be filed only before the FPAA is mailed to the TMP. After the FPAA has been mailed to the TMP, there is no opportunity for any refund claim to be filed with respect to the partnership item adjustments in the FPAA or any other partnership item refund claims.[645] The exclusive remedy of filing a petition within the 90-day or 60-day period is jurisdictional. Even a claim that the FPAA was not mailed within the applicable period of limitations cannot be asserted if the partners do not file a timely petition under §6226.[646]

Comment: Because of the critical nature of the petition contesting the FPAA, it is also important that the case be actively pursued and that no action be taken that could result in an unintentional dismissal. If the §6226 action is dismissed and cannot be reinstated, the partnership loses the opportunity to contest the partnership item adjustments made in the FPAA.[647]

A limited form of relief from this jurisdictional bar may be available in bankruptcy. Even if no petition was timely filed in response to the FPAA, the bankruptcy court retains jurisdiction

[637] *Tempest Assocs. v. Commissioner*, 94 T.C. 794 (1990).

[638] Tax Court Rule 245(b), (e).

[639] §6226(f).

[640] §6226(g), §6226(h). *See Jaco, L.C. v. Commissioner*, T.C. Memo 2000-265 (court can consider issue-reducing partnership items but lacks jurisdiction to order resulting refunds).

[641] Tax Court Rule 245(e).

[642] Tax Court Rule 142(a).

[643] Reg. §301.6226(a)-1. If the partnership's principal place of business is outside the United States, venue is established in the District of Columbia. §6230(j). *See Peat Oil & Gas v. Commissioner*, T.C. Memo 1993-130 (in determining principal place of business for venue on appeal, parties and courts should rely on entity's representations made when forum shopping not apparent).

[644] §6511(a), §6532(a).

[645] §7422(h). *See also Trost v. Commissioner*, 95 T.C. 560 (1990).

[646] *Genesis Oil & Gas, Ltd. v. Commissioner*, 93 T.C. 562 (1989).

[647] §6226(h); *Nunez v. Commissioner*, 710 F. Supp. 745 (E.D. Cal. 1989).

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to review the partnership item determination with respect to the bankrupt partner and the "finality" of the FPAA is not *res judicata* in that bankruptcy proceeding.[648]

C. Role of the TMP

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TMP plays an essential role in the judicial phase of the TEFRA partnership proceeding. The most comprehensive treatment of the TMP's role appears in the Tax Court Rules, which set forth the following duties to be fulfilled by the TMP:

- notifying all partners of the filing of the Tax Court petition and otherwise keeping the other partners fully informed of the partnership action;[649]
- signing a stipulation consenting to entry of decision which binds all partners and certifies that no party objects to entry of the decision (this is not a mandatory duty but is an action which may be taken only by the TMP);[650]
- if the TMP does not consent to entry of decision, serving copies of the IRS's motion for entry of decision, a copy of the proposed decision, a copy of the IRS's certificate of service on the court, and a copy of Tax Court Rule 248 on all other parties to the action within three days after receiving the IRS's certificate;[651] and
- receiving and serving within seven days on all parties a copy of the IRS's statement of the identity, taxable year, and terms of the settlement of partnership items entered into between the IRS and any partner.[652]

The TMP is considered to be a party to the proceeding whether or not the TMP files the petition or elects to be a participating partner.[653]

Comment: This allows the court to sanction the TMP for failure to perform the TMP function even if the TMP does not file a petition and has already settled the audit personally and had the TMP's partnership items converted to nonpartnership items.

As such, the TMP is required to perform these duties even if the Tax Court petition was filed by a notice partner. To assist the TMP in performing these tasks, the Tax Court and the parties are directed to serve copies of all pleadings on the TMP in every case.[654] Even if the TMP fails to provide the required notices to the partners, however, the partners acquire no additional rights and are bound by the result of the partnership proceeding.[655]

Because of this critical role in the Tax Court procedure, the Tax Court requires the continuous appointment of a TMP during the pendency of the case. Tax Court Rule 250 allows the Tax Court to appoint a new TMP or remove and replace the TMP to ensure the existence of a properly functioning TMP. If necessary, the Tax Court will appoint a limited partner as TMP if no general partner is available to serve.[656]

The role of the TMP in the Tax Court proceeding makes it important to appoint a TMP who is willing to fulfill the substantial obligations that come with the position. It is also important for the partner who agrees to be TMP to understand that TMP status, once assumed, cannot be abandoned at will. While the regulations provide a procedure for resigning as TMP during the administrative stage of the TEFRA proceeding (as discussed in III.A.1., above), there is no express provision in the Tax Court Rules allowing the TMP to resign. In practice, it can be expected that the Tax Court will not be receptive to the resignation of a TMP during the pendency of a Tax Court proceeding unless a qualified replacement TMP is designated and approved by the partners who are parties to the action.

Note: There has been considerable criticism of the powers conferred on the TMP by the Tax Court Rules.[657] These concerns are particularly acute in the case of tax shelter partnerships when the promoter is the TMP. A number of inherent conflicts of interest in these situations cast doubt on the fairness of the Tax Court Rules in this respect.

D. Right of Other Partners to Conduct or Join Litigation

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Each partner in the partnership is treated as a party to the §6226 action so long as that partner's partnership items

[648] *Cent. Valley Ag Enters. v. United States*, 531 F.3d 750 (9th Cir. 2008).
[649] Tax Court Rule 241(f). *See* §6223(g).
[650] Tax Court Rule 248(a).
[651] Tax Court Rule 248(b).
[652] Tax Court Rule 248(c).
[653] Tax Court Rule 247(a).
[654] Tax Court Rule 246(b), (c).
[655] §6230(f); *Kimball v. Commissioner*, T.C. Memo 2008-78.
[656] *Computer Programs Lambda II*, 90 T.C. 1124 (1988). Note, however, that the Tax Court is not required to appoint a TMP to continue litigation when the partnership itself fails to do so. *Cinema '84 v. Commissioner*, 412 F.3d 366 (2d Cir. 2005), *cert. denied sub nom. Reigler v. Commissioner*, 126 S. Ct. 631 (2005).
[657] *See generally* Note, "United States Tax Court, Part Six: Partnership Proceedings," 52 *Albany L. Rev.* 163 (1987).

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have not been converted to nonpartnership items.[658] A partner is treated as a party even if the adjustments in the FPAA have no impact on that partner.

Example: P Partnership consists of partners B, C, and D Corporation (an S corporation). The issue in the audit is whether the distributive shares claimed by B, C, and D Corporation are correct. This issue is summarized as follows:

Partner	As Claimed	Per IRS
B	30%	20%
C	30%	40%
D	40%	40%

D Corporation is treated as a party even though the FPAA does not propose an adjustment that impacts D Corporation.

Although not named parties to the proceeding, nonpetitioning partners are nevertheless parties to the court proceeding under §6226(d) as if they had personally petitioned.[659] In addition, non-notice partners are included as parties in the FPAA proceeding so long as the non-notice partners' partnership items have not been converted to nonpartnership items. There is no limitation of the "party" definition in §6226(c) to notice partners.

The partners other than the TMP have two ways in which to participate in the litigation contesting the FPAA. First, if the TMP does not file a petition within the 90-day period after the FPAA is mailed, a notice partner or a five-percent litigation group may file a petition contesting the FPAA within the 60-day period following the TMP's 90-day period. See VII.A.1.b., above, for further discussion of these issues. Even if a petition is filed by a partner other than the TMP, however, the TMP is allowed to intervene in the resulting judicial action within 90 days after the petition is served on the IRS.[660] This intervention allows the TMP to participate in a position substantially similar to that which the TMP would be in if the TMP filed the petition in the first instance. As discussed in VII.C., above, however, even if the TMP does not intervene, many of the TMP responsibilities remain with the TMP when another partner files the petition.

The second manner in which partners may participate in the litigation is by becoming a "participating partner." This status is not limited to notice partners and five-percent group representatives but rather is available to all partners in the partnership.[661] Tax Court Rule 245(b) specifies the procedure for a partner to be recognized as a participating partner.[662] The partner must file a notice of election to participate which bears the caption of the case and sets forth the facts establishing that the partner satisfies the "interest in the outcome" requirement of §6226(d).[663] The notice of election to participate must be filed within 90 days after the date the petition is served on the IRS. The Tax Court has the authority to grant leave to file a notice of election to participate outside of this 90-day period upon a showing of sufficient cause.[664] The Tax Court will typically allow an untimely notice of election to participate to be filed when the partner has directly filed a petition which is ultimately dismissed under the priority scheme provided in §6226 for multiple petitions.[665] The district courts will also allow a participating partner to intervene so long as it is done in a timely fashion and does not prejudice other parties.[666]

After a partner files the notice of election to participate, this participating partner becomes entitled to special recognition in the court proceeding.[667] Tax Court Rule 245(e) allows a participating partner to file an amendment to the petition to raise new issues. This amendment must be filed within the same time period as the notice of election to participate (i.e., within 90 days after the petition is served on the IRS) unless leave of court is granted to file late. Tax Court Rule 246 provides that a participating partner is also entitled to be directly served with all papers issued by the court or by any party. Tax Court Rule 248(b) effectively requires separate consent from all participating partners before the IRS can move to enter a settlement decision in a case when the TMP does not settle the case for all partners.[668]

The notice of election to participate greatly enhances the partner's direct access to information concerning the proceeding and the partner's involvement in the settlement of the partnership item adjustments. If confusion exists concerning the identity of the TMP or if the identified TMP is not completely cooperative, a partner should consider filing the notice of election to participate to ensure the receipt of sufficient notice and opportunity to settle the partnership item adjustments.

[658] §6226(c)(1), §6226(d). Since there is a unified statute of limitations under §6229 for all partner's partnership items in most circumstances, the §6226(d)(1)(B) exception for an expired statute of limitations should arise only in the situations in which the treatment is not uniform (e.g., participants/nonparticipants in fraud on the return, the IRS's failure to comply with §6223 notice requirements and the exceptional case where the IRS solicits partner-level statute extensions for partnership items). *See, e.g., Shapiro v. United States*, 951 F. Supp. 1019 (S.D. Fla. 1996) (limited partner is bound by Tax Court's decision, upholding partnership adjustments, because each partner in a partnership that is the subject of an action under §6226 is treated as a party to the action).

[659] *See* CCA 201030030 (as a result of decision in *Salman Ranch LTD v. United States*, 573 F.3d 1362 (Fed. Cir. 2009), holding that overstatement of basis may not constitute omission from gross income for purposes of limitations period under §6501(e)(1)(A), IRS must issue refunds to named parties as well as nonpetitioning partners).

[660] §6226(b)(6); Tax Court Rule 245(a).

[661] §6226(c)(2); Tax Court Rule 245(b).

[662] Nonparticipating partners' rights to participate in a TEFRA proceeding under §6226(c)(2) are not absolute but are subject to the requirements of the Tax Court Rules. *Blomquist Holdings, LLC v. Commissioner*, 165 T.C. No. 6, (Sept. 17, 2025).

[663] *Sugarloaf Fund LLC v. Commissioner*, 141 T.C. 214 (2013) (election to participate rejected because subtrust did not have interest as partner).

[664] *Chimney Rock Holdings, LLC v. Commissioner*, T.C. Memo 2025-39 (Grounds for intervening after TMP settlement not sufficient).

[665] *See Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987).

[666] *See Sixty-Three Strategic Inv. Funds v. United States*, No. C 05-1123 VRW, 2005 BL 101347 (N.D. Cal. 2005). *See also Imprimis Investors LLC v. United States*, 83 Fed. Cl. 46 (2008) (settlement agreement in unrelated litigation did not bar partner from intervening as participating partner in TEFRA partnership case).

[667] Partners who do not file a notice of election to participate may nevertheless be entitled to participate in settlement negotiations with IRS Appeals by virtue of §6224(a).

[668] See VII.F., below, for further discussion of settlement of litigation.

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E. Procedures for Conducting the Case

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

After determining whether the proper party has filed the petition within the appropriate period and determining which partners have the opportunity to participate, the procedures for conducting the litigation are generally the same as the procedures for conducting any non-TEFRA litigation. The settlement negotiations, discovery, pre-trial motions, and the trial of the case should all be conducted in basically the same manner in which a non-TEFRA partnership litigation is conducted. See 630 T.M., *Tax Court Litigation*, for further discussion of the conduct of Tax Court litigation. See 631 T.M., *Refund Litigation*, for a general discussion of the procedures applicable in federal district court and Court of Federal Claims.

One topic which has generated considerable discussion has been the manner for conducting discovery in a §6226 action.[669] Questions have arisen concerning the amount of discovery allowed to a participating partner other than the TMP. As with all phases of the administrative and judicial proceeding, the TEFRA procedures assume that the TMP will conduct most of the discovery with the IRS. The IRS sought to limit the circumstances under which a participating partner could serve discovery in addition to that served by the TMP. The Tax Court, however, has refused to enact any express restriction, relying instead on the availability of a protective order under Tax Court Rule 103 to alleviate potential problems on a case-by-case basis.

There is also some distinction in the application of the burden of proof. The Tax Court has held that §7491(c) (which imposes a burden of production on the IRS for penalty determinations) does not apply in a partnership proceeding.[670] There can also be burden of proof issues related to issues raised in the FPAA. See VI.I.J., above for further discussion of these issues.

Another distinction between the TEFRA and non-TEFRA procedures in district court is that the petition contesting the FPAA is not technically a refund action within the meaning of 28 U.S.C. §1346(a)(1). Because the action is not a refund suit, there appears to be no right to a jury trial.[671] Apart from this significant deviation, the procedures for conducting a U.S. district court or U.S. Court of Federal Claims action should be essentially equivalent to the procedures applicable in a non-TEFRA refund suit.

[669] *See* Note, "United States Tax Court, Part Six: Partnership Proceedings," 52 *Albany L. Rev.* 163, 206 (1987), for a discussion of the varying discovery proposals.

[670] *Dynamo Holdings LP v. Commissioner*, 150 T.C. 224 (2018).

[671] *RCL Props., Inc. v. United States*, 2009-1 USTC ¶ 50,351 (D. Colo. 2009); *Thomas v. United States*, 695 F. Supp. 1021 (E.D. Mo. 1988).

F. Partnership Penalty Procedures

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

For partnership taxable years ending before August 6, 1977, penalties (or additions to tax) were treated as substantive affected items and were subject to the affected item procedures discussed in III.B.2., above.[672] No final penalty determination could be made in the TEFRA partnership proceeding concerning the partnership item adjustments.[673]

After its amendment in 1997, §6221 requires penalty determinations to be made in the partnership proceeding if the proposed penalty "relates to an adjustment to a partnership item." This rule works smoothly to the extent the penalty is based on the partnership's position on a partnership item. For example a determination that the partnership is a sham or the partnership or its transactions lacked economic substance is clearly made in the partnership proceeding.[674]

The requirement to determine penalties in the partnership proceeding may encompass not only penalties on partnership item adjustments, but also substantive affected item adjustments. Presumably, this is because an affected item, by definition, is affected by (i.e., "relates to") a partnership item adjustment. The Supreme Court suggested that these affected item penalty issues must be contested in the partnership-level proceeding even though the partnership proceeding, by design, has already concluded before the affected item notice of deficiency is issued. This means the only challenges that may be made at the partner level are any partner-level defenses.[675]

Since the penalties must be asserted in the partnership proceeding, the IRS's compliance with the §6751 supervisory approval requirement must also be determined in the partnership

[672] See former §6621.

[673] *See N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987); *Maxwell v. Commissioner*, 87 T.C. 783 (1986).

[674] *Gunter v. Commissioner*, 789 Fed. Appx. 836 (11th Cir. 2020); *Highpoint Tower Technology, Inc. v. Commissioner*, 931 F.3d 1050 (11th Cir. 2019); *Petaluma FX Partners, LLC v. Commissioner*, 792 F.3d 72 (D.C. Cir 2015); *Logan Trust v. Commissioner*, 616 Fed. Appx. 426 (D.C. Cir. 2015); *Manroe v. Commissioner*, T.C. Memo 2020-16. *See also Thompson v. Commissioner*, 811 F.3d 1008 (8th Cir. 2016) (concession of penalty in partnership proceeding law of the case and res judicata).

[675] *United States v. Woods*, 571 U.S. 31 (2013); *Moxon Corp. v. Commissioner*, 165 T.C. No. 2 (2005) (penalties on affected items upheld even though affected item deficiency upon which the penalties are based was barred); *Hamel v. Commissioner*, T.C. Memo 2024-62, reconsideration denied, T.C. Memo 2025-19 (penalties on affected item determined in partnership proceeding). *See Domulewicz v. Commissioner*, 129 T.C. 11 (2007), *aff'd in part and remanded sub nom., Desmet v. Commissioner*, 581 F.3d 297 (6th Cir. 2009), *supplemented by Domulewicz v. Commissioner*, T.C. Memo 2010-177 (legal fees subject to deficiency procedures); *NPR Invs. LLC v. United States*, 740 F.3d 998 (5th Cir. 2014); *Manroe v. Commissioner*, T.C. Memo 2020-16 (Tax Court has jurisdiction to redetermine income tax deficiencies, but no jurisdiction to consider penalties determined at partnership level).

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proceeding.[676] The cases indicate that the penalty determination is typically by the Revenue Agent and the approval must occur before the FPAA is issued and not at an earlier stage unless there is a formal written communication of a determination.[677] If the initial penalty determination is made by Counsel, supervisory approval in Counsel's office is required.[678] It may be, however, that the IRS does not have the burden of production in the partnership proceeding to establish supervisory approval, however.[679] For further discussion of the supervisory approval requirement under §6751(b), see 634 T.M., *Civil Tax Penalties*.

Courts with jurisdiction over a partnership proceeding under §6226(f) not only have jurisdiction to determine the applicability of any penalty that relates to an adjustment to a partnership item, but also to determine whether the partnership had reasonable cause or acted in good faith with regard to any penalty that allows for such defenses. The courts look to the actions of the partnership through its managing partner to evaluate these defenses.[680]

It should be noted that §6662 contains various types of penalties, including penalties that require satisfaction of threshold tax limits before they will be imposed. For example, the substantial understatement penalty of §6662(b)(2) and §6662(d) is not imposed on an individual taxpayer unless the amount of the understatement exceeds the greater of $5,000 or 10% of the tax required to be show on the taxpayer's return for the taxable year.[681] Thus, even if a partnership proceeding results in a determination that the partnership took a return position that gives rise to liability for the substantial understatement penalty at the partner level, the imposition of the penalty on a particular partner will still depend on whether or not the understatement satisfies the $5,000/10% tax threshold. That determination is undertaken in the computational adjustments made for each partner following the completion of the partnership proceeding.

A significant gap in the statutory framework existed for the "penalty interest" for tax-motivated transactions under former §6621(c).[682] The former §6621(c) interest issue historically had not been considered a partnership item and, therefore, could not have been assessed in a partnership proceeding.[683] Courts later held that findings with respect to the characterization of the partnership's transactions that underlie the penalty interest determination were partnership items that must be determined in the partnership-level proceeding.[684] In fact, it may be necessary to make partnership-level findings relating to the partnership-level bases for penalty interest even in dismissed or settled cases.[685] According to the Fifth Circuit, penalty interest under former §6621(c) carries a partnership-item component and a partner-item component. The partnership component is determining whether the partnership was a sham or whether a series of transactions was a sham.[686] The partner-level determination comes later and focuses on whether a particular partner had an underpayment of tax attributable to these shams that was over $1,000.

The penalties that can be determined in the partnership-level proceeding must relate to an adjustment to a partnership item. Assessable penalties proposed against a partner are not within the Court's jurisdiction in a partnership proceeding.[687] Similarly, penalties attributable to a consistency assessment are

[676] *Dynamo Holdings LP v. Commissioner*, 150 T.C. 224 (2018); *Ginsburg v. United States*, 17 F.4th 78 (11th Cir. 2021); *Rogers v. Commissioner*, T.C. Memo 2019-61 (cannot challenge §6751 approval in partner-level innocent spouse action); *Endeavor Partners Fund LLC v. Commissioner*, T.C. Memo 2018-96, *aff'd*, 943 F.3d 464 (D.C. Cir. 2019); *Nix v. United States*, 339 F. Supp. 3d 580 (E.D. Tex. 2018).

[677] *Sand Investment Co. v. Commissioner*, 157 T.C. 136 (2021); *Palmolive Building Investors, LLC v Commissioner*, 152 T.C. 75 (2019); *Sand Valley Holdings, LLC v. Commissioner*, T.C. Memo 2025-74; *Ivey Branch Holdings, LLC v. Commissioner*, T.C. Memo 2025-63; *Hancock County Land Acquisitions, LLC v. Commissioner*, T.C. Memo 2025-50; *Green Valley Investors, LLC v. Commissioner*, T.C. Memo 2025-15; *Cattail Holdings, LLC v. Commissioner*, T.C. Memo 2023-17; *Sparta Pink Property, LLC v. Commissioner*, T.C. Memo 2022-88; *Morgan Run Partners, LLC v. Commissioner*, T.C. Memo 2022-61; *Oxbow Bend, LLC v. Commissioner*, T.C. Memo 2022-23; *Pickens Decorative Stone, LLC v. Commissioner*, T.C. Memo 2022-22; *Excelsior Aggregates, LLC v. Commissioner*, T.C. Memo 2021-125; *Tribune Media Co. v. Commissioner*, T.C. Memo 2020-2 (all requiring penalty approval before the FPAA is issued). *But see*, *Belair Woods, LLC v. Commissioner*, 154 T.C. 1 (2020) (formal written communication before FPAA could be initial determination).

[678] *Anaheim Arena Management, LLC v. Commissioner*, T.C. Memo 2025-68; *GWA, LLC v. Commissioner*, T.C. Memo 2025-34; *North Donald LA Property, LLC v. Commissioner*, T.C. Memo 2023-50; *Nassau River Stone, LLC v. Commissioner*, T.C. Memo 2023-36.

[679] *Dynamo Holdings LP v. Commissioner*, 150 T.C. 224 (2018).

[680] *See, e.g., CNT Investors LLC v. Commissioner*, 144 T.C. 161 (2015); *Vision Monitor Software LLC v. Commissioner*, T.C. Memo 2014-183; *Santa Monica Pictures v. Commissioner*, T.C. Memo 2005-104 (reasonable cause exception may be considered at partnership level if it involves actions by managing member partner). *See also NPR Invs. LLC v. United States*, 740 F.3d 998 (5th Cir. 2014) (partners' individual reasonable-cause defenses under §6664 are partner-level defenses that the district court did not have jurisdiction to consider in a partnership-level proceeding); *Klamath Strategic Inv. Fund, LLC v. United States*, 472 F. Supp. 2d 885 (E.D. Tex. 2007), *aff'd*, 568 F.3d 537 (5th Cir. 2009) (although Reg. §301.6221-1(d) suggested that reasonable cause exception was partner-level defense, and government asserted that court's jurisdiction extended only to determining initial applicability of penalties to partnership as a whole, court concluded that no administrative benefit would result from additional proceedings and, therefore, it had jurisdiction to determine reasonable cause defenses in partnership-level proceeding); *Stobie Creek Inv. LLC v. United States*, 82 Fed. Cl. 636 (2008); CCA 201303010.

[681] §6662(d)(1)(A). For tax years beginning after December 31, 2017, if the taxpayer claims a §199A deduction, a substantial understatement under §6662(d)(1)(A) is determined by substituting 5% for 10%.

[682] Former §6621(c), before its repeal, applied to returns due (without regard to extensions) before Jan. 1, 1990.

[683] *N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987). See *Field v. United States*, 328 F.3d 58 (2d Cir. 2003).

[684] *Acute Care Specialists II v. United States*, 727 F.3d 802 (7th Cir. 2013); *Bush v. United States*, 717 F.3d 920 (Fed. Cir. 2013); *Prati v. United States*, 603 F.3d 1301 (Fed. Cir. 2010); *Keener v. United States*, 551 F.3d 1359 (Fed. Cir. 2010); *River City Ranches #1 Ltd. v. Commissioner*, 401 F.3d 1136 (9th Cir. 2005), *on remand*, T.C. Memo 2007-171; *Kimball v. Commissioner*, T.C. Memo 2008-78; *Ertz v. Commissioner*, T.C. Memo 2007-15.

[685] *Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013); *Duffie v. United States*, 600 F.3d 362 (5th Cir. 2010), *cert. denied*, 562 U.S. 897 (2010); *Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004), *cert. denied*, 125 S. Ct. 2312 (2005); *Prati v. Commissioner*, 603 F.3d 1301 (Fed. Cir. 2010); *Keener v. United States*, 551 F.3d 1358 (Fed. Cir. 2009); *Affiliated Equip. Leasing II v. Commissioner*, 97 T.C. 575 (1991); *Ertz v. Commissioner*, T.C. Memo 2007-15; *McGann v. United States*, 81 Fed. Cl. 642 (2008) (dismissal of FPAA without finding of sham precluded assessment of former §6621(c) penalty interest); *Bartimmo v. United States*, 525 F. Supp. 2d 879 (S.D. Tex. 2007); *Mellina v. United States*, 518 F. Supp. 2d 825 (N.D. Tex. 2007).

[686] *Duffie v. United States*, 600 F.3d 362 (5th Cir. 2010), *cert. denied*, 562 U.S. 897 (2010).

[687] *Endeavor Partners Fund, LLC v. Commissioner*, T.C. Memo 2016-12 (Tax Court lacked jurisdiction over §6707 investigation of an indirect partner who was an officer of the TMP).

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asserted at the partner level because there is no partnership item adjustment.[688]

G. Settlement of Litigation

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The law concerning settlement of TEFRA partnership litigation is similar to the law concerning the administrative settlement of the TEFRA partnership audit. Due to the different procedural posture, however, the settlement of litigation has different mechanical procedures to ensure that the TEFRA concepts are observed.

One aspect of judicial settlements which is identical to administrative settlements is the procedure for assessment of the agreed adjustments. A judicial settlement converts the settling partner's partnership items to nonpartnership items. This drops the partner out of the partnership proceeding. After the settlement, the IRS makes the assessment of tax to reflect the settlement by means of a computational adjustment. The partner is bound by the settlement agreement with respect to the substantive partnership item adjustments and may only contest the computational aspects of the assessment through the §6230(c) refund procedures. See III.B.4.a. and III.D.1., above, and XI.A., below, for further discussion of the assessment procedures.

The conversion of the partner's partnership item in a settlement agreement means the partner no longer has an interest in the outcome of the partnership case. This eliminates the basis for subject-matter jurisdiction. As a result, a court is entitled to determine the validity of a settlement agreement because it is entitled to determine its own jurisdiction.[689]

Other aspects of judicial settlements vary from their administrative counterpart. This section highlights the most significant similarities and differences.

1. Consistency Requirement

The consistent settlement requirement of §6224(c)(2) applies in the judicial stage of a TEFRA partnership proceeding as well as in the administrative stage, with one possible exception. Unless the IRS has failed to properly issue an NBAP or FPAA to a notice partner or a five-percent notice group, a partner desiring a consistent settlement must request the settlement within the later of 150 days after the FPAA is mailed to the TMP or 60 days after the day the other partner's settlement agreement was executed.[690] While this rule clearly applies in the administrative phase of the proceeding, it is not entirely clear whether the courts will enforce the time limit specified in this administrative regulation.[691]

Tax Court Rule 248(c) implements a procedure designed to give all parties to the Tax Court proceeding the opportunity to request a consistent settlement within the 60-day period provided by the regulations. This Rule requires the IRS to serve a statement explaining the terms of the settlement on the TMP and the TMP to serve the statement on the remaining partners.[692] See VIII.G.4.c., below, for further discussion of this type of settlement.

Until the applicability of the regulations is definitely resolved, partners desiring a consistent settlement should attempt to comply with the 60-day time limit.[693] If the IRS fails to comply with the notice procedures in Tax Court Rule 248(c), the partner may have an extended opportunity to obtain a consistent settlement through the Tax Court or the computational adjustment refund procedure.[694]

2. Authority of the TMP to Bind Other Partners

As discussed in VI.I.2., above, the TMP generally has administrative settlement authority only with respect to non-notice partners who have not become members of a five-percent notice group and who have not filed a "no settlement" statement notifying the IRS that the TMP does not have the authority to settle for that partner. The TMP's authority is significantly expanded, however, in the judicial stage of the TEFRA partnership proceeding.

Tax Court Rule 248(a) provides that the TMP may execute a stipulation consenting to entry of a decision which binds all partners. This includes all notice partners, all five-percent litigation groups, and all participating partners. Tax Court Rule 248(a) attempts to justify this greatly expanded TMP authority by stating that the signature of the TMP constitutes a certificate by the TMP that no party objects to entry of the decision. There is no provision in the Tax Court Rules, however, for this form of decision to be vacated if a partner was not informed and did not actually consent to the TMP's stipulation to entry of the decision. In addition, §6230(f), while technically applicable only to Code and regulations provisions, and not to Tax Court Rules, could be cited as authority for the argument that the TMP's fail-

[688] *Malone v. Commissioner*, 148 T.C. 372 (2017).

[689] *Treaty Pines Invs. Partnership v. Commissioner*, 967 F.2d 206 (5th Cir. 1992). *See also H Graphics/Access LP v. Commissioner*, T.C. Memo 1992-345.

[690] Reg. §301.6224(c)-3(c)(3).

[691] *See Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988), in which the Tax Court refused to follow the temporary regulations with respect to the determination of the partnership's TMP.

[692] *Crnkovich v. United States*, 41 Fed. Cl. 168 (Fed. Cl. 1998), *aff'd*, 202 F.3d 1325 (Fed. Cir. 2000).

[693] In T.D. 8965, 66 Fed. Reg. 50541 (Oct. 4, 2021), the IRS removed Reg. §301.6224(c)-3T and issued Reg. §301.6224(c)-3, effective for partnership tax years beginning after October 4, 2001, which is substantially the same as the temporary rule.

[694] *See Monti v. United States*, 2002-1 USTC ¶ 50,243 (E.D.N.Y. 2001).

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ure to obtain the consent of all parties is not a basis for vacating the decision.

Comment: Tax Court Rule 248(a) greatly expands the settlement authority of the TMP over that provided by §6224(c)(3). The validity of this rule apparently has not been tested in any reported litigation. Although not addressing the validity of Tax Court Rule 248, courts have declined, on jurisdictional grounds, to hear refund suits brought by limited partners of tax shelter partnerships who claim the TMP lacked authority to enter into a binding agreement on their behalf. In *Kaplan v. United States*,[695] the Seventh Circuit held that a limited partner seeking a refund could not avoid the jurisdictional bar of §7422(h) by asserting that the issue before the court was the validity of the TMP as the partnership's representative. The court reasoned that the underlying substantive claim concerned the propriety of adjustments to the partnership's return.[696] The partners have a difficult task vacating a final decision in the Tax Court as well, as it requires a showing of fraud on the court.[697] A question exists whether a false certification by the TMP that no party objects to the settlement is fraud on the court or merely fraud on the partners.

3. *Authority of the Pass-thru Partner to Bind Indirect Partners*

As discussed in VI.I.3., above, a pass-thru partner has the authority to bind indirect partners to administrative settlements with the IRS if the IRS has not been notified of the indirect partners' existence. It is not clear whether this settlement authority extends to judicial settlements.

At least two arguments support the position that the pass-thru partner can bind the indirect partner. First, the language of §6224(c)(1) does not expressly limit the pass-thru partner's settlement authority to administrative settlements. Second, the pass-thru partner's authority to settle is actually a rule of practical necessity. If an indirect partner has not been identified to the IRS or the court, there is no way to solicit the indirect partner's consent to any settlement. Only the pass-thru partner knows the identity of the indirect partners; therefore, the pass-thru partner can be presumed to have obtained the indirect partners' consent to any settlement.

The principal argument against extending the pass-thru partner's authority to judicial settlements is that the pass-thru partner may not be a party to the judicial action. Tax Court Rule 247(a) defines the parties to a TEFRA judicial action to include all partners that satisfy §6226(c) and §6226(d). A pass-thru partner satisfies §6226(c) because the pass-thru partner is a partner in the partnership. It is unclear whether the pass-thru partner meets the requirements of §6226(d), however. Section 6226(d) is captioned "Partner Must Have Interest in Outcome." Technically, a pass-thru partner does not have an interest in the outcome of the judicial action because, by definition, the pass-thru partner's partnership items flow through the pass-thru partner to the indirect partners. Other than the caption, however, a pass-thru partner does not run afoul of the operative provisions of §6226(d). Nevertheless, in at least one case a partnership argued that a pass-thru partner could not serve as the partnership's TMP because of the absence of an interest in the outcome of the proceeding.[698]

Probably the best rule is that until all indirect partners have been properly identified to the IRS or the court, the pass-thru partner should be considered a party to the judicial action with the capacity to bind any unidentified indirect partners to a settlement. At the point at which all of the pass-thru partner's indirect partners have been identified, however, the pass-thru partner can no longer bind any indirect partners; therefore, the pass-thru partner should cease to be considered a party. This rule is supported by the conceptual foundation of the TEFRA procedures, if not the literal language.

The Tax Court Rules impose on the TMP the burden of identifying the indirect partners. In settlements under Tax Court Rule 248(a) and (b), the rule presumes that the TMP knows the identity of all partners (including indirect partners) and has notified all partners of the partnership settlement. This presumption requires the TMP to identify all indirect partners so they have an opportunity to object to the settlement. It is only when the settlement is made on a partner-by-partner basis pursuant to Tax Court Rule 248(c) that the TMP is relieved from the burden of determining whether the pass-thru partner has the authority to bind indirect partners. In this instance, the pass-thru partner must poll the indirect partners to ensure that they all consent to the settlement agreement to be executed by the pass-thru partner.

4. *Forms and Procedures Used to Implement the Settlement*

The Tax Court has enacted a significant procedural mechanism to address the settlement of TEFRA partnership litigation. There are four different types of "settlement," which have different forms and procedures: (1) TMP settlements for all parties, (2) IRS-proposed settlements which are not objected to, (3) partner-by-partner settlements, and (4) "piggyback" agreements for test-case litigation.

a. *TMP Settlements for All Parties*

Tax Court Rule 248(a) authorizes the TMP to settle for all parties by executing a settlement agreement which certifies that no party objects to entry of decision. This settlement is implemented by a stipulated Decision executed by the TMP personally, not by counsel.[699]

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[695] 133 F.3d 469 (7th Cir. 1998). *See Keener v. United States*, 551 F.3d 1358 (Fed. Cir. 2009) (partners in TEFRA partnership that settled with IRS are precluded under §7422(h) from later seeking refund as issues could have been raised in prior Tax Court proceeding).

[696] *See Klein v. United States*, 86 F. Supp. 2d 690 (E.D. Mich. 1999) (underlying claim involved claimed partnership deductions and credits for the recycling tax shelter, not the authority of the putative TMP).

[697] *Davenport Recycling Assocs. v. Commissioner*, T.C. Memo 1998-347, *aff'd*, 220 F.3d 1255 (11th Cir. 2000); *Brookes v. Commissioner*, 108 T.C. 1 (1997), *appeal dismissed*, 163 F.3d 1124 (9th Cir. 1998). The standards for vacating a final decision in a TEFRA proceeding are the same as those applied in a deficiency case. *Cinema '84 v. Commissioner*, 122 T.C. 264 (2004). For further discussion of the Tax Court's authority to vacate a decision after it has become final, see 630 T.M., *Tax Court Litigation.*

[698] *Chomp Assocs. v. Commissioner*, 91 T.C. 1069 (1988).

[699] Comments to Tax Court Rule 248, at 90 T.C. 1375. See the Worksheets, below, for an IRS example of this Decision.

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A closing agreement between the TMP and the IRS does not operate as a settlement agreement until the stipulated Decision is entered.[700]

This Decision constitutes a §6224(c) settlement agreement. As a result, the Decision effectively terminates the litigation and converts all partners' partnership items to nonpartnership items, which the IRS then assesses as a computational adjustment. See VII.F.1., above, for a discussion of some of the conceptual problems with this settlement mechanism.

b. IRS-Proposed Settlements with No Objection

Tax Court Rule 248(b) establishes a procedure whereby the IRS can propose a settlement that becomes final if the partners do not object. This procedure is available only when: (1) the 90-day period in which partners can elect to participate or intervene has expired; (2) all participating partners have executed agreements which settle their partnership items or do not object to the IRS settlement motion; and (3) if the TMP is a participating partner, the TMP does not object to the settlement motion. The most common time for using this settlement is after the TMP and all participating partners have separately settled their partnership items with the IRS.

If all three of these conditions are satisfied, the IRS can file a proposed Decision and a "Motion for Entry of Decision" to attempt to enter the Decision based on the settlement. Within three days after filing the motion and Decision, the IRS must serve the TMP with a certificate as to the date the motion was filed with the court.[701] Within three days after receiving the IRS's certificate, the TMP must serve a copy of the motion, the form of Decision and the IRS's certificate on all partners who have not yet settled. Participating partners do not need to be served by the TMP because the procedure requires that all participating partners must have consented to the settlement before the motion can be filed.

The court enters the proposed Decision unless a partner files a motion for leave to file a notice of election to participate within 60 days after the IRS motion is filed. The court may deny this motion if the partner does not show a good reason for the objection and the ability to conduct the partnership proceeding make a "substantial showing" as to why they should be permitted to participate.[702] The Tax Court has considered certain factors in determining whether the high bar of the substantial showing required under Rule 248(b) is satisfied.[703] First, if the objecting partners allege that the terms of the settlement are unreasonable or otherwise make an argument regarding the substantive facts of the case. Second, if the objecting partners offer support for their assertion that they are prepared to litigate. Third, if the objecting partners allege that the TMP has breached its fiduciary duty or otherwise acted again the interests of the objecting partners.[704]

If the motion is granted, the partnership proceeding continues. If no motion is filed or if a motion is filed but is denied, the court may then enter the Decision in the case with respect to all partners. The entry of the Decision concludes the partnership proceeding. After the Decision becomes final, the IRS has one year in which to assess the partnership item adjustments against the partners. Because the partnership items are determined by a decision rather than a settlement agreement, there is technically no conversion of partnership items to nonpartnership items under this procedure.[705]

Comment: The nature of this procedure probably dictates how the IRS will devote its energy to settle the cases. If the IRS can obtain the settlement or consent of all participating partners, the IRS can file the Rule 248(b) motion. Any objecting partner then has to become a participating partner (with court approval) to avoid being bound by the settlement. This forces the partner into a more active role in the proceeding. Many partners may not be willing to assume this role. Accordingly, it is likely that the IRS will focus on settling the participating partner cases (possibly at the expense of the nonparticipating partners) to force the settlement for the entire partnership.

c. Partner-by-Partner Settlements

Because most TMPs are unwilling to execute a Stipulation to Entry of Decision pursuant to Tax Court Rule 248(a), and because it is sometimes difficult to obtain the consent of all participating partners to a Motion for Entry of Decision under Tax Court Rule 248(b), it is common for the IRS to use alternative settlement mechanisms. As the partners typically settle at different times, the most common settlement device is Form 870-PT, Form 870-LT, and/or Form 906, Closing Agreement.

These documents must be executed by IRS Appeals, as no delegation order exists by which the Commissioner delegates the authority to enter into a settlement agreement to the Chief Counsel's Office. Once executed, Form 870-PT, Form 870-LT, and/or Form 906 constitutes a settlement agreement between the settling partner and the IRS with respect to the partnership items included in the agreement.

When the IRS executes this settlement agreement, the partner's partnership items covered by the agreement convert to non-partnership items. This conversion triggers the mechanism which results in the assessment of a computational ad-

[700] *Davis v. United States*, 811 F.3d 335 (9th Cir. 2016) (closing agreement with TMP was settlement agreement with partnership, not with any partner).

[701] See the Worksheets, below, for an IRS example of the Motion for Entry of Decision, the Certificate of Filing of Motion for Entry of Decision, and the Decision.

[702] Tax Court Rule 248(b)(4); *Chimney Rock Holdings*, T.C. Memo 2025-39; *Oceanic Leasing v. Commissioner*, T.C. Memo 1996-458.

[703] *Walker Church Greene 819, LLC v. Commissioner*, T.C. Memo 2026-11 (holding that objecting partners had not made a substantial showing pursuant to Tax Court Rule 248(b)(4) when the objecting partners made last-minute attempts to participate after failing to avail themselves of more timely opportunities, reasoning that the objecting partners' "lack of demonstrated preparedness cuts against granting a motion that would permit them to 'swoop in at the last minute and disrupt' the proposed settlement"); *Blomquist Holdings, LLC v. Commissioner*, 165 T.C. No. 6 (Sept. 17, 2025) (concluding that there was no substantial showing when partners had three years to participate, reasoning that the objecting partners provided no reason for their delay; rejecting objecting partners' conflict of interest argument because TMP's alleged conflict was not recently discovered, nor was there evidence that the settlement was unreasonable or influenced by the alleged conflict). *See also Blomquist Holdings, LLC*, 165 T.C. No. 6 *at* 11–12 (citing orders where the Tax Court found that an objecting partner made a substantial showing when the circumstances surrounding a settlement indicated that the TMP acted contrary to the party's interests or otherwise breached their fiduciary duty).

[704] An investigation into a TMP will not automatically disqualify a TMP from negotiating and entering into a settlement agreement with the IRS, and therefore does not automatically create a conflict of interest. See *Walker Church Greene 819*, T.C. Memo 2026-11 *at* 13.

[705] See IX.C. and IX.D.1., below, for further discussion of the distinction.

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justment with respect to these converted items.[706] See III.B., and III.D.1., above, and IX.D., below, for further discussion of these computational adjustment procedures for converted items. If all of the partnership item adjustments proposed in the FPAA are covered by the settlement agreement, the conversion of these items also causes the partner to cease to be a party to the court proceeding.[707]

In some cases, partners have contended that the agreements between the partners and the IRS covering the partnership items were void and unenforceable because the partnership had a case docketed in the Tax Court regarding the partnership items, and therefore Appeals lacked authority to enter into the settlement agreement. For example, in *In re Klee*,[708] the debtors successfully argued that the Associate Chief of Appeals lacked the authority to enter into the agreement because Delegation Order 97 (Rev. 34)[709] generally limits such authority to tax years in which a person does not have an issue docketed before the Tax Court.[710] However, after initial successes, these contests generally fail.

The settlement between the IRS and a partner in a pending Tax Court case also triggers two notice requirements. First, if the partner is the first participating partner to accept the settlement, Tax Court Rule 248(c)(1) requires the IRS to file with the Tax Court a "Notice of Settlement," which identifies the participating partner who has entered into the agreement. If other participating partners subsequently accept the same settlement, the IRS files a "Notice of Consistent Agreement" with the court.[711] These two notices allow the court to monitor the status of the participating partners. An agreement between the IRS and the nonparticipating partners is of less concern to the court, as the court does not directly serve notices on these nonparticipating partners.

The second notice triggered by a settlement agreement is a statement to the TMP concerning the settlement agreement. The statement is provided by the IRS within seven days after the IRS and any partner execute a settlement agreement. The statement must notify the TMP of: (1) the identity of the settling parties, (2) the tax years in the settlement, and (3) the terms of the settlement. Within seven days after receipt of this statement, the TMP must serve a copy of the statement on all parties to the action.[712]

Note: It is not clear whether this procedure applies separately to each settlement or only when the terms of the settlement are different from the previous settlements.

The purpose of the settlement notification statement is to provide the remaining partners with an opportunity to request a consistent settlement. Reg. §301.6224(c)-3 provides a 60-day period in which the remaining partners may elect a consistent settlement. This election is accomplished by providing a written notification to the IRS within 60 days after the date the settlement agreement was executed.

Frequently, the IRS asserts various penalties related to partnership item adjustments. These penalties may be incorporated in the settlement agreement between the IRS and a partner in the TEFRA partnership litigation.[713] The combined settlement of the partnership items, penalties, and any affected items is implemented on Form 870-LT or Form 870-L(AD).

d. "Piggyback" Agreements

One of the central purposes of the TEFRA partnership audit procedures is to consolidate the litigation of the partnership item adjustments for one partnership into one unified proceeding. Quite often, however, a partnership may be only one of several partnerships in a promotion in which all partnerships present essentially the same issues. In non-TEFRA cases, these common issues are typically resolved in test-case litigation in which the IRS and the partners select a representative sample of partners' cases which are consolidated for trial. The IRS typically solicits stipulations to be bound or "piggyback agreements" from the partners who have not been selected for the test-case litigation. The piggyback agreement binds these nonconsolidated partners to the outcome of the test-case litigation with respect to the common issues.

There is currently no procedure in the Tax Court Rules under which a TEFRA partnership may execute a piggyback agreement. There would appear to be no reason why a TEFRA partnership should be precluded from entering into such an agreement. Questions may arise, however, as to the proper parties to execute the piggyback agreement. The IRS apparently takes the position that the TMP may bind the entire partnership to a piggyback agreement much in the same manner as with a settlement agreement pursuant to Tax Court Rule 248(a). The authority of the TMP to bind all partners under this procedural device is subject to some question. If a binding TMP stipulation cannot be obtained, the IRS will use the proposal and objection procedure similar to Tax Court Rule 248(b). The IRS will file a proposed piggyback agreement and a motion requesting the court to issue an order to all partners to show cause why the piggyback agreement should not be accepted and filed on behalf of the partnership.

There is some confusion as to whether a piggyback agreement constitutes a settlement agreement. This characterization is important because if a piggyback agreement is a settlement agreement, the execution of the piggyback agreement would cause the conversion of the partnership items to nonpartnership items and begin the running of the one-year period in which the IRS must make a computational adjustment. This result clearly is not intended, however, because the execution of the pig-

[706] §6231(b)(1)(C). Similarly, settlement with the U.S. Attorney General (or a delegate) also converts covered partnership items and triggers the assessment of a computational adjustment with respect to those converted items. §6231(b)(1)(C).

[707] §6226(d)(1)(A).

[708] 216 B.R. 42 (Bankr. D. Or. 1997).

[709] Delegation Order 97 (Rev. 34) is now Delegation Order 8-3, printed in IRM 1.2.2.9.3., and is supplemented by Delegation Order 4-25 (Rev. 2), printed in IRM 1.2.2.5.21. *See also* IRM 8.13.1.6. (appeals authority, responsibility, and procedure).

[710] *But see Crowell v. United States (In re Crowell)*, 305 F.3d 474 (6th Cir. 2002), *aff'g* 258 B.R. 885 (E.D. Tenn. 2001) (IRS overcame lack of authority obstacle by arguing that Delegation Order 209 (Rev. 5) gave subordinate officials, such as Associate Chiefs of Appeals, necessary authority to execute written agreements with partners whether or not the partnership has a Tax Court case docketed); *Grossman v. United States*, 57 Fed. Cl. 319 (2003). Delegation Order 209 (Rev. 5) is now Delegation Order 4-19 (Rev. 2), printed in IRM 1.2.2.5.16.

[711] See the Worksheets, below, for an IRS example of the Notice of Settlement Agreement and Notice of Consistent Agreement.

[712] Tax Court Rule 248(c)(2).

[713] Reg. §301.6224(c)-3(b)(1).

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gyback agreement does not resolve the underlying partnership item adjustments, but merely establishes a procedure for their resolution. There would be no numbers that could be incorporated into the computational adjustment. Some courts have held, however, that when an individual partner signs a piggyback closing agreement that covers TEFRA years, the closing agreement constitutes a settlement agreement, which does convert the partner's partnership items.[714] This result was probably changed by the enactment of §6229(f)(2) as part of the 1997 TRA.

5. Alternative Events Constituting a Settlement Agreement

Settlement agreements are not necessarily confined to the specific IRS forms discussed in VII.H.4., above. General contract terms apply. See VI.I.5., above, for further discussion of the events which may constitute a settlement agreement. The discussion for administrative settlements applies equally in a judicial proceeding.

6. Coordination with Non-TEFRA Years

Situations frequently arise in which a partnership may be a TEFRA partnership in one year and a non-TEFRA partnership in an earlier or later year. The coordination of the settlement for the TEFRA and non-TEFRA years may raise problems. If a petition has been filed with respect to the TEFRA year, but no notice of deficiency has been issued for the non-TEFRA year, the coordination of the partner-by-partner settlement of the non-TEFRA year would be accomplished in the same manner as when all years are at the administrative stage. This issue is discussed more fully in VI.I.5., above.

If a petition has been filed with respect to the non-TEFRA year, however, it is necessary for the partners to ensure that settlement documents are executed in the non-TEFRA case to reflect the overall settlement of both TEFRA and non-TEFRA years. If both the TEFRA and non-TEFRA years have been petitioned to the Tax Court, the coordination of these years should be facilitated by the IRS policy of consolidating responsibility for all related cases in one Appeals office and one Area Counsel office. Once the two years are joined in one IRS jurisdiction, the non-TEFRA adjustments can be implemented in the form of a stipulated Decision (if all issues in the non-TEFRA case can be resolved) or by a Stipulation of Settled Issues which sets forth the resolution of the adjustments with respect to the partnership issue (if all issues in the notice of deficiency cannot be resolved when the TEFRA partnership issues are settled).

Comment: These issues are even more complicated if the various years are being litigated in different courts. The partner again should attempt to obtain consolidated consideration in the Area Counsel or Appeals office with responsibility for the partnership. This provides the best opportunity for a coordinated settlement.

7. Advance Payments

The procedures for making an advance payment with respect to partnership item adjustments at issue in a judicial proceeding are slightly modified from the issues in an administrative context discussed in VI.I.7., above. Unless the partner wishes to execute a settlement agreement for the partnership items which converts the partnership items to nonpartnership items, Announcement 86-114[715] directs the partner to file a Form 1040X, *Amended U.S. Individual Income Tax Return,* reflecting the additional tax liability in accordance with the advance payment to be submitted. The form must be modified to effect a waiver of the restriction on assessment contained in §6225. The Announcement directs that the following language be typed or handwritten on Form 1040X:

> This Form 1040X reflects adjustments from (name of partnership) for the year covered by this form. Under I.R.C. §6224(b), I/we hereby waive the restrictions on assessment and collection contained in I.R.C. §6225 with respect to the tax liability attributable to adjustments regarding the partnership items and any other amounts that are subject to a computational adjustment under I.R.C. §6231(a)(6) shown on Form 1040X.

The Announcement implies that the filing of Form 1040X with the waiver language does not cause the conversion of the pending partnership items to non-partnership items. If the full amount of tax and interest is not paid with the Form 1040X, however, the IRS bills the partner for any unpaid balance. The authority for this procedure is §6224(b)(1)(B), which allows the partner to waive any restriction on IRS action including the restriction on assessments contained in §6225. This §6224(b) waiver is not one of the events which results in a conversion of the partnership items to nonpartnership items under §6231(b).

If the partner simply wishes to stop the running of interest on a potential deficiency attributable to the partnership item adjustments, the partner may make a deposit in the nature of a cash bond. Because the cash bond procedure does not require any waiver of the restrictions on assessment, no special Form 1040X would be required. The cash bond would simply be posted to the partner's account and applied to the amount of any computational adjustment which results at the conclusion of the TEFRA partnership litigation. Any excess cash bond deposited, however, would not be refunded with interest.[716]

Finally, as is the case with advance payments at the administrative stage, the procedures for a deposit of a disputed tax may allow an advance payment that earns refund interest without waiving the restrictions on assessment.[717] The FPAA should be a sufficient statement of proposed additional tax to trigger these procedures.

H. Decision and Appeal

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA pro-

[714] *Crnkovich v. United States*, 41 Fed. Cl. 168 (1998), *aff'd*, 202 F.3d 1325 (Fed. Cir. 2000). *See also Monahan v. Commissioner*, 321 F.3d 1063 (11th Cir. 2003) (piggyback agreement constituted a settlement agreement that effectively resolved all remaining disputed issues; denial of petition for review of affected items notice of deficiency upheld), *aff'g* T.C. Memo 2002-52.

[715] 1986-47 I.R.B. 46.

[716] Rev. Proc. 2005-18.

[717] §6603.

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cedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The rules concerning the finality of a decision and the appeal of a §6226 action are essentially the same as the rules for any other decision of the respective court in which the action is brought.

1. Scope and Form of Decision

In Tax Court, the court issues an opinion after the conclusion of the TEFRA partnership litigation. The parties then file either agreed computations of the final partnership item adjustments or separately file each side's computation of the partnership item adjustments pursuant to Tax Court Rule 155. The court then issues an order entering a decision in the case.[718] The rules for vacating an entered decision are the same as for an entered decision in a non-TEFRA Tax Court case.[719]

A decision is required to conclude the partnership proceeding. This decision can only order changes to partnership items (and penalties). The decision cannot determine or order a refund.[720]

2. Appeal

The TMP, a notice partner or a five-percent litigation group may appeal the decision of the Tax Court by filing a notice of appeal with the clerk of the Tax Court within 90 days after the date of the order entering the decision.[721] Court of Federal Claims rules and district court rules are similar except that the notice of appeal of the final decision must be filed with such courts within 60 days after entry of the judgment or order.[722] The decision of the Tax Court is appealable to the circuit court in which the partnership had its principal place of business on the date the petition was filed.[723] The decision of the district court is appealable to the circuit court in which the district court is located.[724] The decision of the Court of Federal Claims is appealable to the Federal Circuit.[725]

While these appeal procedures are essentially the same, the impact of the procedures in a TEFRA case is significantly different from the impact in an appeal in a non-TEFRA case. In non-TEFRA cases, it is common for all partners to agree to be bound by one test case. After the opinion and decision is entered in the test case, each partner can appeal separately to the circuit court in which the partner resides on the petition date.[726] Under TEFRA, there is only one appeal to one circuit court.

If no notice of appeal is filed within the applicable period, the decision of the trial court becomes final and unappealable at the end of the appeal period.[727] If an appeal is filed, the decision becomes final after the appeal is resolved and the time to take any further appeal expires. Once the decision becomes final, the decision cannot be challenged (even in a collection due process proceeding) without moving to vacate the decision.[728] The finality date is critical because it ends the suspension of the partnership item and affected item statute of limitations. The IRS then has at least one year after the date the decision becomes final to assess the partnership item adjustments through the computational adjustment procedure.[729]

If a notice of appeal is filed from a Tax Court decision, the restriction on assessment of the deficiencies attributable to the partnership items is lifted unless an appeal bond is posted before the notice of appeal.[730] The amount of the bond must cover the aggregate deficiencies, interest, and penalties for all of the parties to the action (not all of the partners in the partnership) as estimated by the Tax Court.[731] Since §6225 does not prohibit assessment for proceedings commenced in district court or the Court of Federal Claims, the appeal bond procedure does not apply. If the Tax Court decision is reduced or eliminated, §7486 requires the IRS to abate and refund any excess amount assessed or paid.[732]

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[718] See the Worksheets, below, for an IRS example of a form Decision to be entered pursuant to an opinion of the Tax Court.

[719] A party may move to vacate the final decision. The Tax Court employs the same reasoning applied in deficiency cases to a decision in a TEFRA proceeding. *Cinema '84 v. Commissioner*, 122 T.C. 264 (2004). For further discussion of the Tax Court's authority to vacate a final decision, see 630 T.M., *Tax Court Litigation.*

[720] *Klamath Strategic Inv. Fund v. United States*, 568 F.3d 537 (5th Cir. 2009).

[721] §6226(g), §7459(c), §7483. *See Bush v. United States*, 717 F.3d 920 (Fed Cir. 2013) (no basis for partners to challenge tax-motivated-transaction-based penalties where partnership failed to appeal earlier Tax Court ruling).

[722] 28 U.S.C. §2107, §2522.

[723] §7482(b)(1)(E); 28 U.S.C. §1291.

[724] 28 U.S.C. §1294.

[725] 28 U.S.C. §1295(a)(3).

[726] *See* §7482(b)(1)(A); *Abatti v. Commissioner*, 86 T.C. 1319 (1986), *aff'd*, 859 F.2d 115 (9th Cir. 1988).

[727] §7481(a)(1). *See also Benenson v. United States*, 385 F.2d 26 (2d Cir. 1967); *Richland Knox Mutual Ins. Co. v. Kallen*, 376 F.2d 360 (6th Cir. 1967).

[728] *See generally* Tax Court Rule 162. *See also Tashjian v. Commissioner*, 320 Fed. Appx. 649 (9th Cir. 2009) (unpub.) (cannot contest partnership item decision in subsequent collection due process case for partner).

[729] §6229(d)(2). *Compare Conway v. United States*, 326 F.3d 1268 (Fed. Cir. 2003) (date the Tax Court reissued an opinion, vacating earlier opinion because entry date had been omitted on first opinion, was date to use in computing §6229 limitations period), *with Hirshfield v. United States*, 2001-2 USTC ¶ 50,480 (S.D.N.Y. 2001); *Carroll v. United States*, 2000-2 USTC ¶ 50,971 (E.D.N.Y. 2000) (Tax Court decision entered February 1994 became final on May 24, 1994; thus, Tax Court had no jurisdiction to vacate it by June 6, 1994, order, and the IRS's notice of deficiency issued July 3, 1995, was time-barred as a matter of law under §6229(d)), *recons. granted in part*, 198 F. Supp. 2d 328 (E.D.N.Y. 2001) (granting recovery of payments made for time-barred assessments for additions to tax for negligence and valuation overstatement, but restricting recovery based on §6511(b)(2)(B) jurisdictional limit), *vac'd and rem'd*, 339 F.3d 61 (2d Cir. 2003) (directing district court to award taxpayer full reimbursement). If any additional time was remaining on the three-year statute of limitations at the time the FPAA was issued, this time will be tacked on to the one-year period for purpose of determining the last date for making the computational assessments. See V.C., above, for further discussion of these issues.

[730] §7485(a). *See* FSA 199933004.

[731] §7485(b). One way to estimate the amount of the bond is to apply the highest individual rate of tax to the total adjustments determined by the court and to double that amount to take into account interest and penalties. *See* H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 687 (1997).

[732] *Wechsler v. United States*, 2000-1 USTC ¶ 50,518 (S.D.N.Y. 2000). *But see Estate of Smith v. Commissioner*, 115 T.C. 342 (2000) (abatement required only if amount of reduction can be determined from appeals court's opinion).

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VIII. Partner-Level Proceedings

A. *Overview*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TEFRA statutory scheme contemplates a partnership proceeding which determines the adjustments to partnership items and certain penalty issues. After the partnership proceeding concludes or the partner's items convert to nonpartnership items, it is necessary to conduct partner-level proceedings to apply any partnership-level determinations to the partner's tax liability. The principal forms of these partner-level proceedings are: (1) computational adjustment proceedings; (2) substantive affected item proceedings; (3) converted item proceeding; and (4) Collection Due Process (CDP) proceedings. Because of the peculiar fit of penalties in the statutory scheme, the application of these procedures to penalties will be discussed separately.

B. *Computational Adjustment Proceedings*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

1. *Making Computational Adjustments*

Computational adjustments are made when a circumstance or action has occurred at the partnership level and the partner's resulting tax liability can be computed without further substantive partner-level determinations.[733] The statute of limitations for the computational adjustments is determined by the nature of the underlying items. See V., above, for further discussion of the statute of limitations issues.

The computational adjustment procedures apply in the following circumstances:

- the IRS makes an assessment of an item to make the partner's treatment consistent with the partnership's treatment of that item if the partner did not report the inconsistent treatment,
- the partnership is a foreign partnership for which no U.S. return is filed after the IRS requests the U.S. partner to do so,[734]
- the partner has entered into a settlement agreement with the IRS pursuant to §6224(c),[735]
- the IRS has issued an FPAA and no partner has filed a timely petition in response,
- a decision has been entered by the court reviewing an FPAA, and
- a decision has been entered by the court reviewing the IRS's failure to allow an AAR filed by the TMP.

Whatever the procedural basis for a computational adjustment, the computation can only include the changes resulting from the partnership item or computational affected item adjustments. The IRS cannot change unrelated items through the computational adjustment procedure.[736]

2. *Challenging Computational Adjustments*

Two sets of procedural rules apply with respect to the partner's right to challenge a computational adjustment.

a. *Challenging Additional Tax or Penalty*

The first procedure applies if the computational adjustment results in additional tax due from: (1) a consistency assessment, (2) a settlement, (3) an uncontested FPAA adjustment, or (4) a court decision. In these situations, the partner must file a claim for refund to contest the computation within six months after the day on which the notice of computational adjustment is mailed to the partner.[737] This six-month refund claim appears to be the exclusive procedure by which a partner may contest a computational adjustment that results in additional tax due.[738] The refund procedure is not available if the

[733] §6230(a)(1). *See Standifird v. Commissioner*, T.C. Memo 2024-30.

[734] §6231(f); Reg. §301.6231(f)-1.

[735] An assessment may be considered a computational adjustment even when the settlement reflects no change to partnership items. *Bush v. United States*, 655 F.3d 1323 (Fed. Cir. 2011). For settlement agreements entered into after March 9, 2002, TEFRA partnership audit procedures that apply to settlement agreements with the IRS also apply to settlements with the U.S. Attorney General (or a delegate). §6224(c).

[736] *Mandich v. United States*, 124 Fed. Cl. 19 (2015) (unrelated carryovers could not be disallowed in computational adjustment).

[737] §6230(c)(2)(A). *Pond v. United States*, 69 F.4th 155 (4th Cir. 2023). See the Worksheets, below, for an example of a notice of computational adjustment.

[738] §7422(h) (no refund actions are allowable with respect to partnership items except as allowed in §6228(b) or §6230(c)). *Randell v. United States*, 64 F.3d 101 (2d Cir. 1995) (IRS assessments against partner were computational adjustments for which no notice of deficiency was required; taxpayer's suit to enjoin assessments was properly dismissed under Anti-Injunction Act); *Ivanhoe v. United States*, 130 AFTR2d 2022-5228 (D. Ct. 2022) (six month period applies to consistency assessment); *Williams v. United States*, 97-1 USTC ¶ 50,444 (E.D. Ky. 1997) (because individual partner's refund suit does not qualify for any exceptions under §6228(b) or §6230(c), refund action attributable to partnership items is barred under §7422(h)), *aff'd by unpub. opin.*, 165 F.3d 30 (6th Cir. 1998); *Gosnell v. United States*, 2011-2 USTC ¶ 50,488 (D. Ariz. 2011), *aff'd*, 525 Fed. Appx. 598 (9th Cir. 2013) (unpub.) (IRS is not required to send notice of deficiency to partner where computational adjustments did not require IRS to make partner-level determination before assessing and collecting additional tax, interest, and penalties from partner). *But see Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013) (six-month period not applicable to refund claim based on partner-level penalty interest determinations); *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995) (refund action after a settlement agreement deemed timely under §6511, given §6231(b)(1)(C) rule that partnership items convert to nonpartnership items as of date of settlement agreement and ambiguity of §7422(h)).

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same issues were litigated previously in an affected item proceeding.[739]

This procedure applies even if a partner-level proceeding involving the partner's nonpartnership items is still pending. Section 6230(c) provides the exclusive procedural remedy for contesting the computations. After the §6230(c) proceeding is concluded (or if none is brought), the resulting adjustment can be incorporated in the nonpartnership item proceeding to compute the final deficiency in that action.

b. Contesting Refund Amounts

The second type of computational adjustment procedure applies when a settlement, uncontested FPAA, or court decision results in a refund due the partner that is not fully paid by the IRS. The procedure appears to apply both when the IRS incorrectly computes the amount of the refund and when the IRS fails to issue a notice of computational adjustment altogether, although the former case is less clear.

Note: Section 6230(c)(1)(B) apparently authorizes this procedure any time the refund made is not equal to the amount of the overpayment attributable to the partnership item adjustments.

The refund claim must be filed within two years after the date the settlement agreement is executed, the last date for filing a petition to contest the FPAA adjustments (if none is filed) or the date the court's decision becomes final.[740] There is no Tax Court jurisdiction for this type of refund action.[741]

c. Refund Claims and Suits

For both types of refund claims, the refund claim must be filed with the submission processing center where the partner's return was filed.[742] The partner may not include as a basis for the claim any challenge to the substantive issues underlying the partnership item adjustments. The partner may challenge only the computational aspects of applying the partnership-level adjustments to that partner's taxable income.[743] If the IRS does not allow the partner's refund claim in full, the partner may file a refund suit with respect to the computational adjustment within the period beginning six months after the claim was filed and ending two years after the IRS mails a notice of claim denial.[744]

Comment: One aspect of the computational adjustment procedure that is not altogether clear is whether the partner must pay the amount contained in the notice of computational adjustment before filing the claim. There is no express provision in §6230(c) that requires payment before filing the claim. The references in §6230(c)(1) to a claim for refund and the incorporation in §6230(c)(3) of the limitations period for the filing of refund actions seem to indicate that payment is required before the claim may be filed. Neither the regulations nor the legislative history of TEFRA gives any guidance on this issue. Because the procedures parallel the normal refund claim procedures, however, it seems likely that the IRS will require full payment of the amount in the notice of computational adjustment before considering the refund claim. See 631 T.M., *Refund Litigation*, for further discussion of the general refund procedures.

There is an uneasy interplay between the §6230(c) refund procedures and the prohibition on refund suits for partnership items set forth in §7422(h). The conflict arises most clearly when the computational adjustment results from the conclusion of a partnership proceeding that did not result in the conversion of the partnership items to nonpartnership items (i.e., there was no settlement implemented by the IRS). Section 7422(h) does not bar refund suits relating to settlements that convert the partnership items to nonpartnership items pursuant to §6231(b)(1)(C).[745]

Even when the partnership items were never converted by a settlement or otherwise, §6230(c)(1)(A)(ii) clearly authorizes a refund claim and suit (and, therefore, there should be no restriction from §7422(h)) when the challenge to the computational adjustment is purely computational. The result is less clear, however, when the issue is more substantive. For example, if the partner claims that a settlement occurred but was not incorporated by the IRS in the computation, the fit within §6230(c) is uncertain, and the prohibition of §7422(h) could apply. Since this could deprive the partner of any forum in which to argue that a settlement agreement existed, the courts now appear willing to accept jurisdiction to determine whether the settlement agreement was binding and effective.[746] However, a challenge based on whether a procedural error caused the period of limitations to expire may be barred by §7422(h) when there has been no conversion to a nonpartnership item on the theory that the partnership item statute of limitations issue is itself a partnership item.[747]

Whatever the issue raised in the claim, compliance with the §6230(c) time limits is critical. If a refund claim and suit is not brought within the periods provided by §6230(c), even issues concerning the timeliness of the assessment cannot avoid the bar of §7422(h).[748]

C. Substantive Affected Item Proceedings

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA

[739] *McConnell v. United States*, 2011-USTC ¶ 50,444, 2011 BL 149089 (Fed. Cl. 2011) (unpub.).

[740] §6230(c)(2)(B).

[741] *ASA Investerings P'ship v. Commissioner*, 118 T.C. 423 (2002).

[742] Reg. §301.6230(c)-1(a).

[743] *See* §6230(c)(4). *See also Baxter v. United States*, 48 F.4th 358 (5th Cir. 2022) (partner's refund action based on untimely assessment under §6501 could not be determined without resolving timeliness of FPAA under §6229 time period, which is partnership item; §7422(h) bars partner's refund action because it involves partnership item); *Hudspath v. Commissioner*, T.C. Memo 2005-83 (cannot contest substantive issues in collection due process appeal after assessment).

[744] §6230(c)(3), §6532(a).

[745] *See Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995); *Olson v. Commissioner*, 37 Fed. Cl. 727 (1997), *aff'd*, 172 F.3d 1311 (Fed. Cir. 1999); *Browning-Ferris Indus. Inc. v. United States*, 233 F. Supp. 2d 1223 (D. Ariz. 2002).

[746] *See Prochorenko v. United States*, 243 F.3d 1359 (Fed. Cir. 2001); *Monti v. United States*, 223 F.3d 76 (2d Cir. 2000) (claim to a consistent settlement is not attributable to partnership items, so §7422(h) does not bar suit).

[747] See V.C.2., above, for further discussion of this issue.

[748] *Saidy v. United States*, 97 F.3d 1460 (9th Cir. 1996) (unpub.). *See Gen. Mills, Inc. v. United States*, 123 Fed. Cl. 576 (Fed. Cl. 2015) (where refund claim was filed after six-month period following computational adjustment, court has no jurisdiction).

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procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

1. Making the Substantive Affected Item Adjustment

As discussed above, substantive affected items are nonpartnership items that are affected by partnership item determinations. They are distinguished from computational affected items because the final determination at the partner level requires consideration of partner-level issues that are not purely computational. If the partner-level issues are merely computational, the tax is assessed on the partner by means of a computational adjustment, and the procedures discussed in the preceding section apply.[749] If the affected items are substantive, however, §6230(a)(2)(A)(i) requires that the IRS issue an affected item notice of deficiency before the affected items can be assessed.

The distinction between computational affected items and substantive affected items is sometimes unclear. In general, adjustments are "computational" if there is nothing left to do but perform a calculation to determine tax liability.[750]

To address concerns that the IRS may not know with certainty how a court will classify the affected item (i.e., as "computational" or "substantive"), the IRS may issue a deficiency notice with respect to the affected items after the conclusion of the TEFRA partnership-level proceeding, especially in TEFRA cases where a partner has engaged in a loss transaction associated with the sale of a partnership interest or asset distribution by the partnership. The IRS may then also assess the tax and penalty regardless of whether the partner has petitioned the Tax Court. This protective assessment will guard against a partner's potential arguments that the affected item was directly assessable and not subject to the deficiency procedures.[751]

Substantive affected items cannot be included in an FPAA and cannot be resolved as part of a court proceeding contesting the FPAA.[752] Similarly, partnership items cannot be included in the affected item notice of deficiency and, therefore, cannot be included as part of the affected item proceeding.[753] Mechanically, this statutory scheme results in the following stages in a typical TEFRA partnership proceeding: (1) the IRS issues the FPAA with respect to the partnership items; (2) the partnership item proceeding resolves the partnership item adjustments; (3) within one year after the decision in the partnership item proceeding becomes final, the IRS makes a computational adjustment and/or issues the affected item notice of deficiency;[754] and (4) the affected items are resolved in a separate partner-level proceeding, which does not include any partnership item issues.[755] To avoid potential problems with the "no second notice of deficiency rule" of §6212(c), §6230(a)(2)(C) provides that the affected item notice of deficiency does not count as a notice of deficiency for the purpose of the §6212(c) rule.

The IRS cannot issue an affected item notice of deficiency before the partnership proceeding is concluded.[756] One issue formerly open to question was whether a partnership proceeding was required before affected items could be adjusted in an affected item notice of deficiency. In *Roberts v. Commissioner*,[757] the Tax Court ruled that no partnership proceeding is required before an affected item notice of deficiency can be issued. The court held that a partnership item determination can be the determination not to adjust the partnership items at all.

[749] *See also Desmet v. Commissioner*, 581 F.3d 297 (6th Cir. 2009); *Olson v. United States*, 172 F.3d 1311 (Fed. Cir. 1999); *Hay v. Commissioner*, T.C. Memo 2009-265 (the effect of a foreign tax credit on a partner's liability is an affected item and may be directly assessed if it can be mathematically computed based exclusively on the partner's return and K-1 (as originally filed or as adjusted in the TEFRA proceeding). CCA 201210036).

[750] *Bush v. United States*, 655 F.3d 1323 (Fed. Cir. 2011) (The court noted that deficiency notices still would be due for any deficiencies (including those that otherwise would be computational adjustments) attributable to affected items requiring partner-level determinations. No partner-level determination was necessary because the settlement agreement defined such amounts as the taxpayers' capital contributions to the partnership and established how to calculate those amounts. Thus, the court concluded that the IRS was correct to directly assess the taxes at issue without first issuing a notice of deficiency.).

[751] *See* CC-2009-011. The IRS Chief Counsel's Office further advised that, if a petition is filed in response to the affected item notice of deficiency and the partner moves to enjoin assessment of the tax and the penalties, the IRS should agree to abate the assessment related to the deficiency so long as the court agrees that the loss (or decreased gain) reported on the partner's return is subject to the deficiency procedures (i.e., that further determinations need to be made at the partner level and, therefore, the deficiency procedures must be followed before an assessment can be made). The IRS Chief Counsel's Office indicated that the IRS should argue that the penalties are directly assessable and should not be enjoined.

[752] *Ernst S. Ryder & Assoc., Inc. v. Commissioner*, T.C. Memo 2021-88; *Alpha I LP v. United States*, 89 Fed. Cl. 44 (2009).

[753] *See Merulo v.Commissioner*, 691 F.3d 1108 (9th Cir. 2012); *Bradley v. Commissioner*, 100 T.C. 367 (1993) (court lacks jurisdiction in partner-level proceeding involving nonpartnership items to redetermine a deficiency attributable to tax treatment of partnership item).

[754] The minimum statute of limitations for the affected item notice of deficiency is the Minimum Period provided by §6229(d) which governs suspension of the statute of limitations for partnership items and affected items.

[755] *See Blonien v. Commissioner*, 118 T.C. 541 (2002), *supplemented*, T.C. Memo 2003-308 (in Rule 155 phase, court lacks jurisdiction to consider proper method to allocate cancellation of debt income to taxpayer, as the allocation is a partnership-level item that was determined in partnership-level TEFRA proceeding); *N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987); *Maxwell v. Commissioner*, 87 T.C. 783 (1986); *Bausch & Lomb, Inc. v. Commissioner*, T.C. Memo 2009-112, *appeal dismissed*, 2011-1 USTC ¶ 50,118 (2d Cir. 2010) (unpub.) (NOL adjustment resulting from partnership item cannot be made until after partnership proceeding over). Section 6503(a)(1) was amended by 1997 TRA §1237(c)(2) retroactively to clarify that the statute of limitations on assessment of affected items is suspended from the date on which the affected item notice of deficiency is issued until 60 days after: (1) the 90-day period to petition expires, or (2) if a petition is filed, until the Tax Court decision becomes final.

[756] *GAF Corp. & Subsidiaries v. Commissioner*, 114 T.C. 519 (2000); *Maxwell v. Commissioner*, 87 T.C. 703 (1986); *Miller v. Commissioner*, T.C. Memo 2009-182; *Soward v. Commissioner*, T.C. Memo 2006-262.

[757] *Roberts v. Commissioner*, 94 T.C. 853 (1990). *See Gustin v. Commissioner*, T.C. Memo 2002-64 (upholding validity of deficiency notice based on affected items where administrative partnership-level proceeding was not initiated and the IRS was bound by partnership's treatment of partnership items); CCA 201447031 (IRS cannot dispute Tier 1 partnership items on Form K-1 it issued to Tier 2 that Tier 2 used to compute its outside basis in Tier 1; IRS must open TEFRA proceeding for Tier 1 in order to dispute Tier 1's partnership items). See *Meruelo v. Commissioner*, 132 T.C. 355 (2009), *aff'd* 691 F.3d 1108 (9th Cir. 2012), in which the Tax Court held that the IRS may issue a notice of deficiency during the normal period of limitations applicable to a TEFRA entity when at the time of such issuance the IRS has accepted the TEFRA entity's return as filed. Accordingly, the court found that an affected item notice of deficiency issued with respect to the taxpayer's income tax return arising from his investment in a TEFRA partnership was valid as the partnership return had been accepted as filed and no TEFRA partnership proceeding had begun when the deficiency notice was issued. *See also* CCA 201103054.

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The statute of limitations for substantive affected items piggybacks on the partnership item statute of limitations. See V.D., above, for further discussion.

2. Contesting the Affected Item Notice of Deficiency

The affected item notice of deficiency is treated as a notice of deficiency in all other respects. Accordingly, the partner may file a Tax Court petition within 90 days after issuance of the affected item notice of deficiency to contest the affected items asserted. This gives the partner the opportunity to contest the affected item adjustments before the tax is assessed. Similarly, the partner can pay the affected item deficiency, file a claim for refund, and bring a refund action if the claim is not allowed.

Refund claims with respect to certain other items can be raised if a Tax Court petition is filed in response to the affected item notice of deficiency.[758] This refund rule also presumably includes the "offsetting" effect of a net operating loss or credit carryover to the extent that the statute of limitations remains open for this refund issue.

D. Converted Item Proceedings

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

As set forth in III.B.4., above, converted items are a category of partnership items for which a specified act has occurred that caused the items to convert from partnership items to nonpartnership items. This effectively drops the partner out of the partnership proceeding and provides a new mechanism for resolving the converted items. There are three different categories of converted items: (1) converted items from a settlement; (2) deficiency converted items; and (3) special enforcement area converted items.

1. Converted Items from Settlement

When a partner enters into a settlement agreement with the IRS, §6231(b)(1)(C) causes the partner's partnership items to convert to nonpartnership items. The resulting tax is then determined as a computational adjustment. See VIII.B., above, for the applicable computational adjustment procedures.

2. Deficiency Converted Items

a. Making the Converted Item Adjustment

Deficiency converted items occur in specified circumstances when a partner has been left out of a partnership proceeding and/or has taken affirmative action to treat partnership items inconsistently with the partnership. See III.B.4.b., above, for a more specific definition of these circumstances.

The conversion of items triggers the deficiency procedures. The critical issue for the converted item procedure is the period in which the IRS must issue the notice of deficiency to propose adjustments to these items. In general, the IRS has one year from the conversion date. See V.E., above, to understand the rules for this one-year statute of limitations.

b. Contesting the Converted Item Notice of Deficiency

Once the converted item notice of deficiency is issued within the converted item period of limitations, the non-TEFRA deficiency procedures apply. This can create multiple deficiency proceedings for the same tax year. These proceedings will be coordinated by the IRS and the Tax Court. The proceedings can be consolidated or resolved sequentially with the computations for the earlier proceeding incorporated into the next. Other than these coordination issues, the converted item deficiency proceeding should present no special issues.

3. Special Enforcement Area Converted Items

Special enforcement area converted items are another form of deficiency converted items. They result from a different list of events occurring as a result of the partner's or IRS action. The goal is to coordinate the converted items with other possible nonpartnership item issues. The converted item statute of limitations is the same as for other deficiency converted items. See V.E., above.

For these special enforcement area converted items, the affected partnership items are converted unless: (1) the IRS has issued an FPAA, and (2) either the time to file a petition has expired or the decision of the court has become final.[759] If the conversion occurs with respect to the partner who is the TMP in the partnership, the conversion results in the termination of the TMP designation.[760]

These conversion rules have differing results for spouses filing jointly depending on whether the spouses have separate or joint interests in the partnership. Reg. §301.6231(a)(12)-1(a) provides that spouses holding joint interests are treated as separate partners. Following the Second Circuit's decision in *Callaway v. Commissioner*,[761] the IRS issued regulations that provide that a spouse who files a joint return with an individual holding a separate interest in the partnership is no longer treated as a partner in the partnership once the partnership items of the individual holding the separate interest in the partnership convert to nonpartnership items under §6231(b).[762] If each spouse holds a separate interest in the partnership, this rule is applied separately for each partnership interest. In addition, a spouse who files a joint return with an individual holding a separate interest in the partnership is no longer treated as a partner in the partnership upon the occurrence of an event that would convert the partnership items of the spouse to nonpartnership items if the spouse were the owner of a separate interest.[763] Finally, if the spouses hold a joint interest in a partnership and are treat-

[758] The Tax Court clearly may exercise overpayment jurisdiction with respect to affected items. §6230(d); §6512(b). *See also* CCA 201025057 (§6230(d)(1) prohibits issuing refund after §6229 period has expired unless refund falls with the periods specified in §6230(d)(2), §6230(d)(3), or §6230(d)(4); thus, IRS cannot issue refund unless it has Form 9247 or 9248 or partner's statute is otherwise open). Section 6230(d) is discussed in VIII.D.2.a., below.

[759] Reg. §301.6231(c)-3(a).

[760] Reg. §301.6231(a)(7)-1(l)(1)(iv).

[761] 231 F.3d 106 (2d Cir. 2000), *rev'g* T.C. Memo 1998-99.

[762] Reg. §301.6231(a)(2)-1(a)(4)(i).

[763] Reg. §301.6231(a)(2)-1(a)(4)(ii).

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ed as separate partners under Reg. §301.6231(a)(12)-1, the conversion of partnership items under §6231(b) is applied separately to each spouse.[764]

Note: The regulation provisions concerning the conversion of partnership items in the context of spouses described above are effective for partnership tax years beginning on or after October 4, 2001.[765] For prior tax years, Reg. §301.6231(a)(2)-1T and Reg. §301.6231(a)(12)-1T (both removed by T.D. 8965) described the treatment of spouses under the unified partnership audit rules. Reg. §301.6231(a)(12)-1T covered a married couple owning a partnership interest as joint property. With limited exceptions, those spouses were both treated as partners for purposes of the partnership audit rules. Reg. §301.6231(a)(2)-1T covered a married individual owning a partnership interest as separate property, treating a spouse filing a joint return with such an individual as a partner for purposes of the partnership audit rules. Questions arose concerning the treatment of the spouses who filed jointly with the individual holding a partnership interest as separate property when the partner's partnership items converted to nonpartnership items. The Second Circuit in *Callaway v. Commissioner*,[766] and subsequently the IRS in Reg. §301.6231(a)(2)-1(a)(4), answered that issue by providing that the nonpartner spouse ceases to be treated as a partner in the partnership upon such a conversion.

For each type of converted item, a determination of the item for the partner for whom the item was converted is not controlling in the determination of that item for the other partners.[767] In addition, a judicial decision for the partner's nonpartnership items for the same taxable year as the converted items does not bar a later notice of deficiency or claim for refund based on the converted items.[768] This provision is designed to avoid the normal rule that a Tax Court decision resolves with finality all nonpartnership items for the years before the court.[769]

E. Collection Due Process (CDP) Proceedings

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The ultimate consequence of a TEFRA partnership proceeding is the assessment of tax against the partner. From a tax collection standpoint, this is treated the same as all assessments.

After the IRS files a lien and before the IRS can levy, the IRS is required to issue notices that give the taxpayer an opportunity to file a collection due process (CDP) appeal.[770] This provision is designed to provide an opportunity for review by Appeals of the collection actions.[771] One of the issues that can be raised in the CDP hearing is a challenge to the underlying liability. This challenge is only allowed to the extent the taxpayer "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability."[772]

The CDP appeal may offer an opportunity to contest the tax determined in a TEFRA partnership proceeding in certain circumstances. It appears that the partner will not be allowed to contest the partnership item determination, however, even if the FPAA was not contested on the merits or the assessed partner did not receive an FPAA.[773]

A different result applies, however, with respect to challenges to certain issues in a computational adjustment, however. Even though the underlying partnership item determination cannot be contested under the CDP procedures, the partner can contest items affecting the computation of the resulting tax in a computational adjustment. This is because the computational adjustment process does not otherwise provide a pre-payment forum so the partner has not had a prior opportunity to contest the liability for CDP purposes.[774]

Another opportunity to contest TEFRA adjustments in a CDP hearing exists if the IRS issued an affected item or converted item notice of deficiency that was not actually received. Even if the notice was sent to the partner's last known address, if the notice was not actually received the right to challenge the liability exists in a CDP hearing.[775]

F. Penalty Proceedings

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Penalty determinations have never been an easy fit in the TEFRA procedures. As a result, the penalty determinations borrow from the foregoing procedures for tax determinations, but are sufficiently different such that they need to be analyzed separately

[764] Reg. §301.6231(a)(12)-1(c)(1).

[765] T.D. 8965, 66 Fed. Reg. 50541 (Oct. 4, 2001).

[766] 231 F.3d 106 (2d Cir. 2000).

[767] §6231(e)(1); Reg. §301.6231(e)-1(a). *See also Poison Creek Ranches #1 Ltd. v. Commissioner*, T.C. Memo 1996-504.

[768] §6231(e)(1); Reg. §301.6231(e)-2(a).

[769] §6212(c), §6512(a).

[770] §6231(e)(1); Reg. §301.6231(e)-2(a).

[771] §6320(b), §6330(b). See generally 638 T.M., *Federal Tax Collection Procedure: Defensive Measures.*

[772] §6330(c)(2)(B).

[773] *Hudspath v. Commissioner*, T.C. Memo 2005-83 (FPAA action dismissed); *Davison v. Commissioner*, T.C. Memo 2019-26, *aff'd*, 805 Fed.Appx. 259 (5th Cir. 2020) (indirect partner had prior opportunity from FPAA to direct partner); *Pettennude v. Commissioner*, T.C. Memo 2022-79 (non-notice partner deemed to have prior opportunity from FPAA issued to TMP). *See also Golderg v. Commissioner*, 73 F.4th 537 (7th Cir. 2023); *Elkins v. Commissioner*, T.C. Memo 2020-110 (Partnership proceeding bars partnership item statute of limitations and §6751 penalty approval in partner CDP proceeding).

[774] *Amanda Iris Gluck Irrevocable Trust v. Commissioner*, 154 T.C. 259 (2020).

[775] §6330(c)(2)(B); Reg. §301.6320-12(e)(1). *But see Sego v. Commissioner*, 114 T.C. 602 (2000) (taxpayer's refusal to accept delivery still constitutes receipt).

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1. Partnership Tax Years Ending After August 5, 1997

Congress amended §6221 for partnership tax years ending after August 5, 1997, to require the penalty determination to be made in the partnership proceeding if the penalty "relates to an adjustment to a partnership item." The penalty is assessed through the computational adjustment procedure with no prepayment review provided under the TEFRA procedures. It may be that if the penalty is based on either a partnership item or affected item determination, application of the penalty is determined in the partnership proceeding.[776]

The partner has all of the means available under the computational adjustment procedures to contest the penalty. The primary procedure is to file a claim for refund to raise the partner-level defenses to the penalty.[777] The main partner-level defense is the partner's reasonable cause. This includes reliance on professional advisors.[778] It appears the general partner or TMP also has the opportunity to assert partner-level defenses in a refund action even though the partnership failed to establish reasonable cause based on that partner's efforts in the partnership proceeding.[779]

2. Partnership Tax Years Ending Before August 6, 1997

The original treatment of penalties under the TEFRA procedures was as a substantive affected item. As such, penalties could not be assessed until after the partnership proceeding concluded, the IRS issued an affected item notice of deficiency, and the partner had a pre-payment opportunity to contest all issues related to the penalty determination in a deficiency proceeding.[780] Determinations in the partnership proceeding that served as the basis for a penalty determination would normally be binding in the partner-level penalty case under res judicata or similar principles.[781] However, statutory limits, computational issues, and partner-level defenses could all be raised prior to assessment of the penalty.

Partner-level proceedings were also available for the former §6621(c) penalty interest. Some bases for the penalty interest did not require partnership-level determinations. In theory, these bases could be determined at the partner level. Because former §6621(c) is in Subtitle F, however, the partner-level penalty interest issue could not be part of a deficiency to be included in an affected item notice of deficiency.[782] Therefore, the TEFRA procedures inadvertently eliminated a prepayment forum for most penalty interest issues. Even though preassessment review may have been eliminated, there could be jurisdiction over the partner-level aspects of the determination in a collection due process proceeding.[783] In rare cases, there could also be jurisdiction over the entire penalty interest determination if the partner was otherwise deprived of an opportunity to contest the determination due to the prior confusion regarding the law.[784]

There were also two avenues to contest the former §6621(c) interest after payment. The first was refund procedures.[785] In this refund forum, it appears that the partner may not be confined to the relatively short computational adjustment time limits if the partner-level issues are not merely computational.[786] The other possible avenue is the Tax Court's overpayment jurisdiction.[787]

[776] *Thompson v. Commissioner*, 821 F.3d 1008 (8th Cir. 2016).
[777] §6230(c)(1)(C).
[778] *Nix v. United States*, 339 F.Supp. 3d 580 (E.D. Tex. 2018).
[779] *McNeill v. United States*, 836 F.3d 1282 (10th Cir. 2016).
[780] *See Maxwell v. Commissioner*, 87 T.C. 783 (1986).
[781] *See N.C.F. Energy Partners v. Commissioner*, 89 T.C. 741 (1987).
[782] *Powell v. Commissioner*, 96 T.C. 707 (1991); *Odend'hal v. Commissioner*, 95 T.C. 617 (1990); *White v. Commissioner*, 95 T.C. 209 (1990); *Kohn v. Commissioner*, T.C. Memo 1999-150; *English v. Commissioner*, T.C. Memo 1990-662.
[783] *Kimball v. Commissioner*, T.C. Memo 2008-78.
[784] *Keller v. Commissioner*, 568 F.3d 710 (9th Cir. 2009).
[785] *Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013); *Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004), *cert. denied*, 125 S. Ct. 2312 (2005) (partner-level defenses can be asserted in refund suit); *Field v. United States*, 328 F.3d 58 (2d Cir. 2003) (district court has jurisdiction to hear partner's action for refund of tax-motivated interest paid), on remand, as amended, 307 F. Supp. 2d 498 (S.D.N.Y. 2003) (because former §6221(c) is interest, under §6502(a)(1) and §6601(g), it may be collected any time within 10 years after timely assessment of underlying tax, and interest on that tax may be assessed and collected within same period), *aff'd*, 381 F.3d 109 (2d Cir. 2004) (former §6621(c) interest on deficiencies is not subject to deficiency procedures).
[786] *Irvine v. United States*, 729 F.3d 455 (5th Cir. 2013) (substantive partner-level penalty interest issues not subject to shortened §6230 refund claim period); *Duffie v. United States*, 600 F.3d 362 (5th Cir. 2010), *cert. denied*, 562 U.S. 897 (2010) (computational partner-level penalty interest issues subject to §6320 refund procedures); *McGann v. United States*, 76 Fed. Cl. 745 (2007).
[787] *See Barton v. Commissioner*, 97 T.C. 548 (1991). *But see Powell v. Commissioner*, T.C. Memo 1997-560 (overpayment is required before Tax Court can exercise overpayment jurisdiction); *Heckler v. Commissioner*, T.C. Memo 1996-521; *Greene v. Commissioner*, T.C. Memo 1995-105.

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IX. Administrative Adjustment Request (AAR)

A. Overview

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

An AAR, sometimes referred to as a Request for Administrative Adjustment, is the TEFRA partnership equivalent of an amended return for partnership items. The AAR may not be filed after an FPAA has been issued to the TMP. Accordingly, the AAR cannot serve as the equivalent of a non-TEFRA claim for refund if the partnership fails to properly petition the adjustments proposed in the FPAA within the statutory period.[788]

The AAR can take any one of three different forms: (1) a substituted return filed by the TMP (a "substituted return AAR"); (2) an amended return filed by the TMP which is not treated as a substituted return (a "claim for refund AAR"); and (3) an amended return filed by any partner only with respect to that partner's partnership item (a "partner AAR").

B. Time for Filing AAR

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

All types of AAR must be filed: (1) on or before the date three years after the later of: (a) the date the partnership return was filed; or (b) the due date of the partnership return (determined without regard to extensions); and (2) before the FPAA for that year is mailed to the TMP.[789] If the AAR is not filed within this period, and if no FPAA is mailed to the partnership within the period provided by §6229, the partnership item treatment on the original partnership return becomes final and cannot be amended.

If an agreement is executed to extend the partnership statute of limitations, that agreement also extends the statute of limitations for filing an AAR until six months after the expiration of the Minimum Period.[790] This is the TEFRA equivalent to the rule contained in §6511(c), which extends of the non-TEFRA refund statute. Without §6227(b), the extension of the statute of limitations for assessment of partnership items (Form 872-P) would not similarly extend the period for filing an AAR, because Form 872-P is issued under the authority of §6229(b), which only applies to assessments of tax resulting from partnership items.

The statute of limitations for filing an AAR is also extended for deductions relating to worthless securities or bad debts. Thus, if an AAR relates to the deduction by a partnership for a worthless security under §166 or a bad debt under §165(g), the period for filing an AAR is seven years from the due date of the partnership return with respect to which the request is made (determined without regard to extensions).[791] The AAR must still be filed before the IRS mails the FPAA.

C. AAR Filed by the TMP on Behalf of the Partnership

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The TMP is the only partner who may file an AAR on behalf of the partnership. The TMP may file an AAR on behalf of the partnership either as: (1) a substituted return AAR or as (2) a claim for refund AAR. The principal distinctions between these two types of AAR are: (1) the purposes served by the two AARs, and (2) the options the IRS has available in responding to the AARs. Any AAR deals with specific partnership item issues and not all partnership items as a whole, so separate AARs can be filed on different issues for the same taxable year. It is important to follow the specific requirements for filing an AAR.

The courts do not readily recognize nonconforming documents as informal claims.[792] A failure to follow the proper procedures for filing an AAR may result in the AAR being invalidated.[793]

A substituted return AAR generally should be used when: (1) the partnership wishes to either increase or decrease the partnership taxable income (typically based on a mathematical or clerical error), or (2) when the partnership wishes to increase the partnership taxable income. If the partnership intends to utilize the AAR as a means for reducing the partnership taxable income and generating partner refunds, the TMP should file a claim for refund AAR, which does not request substituted return treatment. Any time the TMP files an AAR on behalf of

[788] §6227(a)(2). A non-TEFRA claim for refund can be filed after payment of the tax if a petition is not filed in Tax Court within 90 days after issuance of a notice of deficiency.

[789] §6227(a).

[790] §6227(b). *See* CCA 201906007 (possible that time to issue FPAA to partner is open, but period to file AAR is closed).

[791] §6227(e).

[792] *See Whittington v. United States*, 380 F. Supp. 2d 806 (S.D. Tex. 2005); CCA 201149022.

[793] *See, e.g., United States v. Stewart*, 663 Fed. Appx. 336 (5th Cir. 2016) (amended partnership returns that lacked accompanying Forms 8082 were insufficient to adjust partnership income from ordinary income to capital gains and IRS thus could recover erroneous refunds); *Rigas v. United States*, 486 Fed. Appx. 491 (5th Cir. 2012) (partner's amended return did not qualify as AAR filed pursuant to §6227(d)); *Samueli v. Commissioner*, 132 T.C. 336 (2009) (AAR must be filed in accordance with §6227).

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the partnership, either as a substituted return AAR or as a claim for refund AAR, the TMP must notify all other partners.[794]

1. Forms

Previously, regardless of the type of AAR, TEFRA partnerships and their partners used Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request*, for all modifications of the original partnership return, including administrative adjustments. Also, other types of flow-through entities used Form 8082 to report contrary positions, etc. The multiple uses of the form led to confusion by taxpayers. Accordingly, the IRS developed Form 1065-X, *Amended Return or Administrative Adjustment Request (AAR)*, and revised Form 8082.[795]

TEFRA partnerships that file *paper* returns should use Form 1065-X to file a substituted return AAR to make corrections to a previously filed return to make corrections. TEFRA partnerships also should use Form 1065-X to file a claim for refund AAR.[796] For tax years beginning on or after January 1, 2021, filers of Form 1065-X may need to include amended Schedules K-2 and K-3 (Form 1065).[797]

Note: For tax years prior to 2021, taxpayers should use the September 2018 version of Form 1065-X; for tax years 2021 and 2022 taxpayers should use the December 2021 version of Form 1065-X; and for tax year 2023 taxpayers should use the August 2023 version of Form 1065-X.

TEFRA partnerships and ELPs should use Form 8082 to file an amended return or AAR if the original filing was electronic or the amended return or AAR is filed electronically. Form 8082 also should be used to make a §6222 notice of inconsistent treatment or a §6227(d) partner-level AAR.[798]

2. IRS Responses

One principal distinction between a substituted return AAR and a claim for refund AAR is in the responses that the IRS may make. The IRS may accept the substituted return AAR as a request for correction of a mathematical or clerical error on the original return.[799] Pursuant to this procedure, the IRS mails a notice of clerical or math error correction to each partner. If the partner does not request the abatement of the math error assessment within 60 days, the adjustment becomes final.[800] If a partner contests the assessment, the assessment may not be made against that partner without commencing a partnership proceeding.[801]

The IRS may also refuse to make the adjustment requested on the substituted return. In this case, the substituted return AAR effectively becomes a claim for refund AAR, and the TMP may bring a refund suit under §6228(a).[802]

Section 6227(c)(2) gives the IRS three possible responses to the claim for refund AAR: (1) allow all partners the credit or refunds requested;[803] (2) conduct a partnership proceeding; or (3) take no action. Because the IRS does not need a separate statutory authorization to conduct a partnership proceeding, §6227(c)(2)(A) effectively authorizes the IRS to either allow the claim or disallow the claim by not taking action.[804]

Note: The specific reference to refunds or credits gives further indication that the §6227(c)(2) AAR is intended to serve as the principal claim for refund mechanism.

The IRS cannot allow the refund or credit to any partner whose items have been converted to nonpartnership items before the refund or credit is made. See V.E., above, for further discussion of the potential problems that can arise in cases involving refunds attributable to converted items.

In general, no refund of an overpayment attributable to a partnership item (or an affected item) for a partnership tax year is allowed after the expiration of the period of limitation under §6229 for that partner for assessment of any tax attributable to that item.[805] However, if an AAR is timely filed, a refund of any overpayment attributable to that partnership item (or an affected item) may be allowed or made at any time before the §6228 period of limitation for bringing suit for that request expires.[806] Furthermore, a refund of the overpayment may be made at any time before the period of limitation specified in §6532 for bringing suit with respect to such claim expires if:

> (i) a timely claim for refund is filed on the ground that the IRS erroneously computed a computational adjustment necessary to make the partnership items on the partner's return consistent with the treatment of the partnership items on the partnership return, or to apply to the partner a settlement, a final partnership administrative adjustment, or the decision of a court in an action under §6226 or §6228(a),
>
> (ii) a timely claim for refund is filed on the ground that the IRS failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action under §6226 or §6228(a), or
>
> (iii) a timely claim for refund is filed on the ground that the IRS erroneously imposed any penalty, addition to tax, or additional amount relating to an adjustment to a partnership item.[807]

[794] Reg. §301.6223(g)-1(b)(1)(vi).

[795] *See* Reg. §301.6227(c)-1(a).

[796] Form 1065-X is used by Electing Large Partnerships (ELPs) to correct errors on Form 1065-B and to file an AAR. Form 1065-X also is used by REMICs that do not meet the small REMIC exception under §860F(e) and §6231 (and the related regulations thereunder) or that make the election under §6231(a)(1)(B)(ii) not to be treated as a small REMIC. The instructions to Form 1065-X provides guidance as to what to attach and who must sign. *See* Instructions for Form 1065-B.

[797] Instructions for Form 1065-X.

[798] The Instructions for Form 8082 provide special rules for ELPs.

[799] §6227(c)(1).

[800] *See* CCA 201114026 (60-day objection letter should be issued to all partners).

[801] §6230(b). See III.D.3., above, for further discussion of the math error adjustment procedures.

[802] *See* Reg. §301.6227(c)-1(b); IRM 4.31.4 (08-28-25) (internal IRS procedures for processing a substituted return AAR).

[803] *See* CCA 201513001 (IRS has two years from date TEFRA partnership filed AAR to issue refund; no time limit for non-TEFRA partnership if no notice of disallowance issued).

[804] *See* §6532; IRM 4.31.4 (08-28-25) (internal IRS procedures for processing a claim for refund AAR).

[805] §6230(d)(1).

[806] §6230(d)(2), §6230(d)(4).

[807] §6230(d)(3), §6230(d)(4).

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If a partner's overpayment is attributable to an IRS adjustment to a partnership item (or an affected item), credit or refund of the overpayment should be allowed or made without the partner having to file a claim for credit or refund.[808]

3. Filing the Refund Suit

The rules governing the filing of a refund suit are the same for both the substituted return AAR and the claim for refund AAR. There are also detailed rules governing the interplay between a refund suit filed by the TMP under §6228(a) and a partnership proceeding leading up to the issuance of an FPAA. These rules ensure that only one proceeding involving the partnership items goes forward. The rules also prefer the FPAA proceeding over the partnership's refund proceeding.

a. Time and Manner of Filing

Because a §6228(a) action is similar to a refund suit, the time and manner of filing the §6228(a) action is similar to non-TEFRA refund litigation procedures. Section 6227(c) does not authorize the IRS to issue a notice of claim disallowance in response to an AAR filed by the TMP however. Accordingly, the time for filing a §6228(a) action is the period beginning six months after the AAR was filed and ending two years after it was filed.[809]

Comment: Under CCA 201016077, it makes no difference whether the IRS takes no action on an AAR or disallows it, because the two-year petition period runs from the date the AAR is filed under §6228 rather than from the date of disallowance.

The TMP and the IRS may extend the two-year period by an agreement in writing.[810] This agreement should be obtained if the AAR is a protective claim. A protective claim is typically a claim to preserve the right to pursue a refund based on the resolution of a pending matter in another tax year. Because the two-year deadline for filing the §6228 action begins to run when the protective AAR is filed (not when the claim is disallowed), the benefits of the protective AAR would be lost after two years unless this period is extended by agreement.

As with a non-TEFRA refund suit, the §6228(a) action is limited to the adjustments requested in the AAR which are not allowed by the IRS and any adjustments which the IRS asserts to offset the reduction in the partnership items contained in the AAR.[811]

Example: The TMP for the BCD Partnership files a claim for refund AAR claiming that the partnership overstated gross income by $10,000 on the original Form 1065. The IRS agrees that BCD's gross income was overstated, but alleges that BCD's deductions were also overstated by $10,000 and, therefore, does not allow the AAR. The IRS may raise the overstated deduction issue in a subsequent §6228(a) action brought by the TMP based on the AAR.

If the "offsetting" adjustment proposed by the IRS is an adjustment to a separately reported flow-through item such as an investment tax credit amount, however, it would appear that this adjustment could not be properly included in the §6228(a) action. Since §6228(a)(5) limits the permissible issues in the §6228(a) action to those which offset the adjustments requested in the AAR, it would seem that the offsetting adjustment would have to be contained in the same "line item" on Schedule K-1. Accordingly, partnership taxable income adjustments may be offset only by other partnership taxable income adjustments and credit adjustments may be offset only by other credit adjustments. The IRS has the option of commencing a partnership proceeding and issuing an FPAA to resolve any offsetting unrelated partnership item adjustments.

As discussed above, only the TMP may file a substituted return AAR or a claim for refund AAR on behalf of the partnership. Similarly, after this type of AAR has been filed by the TMP, only the TMP may file a §6228 refund petition if the AAR is not allowed. It is, therefore, important for the other partners to closely monitor the TMP's progress in filing the §6228(a) action. While the TMP is required to notify the partners of the filing of a §6228(a) action,[812] the partners should nevertheless monitor the statutory period in which the §6228(a) action may be filed to ensure timely filing. If the TMP fails to file a timely §6228(a) petition, the TMP's failure is binding on all partners.[813] The partners' only recourse in this event is to file an AAR for their own share of these partnership item adjustments pursuant to §6227(d). By the time the partner discovers the TMP's failure, however, a partner AAR is typically barred by the §6227(a) statute of limitations.

As with §6226 actions, the Tax Court was the first court to issue detailed rules concerning the contents of the §6228(a) petition. The contents of a Tax Court petition (called a "Petition for Adjustment Under §6228(a)") are similar to the contents of a petition for readjustment of an FPAA under §6226(a). The following items are required to be included in the petition:

- a statement that the petitioner is the TMP;
- the date the AAR was filed and a statement of facts that show that the petition is timely and the court has jurisdiction under §6228(a);
- the taxable year to which the AAR relates;
- the city and state of the IRS office where the AAR was filed;
- a clear and concise statement of the partnership items to be adjusted and the grounds for the adjustment;
- a statement of the facts that support the partnership's position;
- a prayer for relief;
- the signature of the TMP or the TMP's counsel; and
- a copy of the AAR appended as an exhibit.[814]

[808] §6230(d)(5).

[809] §6228(a)(2)(A).

[810] §6228(a)(2)(D). *See U.S. Farm Partners-85 v. United States*, 183 F.R.D. 548 (C.D. Cal. 1998) (related actions do not extend two-year period to file). *See also* Form 9248, *Agreement to Extend the Time to File a Civil Action for Refund by Notice Partner (Shareholder) With Respect to Partnership or Subchapter S Items.*

[811] §6228(a)(5).

[812] Reg. §301.6223(g)-1(b)(1)(vii).

[813] §6230(f). *Hamilton v. United States*, 120 AFTR2d 2017-5701 (N.D. Ind. 2017).

[814] Tax Court Rule 241(e). *See also* Rules of the Court of Federal Claims, Appendix F, Rule 2.

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These rules are essentially the same for a complaint filed in the Court of Federal Claims and should also serve as a guideline for the contents of a U.S. district court complaint. A U.S. district court complaint should contain additional venue allegations that assert that the partnership's principal place of business is in the judicial district where the complaint is filed.

The TMP's role for receipt and distribution of information concerning the conduct of the §6228(a) action is essentially the same as for a §6226 petition contesting an FPAA. Only the TMP may file a §6228(a) action, however, so the TMP will always have primary responsibility for conducting the litigation.

b. Coordination with an FPAA Proceeding

In addition to the express time and subject matter limits, the ability to file a §6228(a) action is also limited by certain events in a related partnership audit proceeding. The TMP may not file a §6228(a) action after the IRS has mailed an NBAP to the partnership for the taxable year to which the AAR relates.[815] If the IRS ultimately does not mail an FPAA to the partnership before the expiration of the partnership item statute of limitations, however, the partnership is still allowed to file a §6228(a) action within six months after the expiration of the partnership item statute of limitations.[816] The §6228(a) action also may not be filed after the FPAA has been mailed to the TMP even if no NBAP was issued to the partnership.[817]

A preference for the conduct of litigation in a §6226 FPAA proceeding exists even after a valid §6228(a) action has been filed. There is no restriction on the IRS's ability to issue an FPAA after the TMP has filed a §6228(a) action.[818] Thus, if the FPAA is issued after the §6228(a) action is filed but before a hearing, the FPAA is automatically incorporated into the §6228(a) action and the action is converted to a §6226 action that includes the adjustments requested in the AAR.[819] This is a necessary preference in favor of the §6226 action, because a §6226 action includes all partnership item issues for the taxable year at issue, while a §6228 action is confined to the issues raised in the AAR plus any offsetting issues raised by the IRS.[820]

If the IRS issues an FPAA after a §6228(a) action is commenced in the Tax Court, the TMP must file an amended petition within 90 days after the FPAA is mailed to the TMP. The amended petition must set forth the information required in a §6226 petition and must attach a copy of the FPAA. The TMP must also serve notice of the filing of the amended petition in the same manner as if the amended petition were a §6226 petition.[821] See VII.A.4., above, for the rules concerning the contents of a §6226 petition. Section 6228(a)(3)(B) automatically incorporates the FPAA into the §6228(a) action. If the §6228(a) proceeding is pending in Tax Court, the IRS is not able to assess the partners' distributive share of the FPAA adjustments as the FPAA is automatically deemed to be part of the court proceeding.

If the §6228(a) action is filed in the district court or the Court of Federal Claims, and an FPAA is subsequently mailed to the TMP, the action is similarly converted to a §6226 action. Accordingly, by choosing the Court of Federal Claims or district court as the forum for the §6228(a) action, the TMP is, in effect, committing the partnership to litigate any subsequent FPAA in that same forum.[822] Unlike a normal §6226 action, though, the requirement that a cash deposit equal to the petitioning partner's tax liability from the distributive share of the partnership item adjustments is waived for this converted §6226 action.[823] This waiver does not restrain the IRS from assessing and collecting the deficiencies attributable to the FPAA from the other partners, however. See VII.A.3., above, for further analysis of the merits of these alternative judicial forums.

Comment: It is unclear what happens to the FPAA adjustments if neither the TMP nor the IRS informs the court of the existence of the FPAA and the §6228(a) action concludes. Presumably, the IRS will alert the court of the existence of the FPAA if the TMP fails to notify the court to avoid any potential problems in this area.

c. Conduct of the Litigation

The rules concerning which partners are treated as parties and who is allowed to participate in the §6228(a) action are essentially the same as those provided in §6226 actions contesting the FPAA. If the partner's partnership items have not been converted to nonpartnership items and the statute of limitations on assessment of the partnership items has not expired, the partner is considered a party to the §6228(a) action and the partner is allowed the opportunity to participate in that action.

To participate in Tax Court cases, the partner must file a notice of election to participate within 90 days after the date the TMP's petition is served on the IRS.[824] If the partner files a notice of election to participate in the §6228(a) action and the action is converted to a §6226 action contesting a subsequently issued FPAA, that partner is deemed to have elected to participate in the §6226 action. Any other partner may participate in the converted §6226 action by filing a notice of election to participate within 90 days after the date the TMP files the amended petition addressing the issues contained in the FPAA.[825]

Once the parties and participants are determined, the §6228(a) proceeding is conducted in much the same manner as other litigation in the Tax Court, U.S. district court, or Court of Federal Claims. One issue that may have an impact on the choice of forum for conducting the §6228(a) litigation is the availability of a jury trial in the district court. As discussed in VII.A.3., above, however, a jury trial is apparently not available in a §6226 action even if the jurisdictional deposit is made

[815] §6228(a)(2)(B); *Harman Road Property, LLC v. Commissioner*, T.C. Memo 2023-143.

[816] §6228(a)(2)(C).

[817] §6228(a)(3)(A).

[818] The judicial determination in a §6228(a) action decides only the partnership item issues raised in the AAR and any offsetting IRS adjustments contested in the case. Because this action is "issue specific," the decision in the action does not bar any adjustment with respect to any other partnership item. §6231(e)(2).

[819] §6228(a)(3)(B). This result applies only if the FPAA were mailed within the §6229 partnership statute of limitations. §6228(a)(3)(C).

[820] §6226(f), §6228(a)(5).

[821] Tax Court Rule 249.

[822] *See also Paramount Communications, Inc. v. United States*, 2000-1 USTC ¶ 50,140 (S.D.N.Y. 1999) (partner's refund suit dismissed after FPAA issued and petitioned by partnership).

[823] §6228(a)(3)(B).

[824] Tax Court Rule 245(b).

[825] Tax Court Rule 249(b).

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pursuant to §6226(e).[826] The reason for this is that the jurisdictional deposit is not a "payment of tax." Therefore, the §6226 action technically is not an action for the refund of any Internal Revenue tax erroneously or illegally assessed or collected within the meaning of 28 U.S.C. §1346(a)(1). The right to a jury trial exists in the district court only if the court has jurisdiction under 28 U.S.C. §1346(a)(1).[827] Accordingly, district court jurisdiction is based solely on 28 U.S.C. §1346(e), which expressly creates such jurisdiction for §6226 and §6228 actions.

A §6228(a) action, however, requests an adjustment of partnership items that will result in a refund to the partners. While district court jurisdiction exists for this action under 28 U.S.C. §1346(e), it is at least arguable that the §6228(a) action is also an action for refund under 28 U.S.C. §1346(a)(1). If this characterization is appropriate, a jury trial would be available.

Comment: This is a difficult issue to resolve. On the one hand, the petition to obtain the adjustments claimed in the TMP's AAR only determines the partnership item amounts at the partnership level and does not directly result in the determination of the amount of refund due to any partner. Accordingly, the characterization of the §6228(a) action as a refund action is somewhat tenuous. On the other hand, if the §6228(a) action claiming a reduction of the partnership items does not constitute a refund action within the meaning of 28 U.S.C. §1346(a)(1), then the TEFRA procedures effectively eliminate any opportunity for a jury trial for adjustment of partnership items. This intention to absolutely eliminate jury trials for partnership items does not appear in TEFRA's legislative history and should not readily be assumed. Because the TEFRA procedures appear to eliminate any opportunity for a jury trial in actions contesting the FPAA, however, it may follow that the total elimination of jury trials for partnership item adjustments was intended to be part of the TEFRA procedures.

4. Appeal

The decision of the Tax Court, U.S. district court, or Court of Federal Claims in a §6228(a) action is treated the same as any other decision in those courts. Even though only the TMP may bring the action initially, any participating partner (except non-notice partners) may appeal the decision.[828] The appeal from a Tax Court decision must be made by filing a notice of appeal with the clerk of the Tax Court within 90 days after entry of the decision.[829] The appeal lies with the U.S. Court of Appeals for the circuit in which the partnership's principal place of business is located as of the date the Tax Court petition was filed.[830]

The notice of appeal of a district court or Court of Federal Claims decision must be made within 60 days after entry of the judgment or order of the court by filing a notice of appeal with the trial court.[831] The appeal from a decision of the district court lies with the U.S. Court of Appeals for the circuit in which the district court is located.[832] The appeal from the Court of Federal Claims lies with the Federal Circuit.[833]

D. Partner AAR

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

AARs filed by partners other than the TMP (or filed by the TMP solely with respect to the TMP as a partner) serve a completely different function than the TMP's AAR. The partner AAR is intended to provide the partner with the opportunity to claim different treatment of the partner's distributive share of partnership items than is reported by the partnership. Accordingly, the procedures that apply to these partner AARs are designed to allow a resolution of the adjustments requested separate and apart from the other partners in the partnership.

1. Manner of Filing

A partner AAR consists of Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request*, and Form 1040X, *Amended U.S. Individual Income Tax Return*, which shows the refund due if the AAR is granted. The original AAR and the partner's amended return (i.e., Form 1040X) are filed with the partner's submission processing center. A duplicate of the Form 8082 must be filed with the submission processing center where the partnership's return was filed.[834] The

[826] *RCL Props., Inc. v. United States*, 2009-1 USTC ¶ 50,351 (D. Colo. 2009); *Thomas v. United States*, 695 F. Supp. 1021 (E.D. Mo. 1988); *see also Silver Moss Props., LLC v. Commissioner*, 165 T.C. No. 3, (Aug. 21, 2025) (no right to jury trial for §6663(a) civil fraud penalty).

[827] 28 U.S.C. §2402.

[828] §6228(a)(6). The inability of a non-notice partner to appeal an adverse decision could have constitutional due process implications.

[829] §7483.

[830] §7482(b)(1)(E).

[831] 28 U.S.C. §2107, §2522.

[832] 28 U.S.C. §1294.

[833] 28 U.S.C. §1295(a)(3).

[834] Reg. §301.6227(d)-1. *See also United States v. Stewart*, 663 Fed. Appx. 336 (5th Cir. 2016) (amended partnership returns that lacked accompanying Forms 8082 were insufficient to adjust partnership income from ordinary income to capital gains and IRS thus could recover erroneous refunds); *Rigas v. United States*, 486 Fed. Appx. 491 (5th Cir. 2012) (1040X alone does not substantially comply with requirements of §6227(d) and does not qualify as AAR); *Metro Riverboat Assocs. v. United States*, 264 Fed. Appx. 461 (5th Cir. 2008) (unpub.) (Form 8082 was found insufficient to constitute a valid AAR); *Hamilton v. United States*, 120 AFTR2d 2017-5701 (N.D. Ind. 2017) (partner did not file AAR with amended return; court lacked jurisdiction to adjust partner's liability to conform with partnership's amended return); *Herrmann v. United States*, 124 Fed. Cl. 56 (Fed. Cl. 2015) (where taxpayer filed Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request*, with an amended return and checked Form 8082 box (a) (notice of inconsistent treatment), but did not check Form 8082 box (b) (administrative adjustment request), the Court of Federal Claims rejected the IRS's assertion that the court lacked jurisdiction to address the partnership items raised in the AAR, rejected the IRS's position that the taxpayer did not file a proper AAR, and determined that the court had subject matter jurisdiction over the proceeding); *Samueli v. Commissioner*, 132 T.C. 336 (2009) (Form 1040X filed without Form 8082 does not qualify as an AAR, and the Tax Court lacked jurisdiction over partnership items where the AAR was absent); FSA 199916013 (the Chief Counsel's Office advised that if a court finds that a partner's amended return qualifies as an AAR, the IRS should consider whether any taxpayer suit with regard to the AAR is timely filed); *Rothstein v. United States*, 98-1 USTC ¶ 50,435 (Fed. Cl. 1998) (the court lacked jurisdiction under §7422(h) where partner used Form 1040X as an AAR to claim a refund of the allocable share of investment credit); *Wall v. United States*, 89 F.3d 848 (9th Cir. 1996) (unpub.) (nonconforming AAR that provided all necessary information substantially complied with re-

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AAR must relate to only one partnership and one partnership tax year. If AARs are filed with respect to two or more partnerships, however, it appears that two or more Forms 8082 can be attached to one amended return (Form 1040X) showing all corrections.

2. IRS Response

Section 6227(d) allows the IRS to take any of the following four actions in response to a partner AAR:

- Allow the amount of refund claimed as if the claim were for nonpartnership items;
- Assess any additional tax shown;
- Notify the partner that the partner's partnership items for that partnership have been converted to nonpartnership items pursuant to §6231(b)(1)(A) (this applies only if the AAR does not make the partner's treatment of the partnership items consistent with the treatment on the partnership return and no NBAP has been issued to the partnership's TMP);[835] or
- Conduct a partnership proceeding.

Note: If the AAR increases the partner's taxable income, the IRS will probably assess the additional tax shown. If the IRS does not assess the additional tax, however, and does not elect to convert the partner's partnership items to nonpartnership items, there is no apparent way to litigate the issue of whether the IRS must accept the AAR adjustments. This is similar to the non-TEFRA situation in which the taxpayer cannot litigate the IRS's refusal to accept an amended return showing more tax due. In practice, this issue probably arises on an infrequent basis.

3. Filing the Refund Suit

The judicial remedies available for the IRS's failure to grant a partner AAR are completely different from those available in the case of the TMP's AAR. If a partner files an AAR that the IRS does not allow in full, one of two provisions converts the partnership items to nonpartnership items and normal nonpartnership item claim for refund procedures then apply. The first provision applies if the IRS responds to a partner AAR by issuing a notice of election to convert the partner's partnership items to nonpartnership items.[836] If the IRS issues this notice, the AAR is treated the same as a nonpartnership item claim for refund and the partner may file a refund suit pursuant to §7422 at any time within two years after the IRS mails the conversion notice.[837]

Note: It is unclear whether the partner must wait six months after the conversion notice before the refund suit can be filed. Section 6532(a) establishes a six-month waiting period for non-TEFRA refund suits conducted pursuant to §7422. As this six-month waiting period is specifically incorporated into §6228 for other forms of suits filed with respect to AARs, its absence for this type of refund suit indicates that the six-month waiting period does not apply when the IRS elects to convert the partnership items to nonpartnership items. Under this interpretation, the conversion notice essentially constitutes a notice of claim disallowance indicating that the adjustments requested in the AAR are not allowed. This interpretation is also supported by the fact that §6228(b)(1) fails to specify which date (i.e., the date the AAR was filed or the conversion notice date) serves as the date that the claim for refund for the nonpartnership items is deemed filed. Absent a refund claim filing date, the beginning of the six-month period cannot be determined. Based on this analysis, it seems likely that the refund suit can be filed at any time from the date the IRS mails the conversion notice to the date two years after that conversion date.

The second procedure by which partnership items are converted to nonpartnership items applies when the IRS does not mail a conversion notice to the partner who filed the AAR. In this situation, the filing of a §6228(b) refund suit by the partner is the event that converts the partnership items to nonpartnership items.[838] This refund suit is conducted pursuant to §7422 and must be filed during the period beginning six months after the AAR is filed and ending two years after the AAR is filed.[839] This two-year period can be extended by Form 907, *Agreement to Extend the Time to Bring Suit*.

This petition may not be filed, however, after the IRS mails an NBAP to the partnership for the same taxable year unless the IRS does not follow up the NBAP with an FPAA issued within the partnership item statute of limitations. If the IRS does not mail the FPAA within the partnership item statute of limitations, the partner may bring an action for failure to allow the AAR within six months after the expiration of the partnership item statute of limitations.[840]

As both of these situations effectively drop the partner out of any potential partnership proceeding, the need to coordinate potential duplicative actions if the IRS issues an FPAA for the same taxable year is eliminated. The conversion of the partner's partnership items to nonpartnership items allows that partner to separately contest the merits of the partnership item reporting without affecting the partnership-level proceeding.[841]

Any subsequent refund litigation is governed by normal non-TEFRA refund procedures, because the partner's partnership items are converted to nonpartnership items and the §7422 procedures then apply. See 631 T.M., *Refund Litigation*, for further discussion of the refund suit procedures applicable in these situations.

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quirements of regulation); *Phillips v. Commissioner*, 106 T.C. 176 (1996) (taxpayers did not avoid recapture of investment credit by filing an amended return revoking the credit after disposition of the property, as amended return did not conform to the AAR requirements).

[835] §6231(b)(2)(B)(ii), §6231(b)(3).

[836] §6231(b)(1)(A).

[837] §6228(b).

[838] §6231(b)(1)(B). *See also Wall v. United States*, 133 F.3d 1188 (9th Cir. 1998) (unpub.).

[839] §6228(b)(2).

[840] §6228(b)(2)(C), §6228(b)(2)(D).

[841] §6231(e)(1).

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X. Special Issues

A. Foreign Partnerships

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The special issues that arise with respect to foreign partnerships focus on the partnership definition contained in §6231(a)(1)(A). This section defines the partnerships covered by the TEFRA procedures as partnerships that are required to file a return under §6031(a). A foreign partnership generally must file a partnership return if, for the taxable year, it has gross income derived from sources within the United States or it has gross income which is effectively connected with the conduct of a trade or business within the United States.[842] Otherwise, no U.S. return is required of a foreign partnership.

Section 6031(e)(2) authorizes the IRS to promulgate regulations providing exceptions to this filing requirement. Regulations issued in November 1999 provide three exceptions. Under the de minimis exception of Reg. §1.6031(a)-1(b)(2), a foreign partnership (other than a withholding foreign partnership as defined in Reg. §1.1441-5T(c)(2)(i)) that has $20,000 or less of U.S.-source income and no income that is effectively connected to a U.S. trade or business is exempt from the filing requirements provided that at no time during the taxable year 1% or more of any item of partnership income, gain, loss, deduction, or credit is allocable, in the aggregate, to U.S. partners. If a foreign partnership has U.S.-source income, but no U.S. partners or income that is effectively connected to a U.S. trade or business, Reg. §1.6031(a)-1(b)(3) provides that the partnership is not required to file partnership returns. In addition, other partnerships that have $20,000 or less of U.S.-source income, but no income that is effectively connected to a U.S. trade or business, are exempt from the filing requirements if: (1) no more than 1% of any partnership item is allocable directly to U.S. partners, (2) the U.S.-source income is subject to withholding under §1441, (3) Forms 1042 and 1042S are filed with respect to the U.S.-source income, and (4) the U.S. tax liability of the partners relating to the U.S.-source income is satisfied by withholding under §1441. Reg. §1.6031(a)-1(b)(4) specifies that, unless a partnership qualifies under the de minimis exception, if it has U.S.-source income and at least one U.S. partner, it must file partnership returns.[843]

In addition, if a foreign partnership actually files a partnership return, whether or not it is required to do so by §6031(a), the TEFRA partnership audit procedures apply to partnership items as defined by §6231(a)(3).[844] For further discussion of the filing of foreign partnership returns, see 6680 T.M., *Partners and Partnerships — International Tax Aspects* (Foreign Income Series).

If a "foreign" partnership is required to file a U.S. partnership tax return but fails to do so, the U.S. partners may claim no deductions, losses, or credits.[845] This special foreign partnership rule applies if at any time after the close of the taxable year either: (1) the TMP resides outside of the United States or (2) the partnership books and records are maintained outside of the United States. In either of these situations, if the partnership does not file a partnership tax return, the IRS can mail a notice to each partner informing the partner that the partnership's deductions, losses, and credits will be disallowed unless the partnership files a return for that year within 60 days after the date of the notice. If no return is filed within the 60-day period, the IRS may make a computational adjustment which disallows the deductions, losses, and credits claimed from that partnership without conducting a partnership proceeding.[846]

Comment: Treatment of this situation as one in which a computational adjustment is appropriate is somewhat tenuous. It does appear that the computational adjustment for foreign partnerships "properly reflects the treatment under this subchapter of a partnership item" because by definition no partnership items are allowable if no partnership return is filed.[847] As this determination does not require partner-level determinations, the immediate assessment of this computational adjustment is authorized.[848] This analysis, however, would also seem to authorize a computational adjustment when no return is filed for a domestic partnership.[849] As discussed in IV.A.2., above, a computational adjustment is not authorized in this situation.

The IRS may not mail the notice or make the computational adjustment on any date on which the TMP resides within the United States and the partnership books and records are maintained within the United States.[850] The IRS also has discretionary authority not to make the computational adjustment if the partner can satisfy the IRS that the losses and credits are proper and that the partner has made a good-faith effort to get the partnership to file a U.S. partnership tax return.[851]

Comment: A U.S. partner investing in a foreign partnership should be sensitive to the provisions of §6231(f). If the partner cannot control the partnership's decision to file a U.S. partnership tax return, the partner may not be able to claim any deductions, losses, or credits from that partnership.

B. Tiered Partnerships

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership

[842] §6031(e); Reg. §1.6031(a)-1(b)(1) (effective for partnership taxable years beginning after Dec. 31, 2000).

[843] Reg. §1.6031(a)-1(b). Reg. §1.6031(a)-1(b)(3) applies to taxable years of a foreign partnership beginning after Dec. 31, 2000. The other provisions apply to the partnership's taxable year beginning after Dec. 31, 1999, except that Reg. §1.6031(a)-1(a)(3)(ii) applies to taxable years of a partnership beginning on or after Nov. 5, 2003. For foreign partnerships that have U.S.-source income but no effectively connected income, these regulations liberalize the exceptions suggested in former Prop. Reg. §1.6031(a)-1 (REG-209322-82, 63 Fed. Reg. 3677 (Jan. 26, 1998)).

[844] FSA 199928010. *See* Reg. §301.6233-1(a).

[845] §6231(f).

[846] Reg. §301.6231(f)-1(b).

[847] §6231(a)(1)(A), §6231(a)(3), §6231(a)(6).

[848] §6230(a).

[849] *See* §6222(a), §6222(b).

[850] Reg. §301.6231(f)-1(c).

[851] Reg. §301.6231(f)-1(d).

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tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

A tiered partnership situation exists when one partnership is a partner in another partnership. There can be multiple tiers of partnerships in this format.

> *Example:* BCD Partnership is a partnership composed of B and C, who are individuals, and D Partnership, a partnership with X and Y as its only partners. In this situation, BCD Partnership is considered to be the "source" partnership, D Partnership is a pass-through partner, and X and Y are indirect partners.

The definition of a partnership contained in §6231(a)(1) effectively resolves many of the potentially complicated issues that arise in this tiered partnership situation. Because a partnership is automatically governed by the TEFRA procedures if one of its partners is itself a partnership, the BCD Partnership in the above example is automatically a TEFRA partnership. This makes D Partnership a pass-through partner and makes X and Y indirect partners. Because indirect partners are governed by the TEFRA procedures, if the IRS commences a partnership proceeding for the BCD Partnership, the results of that TEFRA proceeding flow through to X and Y and an extension of the BCD Partnership TEFRA partnership statute of limitations extends the statute of limitations for adjustment of X's and Y's distributive share of the partnership items.

If D Partnership has business activities other than its investment in BCD Partnership, however, the IRS must conduct a nonpartnership item audit of X and Y to make those adjustments.[852] This is true because D Partnership, with only two individuals as partners, is not a TEFRA partnership under §6231(a)(1)(B). Accordingly, while the results of the BCD Partnership TEFRA proceeding flow through automatically to X and Y, if the IRS wishes to adjust items on the D Partnership return other than the BCD Partnership distributive share, the IRS must audit X and Y directly. If the IRS fails to control the §6501 statute of limitations for X and Y, the IRS may make the adjustments to X and Y only to the extent that they reflect the flow-through partnership item adjustments from BCD Partnership. Similarly, if D Partnership is a TEFRA partnership (e.g., if X or Y is a trust), the IRS must carry out a TEFRA partnership proceeding at D Partnership's level to adjust any items other than the flow-through items from BCD Partnership.[853] The IRS must control D Partnership's partnership item statute of limitations separately to make these adjustments.

The procedures and mechanisms for making the flow-through adjustments for D Partnership as pass-through partner and for X and Y as indirect partners are discussed more fully in III.A.5. and III.A.6., above. In addition, the rules extending the statute of limitations if D Partnership fails to identify X and Y as its indirect partners are discussed more fully in V.C.4.c., above. Finally, the rules governing the obligation of the IRS and the source partnership TMP to provide notices and information to the indirect partners are discussed more fully in VI.B. and VI.D.2., above.

Note: A notice of deficiency issued under §6212 does not give the Tax Court jurisdiction to adjust partnership items that already were or could be the subject of FPAA proceedings.[854] In addition, the IRS may not use a deficiency notice to assert deficiencies attributable to affected items until after the final determination of the related partnership items.[855]

For a further discussion of Tax Court jurisdiction in TEFRA cases, see 630 T.M., *Tax Court Litigation.*

C. Coordination of Partnership Item and Nonpartnership Item Adjustments

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Difficult problems arise in coordinating partnership item adjustments with nonpartnership item adjustments. The three principal problems that have arisen in this area are: (1) coordinating deficiency and refund issues, (2) making nonpartnership item adjustments when the partner's taxable income is "oversheltered" by excess TEFRA partnership losses, and (3) handling penalty computations. The issues concerning penalty computations are discussed in VIII.F., above.

1. General Deficiency and Refund Rules

Section 6231(e) establishes the general rule that a judicial determination in a nonpartnership item proceeding does not bar any adjustment for partnership items and converted items (and presumably affected items). This section expressly states the concept that is implicit throughout the TEFRA provisions, i.e., the partnership proceedings and the nonpartnership proceedings are to remain segregated to the maximum extent possible. The difficulty with the concept of separateness is that the part-

[852] *See Parma v. United States*, 45 Fed. Cl. 124 (1999).

[853] *See Candyce Martin 1999 Irrevocable Trust v. United States*, 739 F.3d 1204 (9th Cir. 2014); *Sente Inv. Club P'ship of Utah v. Commissioner*, 95 T.C. 243 (1990). *See also, American Milling LP v. Commissioner*, 2023-83 (since item at issue partnership item of second tier partnership, ultimate partner was not an indirect or unidentified partner).

[854] *Brookes et ux. v. Commissioner*, 108 T.C. 1 (1997); *Crowell v. Commissioner*, 102 T.C. 683, 693 (1994); *Trost v. Commissioner*, 95 T.C. 560 (1990); *Saso v. Commissioner*, 93 T.C. 730 (1989); *Thompson v. Commissioner*, 137 T.C. 220 (2011) (where partnership previously challenged FPAA notice and lost at Tax Court and Court of Appeals level, IRS notice of deficiency was invalid and Tax Court lacked jurisdiction over Son-of BOSS-related matter).

[855] *GAF Corp. & Subsidiaries v. Commissioner*, 114 T.C. 519 (2000) (Tax Court lacks jurisdiction to consider affected items prior to completion of related partnership-level proceedings); *Maxwell v. Commissioner*, 87 T.C. 783 (1986); and *Lindsey v. Commissioner*, T.C. Memo 2002-278. See also *Rawls Trading LP v. Commissioner*, 138 T.C. 271 (2012), in which the Tax Court held that an FPAA issued to an interim partnership showing only computational adjustments was invalid and did not confer jurisdiction on the court. In so holding, the court noted that, although the FPAA was otherwise valid but merely premature, its only remedy was to dismiss the petition rather than stay the proceedings until after conclusion of the partnership-level proceedings.

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nership and nonpartnership proceedings necessarily have to be combined in one place, the partner's tax return. The combination of these two proceedings on the partner's return has presented significant problems.

In response to the potential problems in this area, the IRS implemented a policy for dealing with partnership item and nonpartnership item deficiencies that generally treated all items as properly reported until a final determination for each item was made. This policy was essentially codified as §6211(c) for partnership tax years ending after August 5, 1997. The following example illustrates this IRS policy.

Example (1): B, an individual, invests in two TEFRA partnerships, P Partnership and X Partnership, in 2010. B, P Partnership, and X Partnership all timely file their 2010 returns on April 15, 2011. B's 2010 income tax return reports the following:

Gross income	$50,000
P Partnership loss	(20,000)
X Partnership loss	(15,000)
Adjusted gross income (AGI)	$15,000

B, P Partnership, and X Partnership are all audited for 2010. The audit of P Partnership concludes on June 28, 2013, with a $12,000 disallowance of B's loss. B's nonpartnership item audit concludes Sept. 13, 2013, when B agrees to an unreported income adjustment of $5,000. Finally, the X Partnership proceeding concludes March 3, 2014, with a disallowance of $10,000 of B's loss.

Under the IRS policy and the statutory scheme provided by §6211(c), the deficiencies would be determined in the order in which the audit adjustments are resolved. Accordingly, B's AGI would be treated as $15,000 until the P Partnership proceeding concludes. The amount of the computational adjustment from the P Partnership proceeding would be based on the deficiency computed as the difference between the revised AGI of $27,000 ($15,000 reported plus $12,000 P Partnership loss disallowed) and the $15,000 AGI reported. When B's audit concludes, the deficiency would be computed based on the difference between the revised AGI of $32,000 ($27,000 as determined after the P Partnership adjustment plus $5,000 unreported income) and $27,000. Finally, when the X Partnership proceeding concludes, the deficiency would be computed as the difference between the revised AGI of $42,000 ($32,000 as determined after the P Partnership and B's nonpartnership item adjustments plus the $10,000 of disallowed X Partnership loss) and $32,000.

The attractive feature of this chronological treatment of the partnership item and nonpartnership item deficiencies is that each step of the deficiency computation results in an amount of tax due that does not depend on future events (i.e., the subsequent resolution of the remaining partnership item and nonpartnership item proceedings). Unfortunately, the chronological method for coordinating partnership item and nonpartnership item adjustments does not work well in all situations.

Example (2): Assume the same facts as in *Example (1)* except: (a) the P Partnership loss is $60,000 and, therefore, the pre-adjustment AGI is ($25,000), and (b) the X Partnership adjustment does not occur until March 1, 2015.

The problem in this situation is that the combined effect of the P Partnership adjustment ($12,000) and B's nonpartnership item adjustment ($5,000) still does not result in a deficiency (−$25,000 + $12,000 + $5,000 = −$8,000). Only after the X Partnership adjustment is made do B's nonpartnership item and P Partnership item adjustments generate a deficiency. The problem is that B's §6501 nonpartnership item statute of limitations expires on April 15, 2014. The nonpartnership item adjustment is barred unless B agrees to extend the §6501 nonpartnership item statute of limitations because the IRS must issue a notice of deficiency to raise this nonpartnership item adjustment, and there is no deficiency for 2010 until after the X Partnership adjustment is made in 2015. The problems with this "oversheltered" situation are discussed more fully below.

Another coordination issue arises when nonpartnership item refunds are made after the determination of partnership item deficiencies and vice versa. Again, the IRS policy is to maintain the separateness of the nonpartnership item issues through the computational adjustment phase. If the computational adjustment from the partnership proceeding generates a deficiency, the partner generally is not able to offset that deficiency with a nonpartnership item refund at the computational adjustment stage. The partner cannot use a nonpartnership item refund claim as an offset because the computational adjustment procedure provides no prepayment judicial forum. If the partnership proceeding generates an additional loss (or net operating loss carryback) and the nonpartnership item proceeding is still pending, however, the additional loss should be incorporated into the nonpartnership item proceeding.[856]

Nevertheless, the partner usually is able to file a separate nonpartnership item refund claim. Section 6511(a) allows a refund claim to be filed within the later of: (1) three years after the return is filed or (2) two years after the tax is paid. If the three-year nonpartnership item refund statute is still open at the time the partner's partnership items are settled, the partner may file a normal refund claim to recover the nonpartnership item refund before the computational adjustment is made. The partner may then achieve an informal offset by delaying the collection of the partnership deficiency long enough for the nonpartnership item refund to be allowed so that it can offset the tax due.

If the three-year refund statute is not open, however, the partner apparently still has an opportunity to raise this nonpartnership item refund issue under the two-year rule. The partner can pay the tax assessed as a computational adjustment from the partnership proceeding and then file the nonpartnership item refund claim to recover a refund to the extent of the tax paid on the partnership item adjustment. While the basis of the claim is nonpartnership items, a refund of the partnership

[856] *Harris v. Commissioner*, 99 T.C. 121 (1992) (could raise NOL from TEFRA proceeding in Tax Court Rule 155 phase of nonpartnership item case), *aff'd on other issues*, 16 F.3d 75 (5th Cir. 1994).

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item tax paid can still be received because an overpayment exists and tax was paid within two years before the refund claim was filed.[857] The tax paid for refund statute of limitations purposes includes any tax paid for partnership items or nonpartnership items. The nonpartnership item refund in this situation is limited, however, to the tax paid within the two-year period preceding the filing date of the nonpartnership item refund claim.[858]

Example (3): Assume the facts in *Example (1)* except: B overreported B's nonpartnership income by $6,000 (rather than underreported) and (b) the X Partnership loss disallowance is only $3,000.

B should file a refund claim before April 15, 2014, to preserve the ability to recover the full claim. If B fails to file the refund claim before April 15, 2014, however, and B is assessed with a $1,000 computational adjustment for X Partnership on November 20, 2014, B can pay the $1,000 tax attributable to the X Partnership adjustment on that date and file a refund claim for the $6,000 of overreported nonpartnership item income on or before November 20, 2016. However, even though the refund from B's nonpartnership item refund claim would be $2,000, B will receive only the $1,000 paid with respect to the X Partnership partnership item adjustments because only that amount was paid in the two years preceding the refund claim filing date.

The IRS's right to offset a refund that results from a TEFRA partnership proceeding with an unasserted nonpartnership item deficiency is less clear. The general rule for refunds is that a refund is allowed only to the extent of the lesser of: (1) the refund due based on the specific grounds stated in the refund claim, or (2) the actual overpayment based on an examination of all issues on the taxpayer's return.[859] It does not appear, however, that this general rule is available to allow the IRS to offset a computational adjustment partnership item refund with a nonpartnership item deficiency if the §6501 statute of limitations on assessment of the deficiency has expired.[860]

Example (4): Assume the facts in *Example (1)* except: (a) the IRS does not issue a notice of deficiency to B for the $5,000 in underreported nonpartnership item income before expiration of the §6501 statute of limitations and (b) the X Partnership proceeding determines that B is entitled to an additional $10,000 loss.

If the computational adjustment for the X Partnership refund is made after April 15, 2014, the IRS will not be able to offset the deficiency from the $5,000 of underreported income against the X Partnership refund.

An exception to this prohibition on refund offsets may exist if the conversion of the partnership items does not result from a settlement. For example, if the conversion occurs because the partner filed an AAR that takes an inconsistent position with the partnership and the IRS elects to convert the partner's partnership items to nonpartnership items, the conversion notice acts as a notice of claim disallowance and the partner must bring a nonpartnership item refund suit.

Example (5): Assume the facts in *Example (4)* except the refund claim from X Partnership arises out of an AAR filed by B under §6227(d) claiming an additional $10,000 in distributive share of X Partnership's loss. If the IRS sends B a conversion notice converting B's X Partnership partnership items to nonpartnership items, B will have to bring a nonpartnership item refund suit under §6228(b)(1) and §7422. The Committee Report language does not cover this situation, so the IRS may be able to raise the $5,000 of underreported income in this §7422 refund suit.

2. Nonpartnership Item Adjustments for "Oversheltered" Partners — the Munro Situation

a. Background Leading to Decision in Munro

As discussed above, the most problematic issue that has arisen concerning implementation of the TEFRA partnership audit procedures has been the coordination of partnership item adjustments with nonpartnership item adjustments on a particular partner's return. These issues arise both in the context of nonpartnership items that have no relation to the partnership items and in the context of affected items that are nonpartnership items related to the partnership items.

The difficulty in coordinating nonpartnership items with partnership item adjustments was illustrated in *Munro v. Commissioner*.[861] In *Munro*, the distributive share of partnership losses greatly exceeded or "oversheltered" the taxpayer's nonpartnership item taxable income.

Example (1): Based on the facts stated by the court in *Munro*,[862] M, the taxpayer, filed an income tax return disclosing negative taxable income of $436,337, which included nonpartnership item taxable income of $454,985 and losses from TEFRA partnerships of $891,322. The IRS audited the partnerships and M's return. Before the conclusion of any of the TEFRA proceedings, the IRS determined that M's income should be increased by $259,500, based solely on nonpartnership item adjustments.

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[857] *See* H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 409, 611 (1982), *reprinted in* 1982-2 C.B. 668.

[858] §6511(b)(2)(B). *See also* CCA 201418049 (non-TEFRA claim may be filed within two years of payment even though payment was for a different item, i.e., the money is fungible for this purpose).

[859] *Lewis v. Reynolds*, 284 U.S. 281 (1932); Rev. Rul. 81-87, 1981-1 C.B. 580. *See* CCA 201418049 (where non-TEFRA refund claim is filed within two years of payment, IRS can raise any non-TEFRA offsets to the refund claim).

[860] H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 409, 611 (1982), *reprinted in* 1982-2 C.B. 668.

[861] 92 T.C. 71 (1989). *Munro* was overruled by §6234, added by the 1997 TRA, which is discussed in X.C.2.b., below. *Munro* remains effective, however, for partnership taxable years ending on or before Aug. 5, 1997.

[862] The figures in the *Munro* opinion do not appear to be entirely consistent. The taxable loss reported on the return (–$436,337) plus the nonpartnership item adjustments ($259,500) plus the partnership item adjustments ($891,322) totaled $714,485. This should equal the taxable income contained in the notice of deficiency. The *Munro* opinion indicates, however, that the taxable income per the notice of deficiency is $659,619. No explanation of this apparent discrepancy is provided in the opinion.

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As is illustrated in the last section, the IRS's standard procedure is to compute deficiencies from TEFRA or non-TEFRA adjustments in the order they are resolved. In *Munro*, however, this standard deficiency computation procedure does not result in a tax deficiency. M's negative taxable income was $436,337, and the nonpartnership item adjustments were $259,500, still leaving a loss of $176,837. M's adjusted taxable income is still negative and, therefore, no tax is due, so there is no deficiency within the meaning of §6211. Because there is no deficiency, no notice of deficiency can be issued to assert these adjustments. It is only after some or all of the TEFRA partnership adjustments flow through to M's return that the nonpartnership item adjustments create a deficiency. The problem is that M's nonpartnership item statute of limitations may expire before the conclusion of the TEFRA proceedings. Because a nonpartnership item deficiency cannot be assessed without first issuing a notice of deficiency, and because there can be no notice of deficiency until the TEFRA proceedings are concluded, the IRS is barred from making the $259,500 in nonpartnership item adjustments.

The IRS's solution to this problem was to effectively disallow the full $891,322 in TEFRA partnership adjustments only for computational purposes, thereby increasing M's taxable income from –436,337 to +454,985. The IRS then added the nonpartnership item adjustments of $259,500 to this taxable income of $454,985, resulting in a deficiency based on a revised taxable income of $714,485. This deficiency was computed to be $313,812 [tax on $714,485 — tax previously assessed ($0)], which meant that the deficiency in tax ($313,812) exceeded the entire amount of the nonpartnership item adjustments contained in the notice of deficiency ($259,500).

The Tax Court rejected the IRS's approach to creating a deficiency for computational purposes and instead adopted an analysis with even more alarming consequences. The court concluded that in *all* cases the TEFRA partnership items must be completely segregated from the nonpartnership items on each partner's tax return. Computationally, this had much the same effect as the IRS approach. In *Munro*, application of the Tax Court rule resulted in a deficiency in nonpartnership items based on the difference between: (1) the tax due on $714,485 and (2) the tax due on M's reported nonpartnership item taxable income of $454,985. This Tax Court procedure effectively created a nonpartnership item taxable income category and a corresponding amount of nonpartnership item tax previously assessed which was never disclosed on M's return. Correspondingly, M also has a partnership item component on M's return, which reflects M's distributive share of the gains and losses of all TEFRA partnerships for M's taxable year. As the TEFRA partnership adjustments are determined, the computational adjustment procedure is then utilized to combine M's nonpartnership item taxable income with M's partnership item gains and losses to determine the amount of tax due from the computational adjustment.

Observation: The negative ramifications of the *Munro* opinion were far-reaching. In the overwhelming majority of cases, the taxpayer has taxable income even after allowing all partnership item losses and credits for deficiency computation purposes. The standard IRS practice had been to allow those losses and credits in computing the nonpartnership item deficiency until the partnership item adjustments had been determined. The opinion in *Munro* essentially had the effect of disallowing or disregarding the TEFRA partnership losses and credits entirely. If the net TEFRA flow-through amounts are a loss, every nonpartnership notice of deficiency issued in these situations had potentially understated the deficiency at issue. Accordingly, if the IRS were to follow the holding in *Munro*, the IRS would have had to seek to amend the petition in each such case to increase the deficiency at issue.

The most troubling aspect of *Munro* from a conceptual standpoint was that the deficiency that is ultimately determined in a *Munro*-type case is a meaningless figure. At the conclusion of a typical deficiency case, the deficiency that is determined is an amount that can be assessed by the IRS once the decision is final. It is not clear, however, that a *Munro* deficiency could be assessed. Presumably, the nonpartnership item deficiency must be combined with the TEFRA partnership item losses before the amount of tax due could be determined. If this combination is not made, the hypothetical nonpartnership item tax liability could be assessed and collected from M. If the TEFRA partnerships are not audited or if the TEFRA partnership proceedings do not result in adjustments, however, this hypothetical liability may never be due.

A second significant conceptual problem with the *Munro* opinion was that the opinion eliminated a potential deficiency in the reverse situation. This problem occurred if there was a nonpartnership item loss but a combined taxable income due to TEFRA partnerships. In this situation, an adjustment to nonpartnership items would result in a deficiency based on the combined taxable income but may result in no deficiency under the segregated nonpartnership item approach in *Munro*.

Observation: The situation presented in *Munro* actually arises in a relatively small number of cases. These cases are presumably even more infrequent now that the taxable years before the application of the passive activity loss limitations in §469 have worked their way through the system. The impact of this situation is further lessened when the loss from oversheltered taxable income is carried back or forward as part of a net operating loss. To the extent that these carryovers are claimed in other years, the adjustment of the nonpartnership items in the generating year results in a deficiency in a carryover year by changing the allowable net operating loss deduction. Finally, it is likely that in practice the IRS will not aggressively pursue the adjustment of nonpartnership items when the adjustments do not result in a tax deficiency in the year at issue. Accordingly, it is likely that the *Munro* situation does not arise in a great number of cases.

To lessen the impact of the *Munro* decision, the IRS engaged in an interim practice which had the effect of overriding the *Munro* opinion and combining the nonpartnership item and the partnership item adjustments for computational purposes. If the partnership item losses did not exceed the nonpartnership item taxable income reported on the original return, the IRS entered into a stipulation with the partner that indicated that the partnership item losses were being allowed in the deficiency computation for the nonpartnership item settlement or decision.[863] The stipulation also extended the nonpartnership item

[863] Former IRM 35.24.7. See IRS Chief Counsel Notice (CC-2009-027) for an IRS example of the "*Munro* Stipulation."

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statute of limitations on assessments and refunds to coincide with the partnership item statute of limitations. This allowed the IRS to make any necessary nonpartnership items assessment or refund at the conclusion of the partnership proceeding. By effectively allowing these partnership item losses, the deficiency that was computed in the settlement of the nonpartnership item adjustments reflected a dollar amount that was actually due from the taxpayer. After this amount was assessed, if a subsequent adjustment to the partnership item loss was reported by the partner, that loss could then be calculated pursuant to the computational adjustment procedure for those partnership items.

This procedure obviously did not work in the situation presented in *Munro* where the nonpartnership taxable income is oversheltered by partnership item losses. In this situation, the IRS applied the Tax Court's approach in *Munro*.

Under the IRS's interim stipulation approach described above, the IRS made the determination that TEFRA partnership proceedings were currently or potentially pending when nonpartnership item adjustments were resolved. Before *Munro*, this type of search was not typically conducted by the IRS. This type of search was necessary, however, with respect to the settlement of nonpartnership items in any case in which a TEFRA partnership distributive share was reported on that partner's individual return. This interim solution did not adequately handle the administrative nightmare created by the *Munro* opinion.

b. Legislation Overruling Decision in Munro

Section 6234 overruled the decision in *Munro*. Accordingly, the IRS is allowed to return to its earlier practice of computing deficiencies by assuming that any TEFRA item, the treatment of which is not finally determined, is correctly reported on the taxpayer's returns.[864] Section 6234 eliminates the need for special computations that involve removing TEFRA items from a taxpayer's return and restores a prepayment forum for TEFRA items. In addition, §6234 provides a special rule to address the factual situation presented in *Munro*.

Specifically, §6234 gives jurisdiction to the Tax Court to issue declaratory judgments concerning adjustments to an oversheltered return — i.e., a return that shows no taxable income and shows a net loss from TEFRA partnership items.[865] In these cases, the IRS can issue a notice of adjustment for the non-TEFRA items, even though no deficiency would result from the adjustment. A notice of adjustment can be issued only if a deficiency would arise in the absence of the net loss from the TEFRA partnerships. The Tax Court's jurisdiction extends not only to determining the correctness of the adjustment but also to making a declaration concerning any other item for the taxable year to which the notice of adjustment relates, except for partnership items and substantive affected items.[866] While no tax is due upon the Tax Court's determination, a decision of the Tax Court is treated as a final decision, subject to appeal by either the taxpayer or the IRS.[867] Therefore, the Tax Court's determination that an adjustment is correct has the effect of increasing the taxable income that is deemed reported on the taxpayer's return. If the taxpayer's partnership items are then adjusted in a subsequent proceeding, the IRS's ability to collect the tax on any increased deficiency attributable to the nonpartnership items is preserved.

If the taxpayer chooses not to contest the notice of adjustment in the Tax Court within 90 days, §6234 provides that when the partnership items are finally determined, the taxpayer can still file a refund claim for any tax attributable to the items adjusted by the earlier notice of adjustment — i.e., a refund claim relating to the nonpartnership items — for the taxable year. While a refund claim is generally not permitted with respect to a deficiency relating to TEFRA proceedings, this exception to that rule is necessary because taxpayers cannot challenge a notice of adjustment by means of a refund claim, as the adjustment notice does not require any payment of additional tax.[868]

Section 6234 coordinates the interplay between TEFRA audit proceedings and individual deficiency proceedings. Any adjustments concerning nonpartnership items that result in an increase in tax liability with respect to a partnership item are treated as computational adjustments and assessed after the conclusion of the TEFRA proceedings. Therefore, deficiency procedures do not apply to these types of increases in taxes, and the statute of limitations applicable to TEFRA proceedings controls.[869]

Section 6234 does not apply, however, where the non-partnership item adjustment results in a deficiency even where the partnership losses are given effect.[870] The deficiency does not necessarily have to be an income tax deficiency. For example, if the IRS is able to issue a nonpartnership item notice of deficiency for self-employment tax, §6234 does not technically apply. If the self-employment tax deficiency case is still pending when the TEFRA adjustments are determined and an income tax deficiency attributable to the nonpartnership items then results, the Tax Court can acquire jurisdiction over the income tax deficiency in the self-employment tax case pursuant to §6214.[871]

In a now reversed opinion, the Tax Court held that for tax years where the taxpayer filed no returns, oversheltered or otherwise, §6234 did not apply.[872] However, relying on the taxpayers' unsigned, unfiled tax returns reporting partnership losses, the court also held that the taxpayers owned no deficiencies or penalties for those years. On appeal, the 9th Circuit reversed the Tax Court's decision, holding that unsigned, unfiled tax returns reporting partnership losses could not be used to offset nonpartnership income in an individual deficiency proceeding, and that the returns had no legal effect because they were not filed

[864] §6234(a). The treatment of partnership items may be finally determined if the taxpayer enters into a settlement agreement with the IRS or, for settlement agreements entered into after Mar. 9, 2002, with the U.S. Attorney General (or a delegate). §6234(g)(4).

[865] §6234(b), §6234(c). For Tax Court procedural rules, see Tax Court Rules 310–316.

[866] §6234(c).

[867] §6234(c).

[868] §6234(d).

[869] §6234(g). For instances in which the Tax Court treats the declaratory judgment action as a deficiency action, see Tax Court Rule 316.

[870] §6234(a)(3).

[871] *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017).

[872] *Stevens v. Commissioner*, T.C. Memo 2020-118, *rev'd on other grounds*, 72 F.4th 1015 (9th Cir. 2023).

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or executed under penalty of perjury.[873] The court also held that the Tax Court erred in excluding from its calculations of "net loss from partnership items" under §6234(a)(3) the net operating loss carryover deductions that were composed of TEFRA partnership losses. The court reasoned that a carryforward NOL should be included in the "net loss from partnership items" under §6234(a)(3) to the extent that the NOL is made up of losses from TEFRA partnerships carried over from prior years. A TEFRA partnership loss allocated to a partner in a given year is a "partnership item," and such items do not lose their character when carried over as an NOL deduction into a subsequent tax year.[874] The case was remanded to the Tax Court for recalculation of the deficiencies and penalties for the tax years at issue.

D. Bankruptcy

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

In certain situations, the application of the TEFRA procedures would create significant administrative difficulties. To relieve these potential problems, §6231(c) specifies certain special enforcement areas in which the partner's partnership items are converted to nonpartnership items. The most common special enforcement area is a bankruptcy situation. The filing of a petition in bankruptcy has a potential impact on the partnership proceeding (if it is filed by the partnership), the TMP or another partner by virtue of the automatic stay provided in 11 U.S.C. §362.

In a non-TEFRA proceeding, the automatic stay prohibits the assessment of tax and the commencement or continuation of a Tax Court proceeding, but does not prohibit the issuance of a notice of deficiency.[875] The purpose of the automatic stay is to prevent the determination and assessment of a tax liability outside of the bankruptcy court. The bankruptcy issues in the context of a partnership proceeding must similarly be analyzed based on the effect of the partnership proceeding on the determination or assessment of a tax liability against the bankrupt debtor.

If the partnership declares bankruptcy, the automatic stay should have no effect on the continuation of the partnership proceeding. This is true because the partnership does not have a tax liability itself and the partnership proceeding is merely a device to determine the correct tax liabilities of the partners. Because the partnership proceeding will not result in the assessment of any liability against the partnership, the bankruptcy court does not acquire jurisdiction over the partnership proceedings, and the automatic stay is not triggered.[876] In addition, because the FPAA is the TEFRA equivalent of the notice of deficiency, and because the issuance of the notice of deficiency is not prohibited by the automatic stay, the issuance of the FPAA similarly is not prohibited.

A different analysis is presented with respect to the bankruptcy of a partner. The partnership proceeding clearly will result in the determination of the tax liabilities of each partner in the partnership. To prevent the bankruptcy of a single partner from precluding the continuation of a partnership proceeding, Reg. §301.6231(c)-7(a) provides that the filing of a bankruptcy petition converts the partnership items of the debtor/partner to nonpartnership items for all partnership taxable years ending before the bankruptcy petition date and for which the partner's statute of limitations is still open. The conversion of these partnership items to nonpartnership items effectively drops the debtor/partner out of the partnership proceeding and allows the partnership proceeding to continue unrestricted by the effect of the debtor/partner's automatic stay.[877] However, where spouses hold a joint interest in partnership property, one spouse's bankruptcy alone does not permit the IRS to convert partnership items into nonpartnership items under the "bankruptcy rule" of Reg. §301.6231(c)-7(a) with respect to the other spouse.[878] In addition, if the bankrupt partner is itself a disregarded or flow-through entity, no conversion occurs because the partner reports no liability from the flow-through amounts that would be at issue in the bankruptcy case.[879] See III.B.4.c. and V.E., above, for further discussion of the manner and timing for assessment of these converted items.

The final set of procedural rules applies when a bankruptcy petition is filed by the TMP. Because the TMP is by def-

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[873] *Keene-Stevens v. Commissioner*, 72 F.4th 1015 (9th Cir. 2023), *rev'g* T.C. Memo 2020-118.

[874] *Keene-Stevens v. Commissioner*, 72 F.4th 1015 (9th Cir. 2023).

[875] 11 U.S.C. §362(a)(4), 11 U.S.C. §362(a)(8), 11 U.S.C. §362(b)(9).

[876] *Am. Principals Leasing Corp. v. United States*, 904 F.2d 477 (9th Cir. 1990); *1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990), *aff'd*, 995 F.2d 235 (9th Cir. 1993) (unpub.). *See also Chef's Choice Produce, Ltd. v. Commissioner*, 95 T.C. 388 (1990); *In re Madison Recycling Assocs.*, 45 Fed. Appx. 497 (6th Cir. 2002) (unpub.).

[877] See *Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987), where the Tax Court approved the designation of a partner's bankruptcy as a special enforcement area causing the conversion of partnership items to nonpartnership items. *See also Dionne v. Commissioner*, T.C. Memo 1993-117 (shareholder in S corporation that is a partner in a TEFRA partnership is a partner for purposes of applying regulation stating that partner's bankruptcy converts partnership items into nonpartnership items). *Cf. Katz v. Commissioner*, 116 T.C. 5 (2001) (allocation between partner and partner's bankruptcy estate held not a partnership item for TEFRA audit procedures; entire year's partnership losses allocable to estate), *rev'd*, 335 F.3d 1121 (10th Cir. 2003) (Tax Court lacked authority to reallocate losses, as the IRS may not challenge partner's allocation of partnership losses between himself and his bankruptcy estate, without partnership-level proceeding). *But see Third Dividend/Dardanos Assoc. v. United States*, 88 F.3d 821 (9th Cir. 1996) (indirect partners' partnership items do not convert to nonpartnership items when pass-thru partner files bankruptcy petition).

[878] *See Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002), *rev'g in part* T.C. Memo 1998-146; *Dubin v. Commissioner*, 99 T.C. 325 (1992) (joint partnership interest arising under community property law), AOD 1999-13 (recommending acquiescence because, under Reg. §301.6231(a)(12)-1T(a) then in effect, spouses holding joint interests are treated as separate partners and the conversion of items occurs only for partners named as debtors), *acq.*, 1999-40 I.R.B. 438, as corrected by Announcement 2000-102, 2000-52 I.R.B. 605. *See also* FSA 200122023 (parent entity's bankruptcy did not convert subsidiary's partnership items to nonpartnership items, as subsidiary owned partnership interest and parent had no separate interest; analogizing situation of consolidated group members to that of joint filing spouses); CCA 201510044 (because parent's bankruptcy does not convert subsidiary's partnership items into nonpartnership items, subsidiary can still be assessed based on TEFRA partnership proceeding outcome using consolidated return to compute several liability against subsidiary).

[879] CCA 201241007.

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inition a partner in the partnership, the rules in the preceding paragraph apply with equal force in converting the TMP's partnership items to nonpartnership items. In addition, Reg. §301.6231(a)(7)-1(l) provides that the TMP's designation as TMP terminates upon the conversion of the TMP's partnership items to nonpartnership items. The Tax Court has upheld this regulation.[880] After this termination of the TMP's designation, that TMP cannot execute a valid agreement to extend the TEFRA partnership statute of limitations.[881] However, if that person would be the TMP but for the fact that the person is the debtor in a proceeding under the Bankruptcy Code, the agreement extending the limitations period for making a partnership assessment will be binding on all of the partners unless the IRS has been notified of the bankruptcy proceeding.[882] The bankruptcy does not operate to suspend the 90-day period in which the TMP may file a petition contesting an FPAA.[883] Finally, additional problems are created when the bankruptcy of the TMP leaves the partnership without a general partner. These problems are discussed more fully in III.A.1., above.

E. Innocent Spouse Relief

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The spouse of a partner is treated as a partner for purposes of participating in a TEFRA partnership proceeding.[884] When one spouse is a partner in a partnership for which the tax benefits are disallowed in a partnership proceeding, the non-partner spouse may want to raise the defense of innocent spouse relief.[885] If successful, the innocent spouse can avoid any direct liability for the deficiency attributable to the partnership.

The innocent spouse can obtain one form of innocent spouse relief by establishing that the innocent spouse did not know or have reason to know of the understatement and it would be inequitable to hold the innocent spouse liable.[886] In addition, the innocent spouse can make a separate liability election to attempt to limit liability for the deficiency if the innocent spouse (1) is no longer married to, is legally separated from, or has been living apart for at least 12 months from the person with whom the innocent spouse originally filed the joint return, and (2) did not actually know of an understatement on the joint return.[887] For further discussion of innocent spouse relief, see 645 T.M., *Innocent Spouse Relief*.

Before passage of the Taxpayer Relief Act of 1997, there was no forum for raising an innocent spouse defense with respect to TEFRA partnership cases. The innocent spouse claim could not be raised in the partnership proceeding.[888] The partnership item deficiency is then imposed on the partners by a notice of computational adjustment — a procedure that allows no pre-payment remedy. If the partner received an affected item notice of deficiency for other issues relating to the partnership, the innocent spouse issue could be raised in this proceeding only as an overpayment issue.[889]

The only other apparent remedy was to have the innocent spouse pay the deficiency and pursue a computational adjustment refund. The authority for even a refund remedy was suspect, however, as the §6230 computational adjustment refund procedure is expressly limited to computational issues, and §7422(h) precludes any other refund action with respect to partnership items. However, because the innocent spouse defense is not a partnership item issue in and of itself, a refund action based on that defense appeared to avoid the §7422(h) prohibition.

The 1997 Act remedied this situation by establishing both a prepayment forum, which had been in existence for non-TEFRA cases, and a refund forum for raising an innocent spouse defense in TEFRA cases. In either case, the spouse of a partner may assert a claim for relief from joint and several liability only after the IRS has issued a notice of computational adjustment to the spouse which is after completion of the partnership-level proceedings. If there are tiered partnerships, it is necessary to wait for the computational adjustments separately for each tier.[890]

Section 6230(a)(3) provides that a partner's spouse can request that an assessment be abated before payment within 60 days after the IRS mails to the spouse a notice of computational adjustment relating to partnership items. The IRS must abate the assessment after receiving the request. Any reassessment is then subject to normal deficiency procedures. If the spouse

[880] *See Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987).

[881] *Barbados #7 Ltd. v. Commissioner*, 92 T.C. 804 (1989).

[882] §6229(b)(2). See Reg. §301.6229(b)-2 for the mechanism for the TMP, or other partners, to provide notice to the IRS that the TMP is a bankruptcy debtor and, therefore, is ineligible to serve as TMP and extend the statute under §6229.

[883] *1983 W. Reserve Oil & Gas Co. v. Commissioner*, 95 T.C. 51 (1990), *aff'd*, 995 F.2d 235 (9th Cir. 1993) (unpub.); *Tempest Assocs. v. Commissioner*, 94 T.C. 794 (1990).

[884] Reg. §301.6231(a)(2)-1(a). *See Greenberg Bros. P'ship #12 v. Commissioner*, T.C. Memo 1998-146 (separate partnership interest of husband deemed partnership interest of wife due to filing of joint return), *rev'd in part on other grounds sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432 (2d Cir. 2002).

[885] §6015.

[886] §6015(b).

[887] §6015(c).

[888] In *Dynamic Energy Inc. v. Commissioner*, 98 T.C. 48 (1992), the Tax Court held that because a claim under former §6013(e) was not a subchapter S item, the court did not have jurisdiction to determine if the spouse of an S corporation shareholder was entitled to innocent spouse relief. Noting that a determination under former §6013(e) did not affect the proper allocation or reallocation of subchapter S items among the shareholders, the court stated that it is only after the subchapter S items are adjusted and properly allocated that a determination can be made as to whether the taxpayer satisfied the innocent spouse requirements. Note that Pub. L. No. 104-188 repealed the provisions affording TEFRA audit treatment to subchapter S items, effective for tax years beginning after Dec. 31, 1996.

[889] If a notice of deficiency is issued during the partnership proceeding, the Tax Court cannot grant relief to an innocent spouse claim until *after* the TEFRA partnership proceeding has concluded. *Adkinson v. Commissioner*, 592 F.3d 1050 (9th Cir. 2010) (IRS issued both an FPAA and a notice of deficiency. The Ninth Circuit acknowledged the Tax Court's jurisdiction over the innocent spouse claim in the deficiency case, but barred any consideration of the claim until the partnership proceeding had concluded). For a discussion of innocent spouse relief, see 645 T.M., *Innocent Spouse Relief*.

[890] *Andrews v. Commissioner*, T.C. Memo 2010-230; *Malsom v. Commissioner*, T.C. Memo 2012-231.

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makes an abatement request, the statute of limitations does not expire until 60 days after the date of the abatement.[891] If the spouse files a Tax Court petition, the Tax Court's jurisdiction is limited to determining whether the innocent spouse requirements have been satisfied. In making this determination, the partnership item adjustments determined in the partnership proceeding that gave rise to the liability in question cannot be challenged.[892]

A refund forum is also provided by §6230(c)(5), which allows a partner's spouse to file a claim for refund to raise an innocent spouse defense within six months from the date the IRS mails a notice of computational adjustment to the innocent spouse. If the IRS denies the refund claim, the innocent spouse can file a refund suit. For these purposes, the partnership item adjustments determined in the partnership proceeding that gave rise to the liability in question cannot be challenged.

After enactment of §6230(a)(3) and §6230(c)(5), Congress enacted §6015, which expanded the innocent spouse protection contained in former §6013(e).

Comment: Case law under former §6013(e) continues to provide guidance on the requirements for innocent spouse relief.

To request relief under §6015, a spouse seeking (electing) relief must file a Form 8857, *Request for Innocent Spouse Relief (and Separation of Liability and Equitable Relief)*, or other similar statement signed under penalties of perjury. The innocent spouse may petition the Tax Court for review of the IRS's determination of relief available to the individual within the later of six months from the date Form 8857 or other similar statement was filed or 90 days after the mailing date of the notice of the IRS's determination.

Note: In CCA 199925040, takes the position that the innocent spouse provisions of §6230(a)(3) and §6230(c)(5) are no longer necessary, because §6015 provides a prepayment forum and a refund forum for such claims in both TEFRA and non-TEFRA cases. Therefore, it recommends that the IRS process innocent spouse claims involving TEFRA partnership adjustments following the procedures used for claims under §6015.

An innocent spouse claim may also be raised before payment in a collection due process (CDP) appeal. Accordingly, there are now multiple opportunities to raise an innocent spouse claim with respect to tax due from a partnership proceeding.

[891] §6230(a)(3)(A).
[892] §6230(a)(3)(B).

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XI. S Corporations (Prior Law)

A. General Applicability of Partnership Rules

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

1. Termination of Applicability for Tax Years Beginning After December 31, 1996

Congress passed the Subchapter S Revision Act of 1982[893] shortly after the passage of TEFRA (subchapter D of chapter 63, former §6241–§6245). One of the changes made by the Subchapter S Revision Act was to extend the TEFRA partnership audit procedures to S corporations.[894] The mechanics of extending those procedures were primarily left for regulations, which were issued as temporary regulations on January 27, 1987.[895] The issues most frequently presented in the S corporation area involve questions of the extent to which the TEFRA partnership audit procedures apply to S corporations.

The Small Business Job Protection Act of 1996 (1996 SBJPA)[896] repealed subchapter D of chapter 63, thereby ending the application of TEFRA to S corporations effective for tax years beginning after December 31, 1996. However, in a provision similar to the partnership consistency rules described in IV.A., above, the 1996 SBJPA added to the Code §6037(c), which effectively retained the requirement that all shareholders of an S corporation file a return consistent with the S corporation return or notify the IRS of the inconsistency.[897]

2. Applicability for Tax Years Beginning Before January 1, 1997

Former §6241[898] stated the general rule applicable to S corporations that, "except as otherwise provided in regulations prescribed by the Secretary, the tax treatment of any subchapter S item shall be determined at the corporate level." In former §6242 through former §6245,[899] the Code specified the TEFRA partnership procedures that specifically applied to S corporations:

- the consistency requirement;
- the notice procedures and opportunity to participate;
- the assessment, refund, and judicial review procedures; and
- the concept of a subchapter S item (similar to the partnership item).

The legislative history to the Subchapter S Revision Act of 1982 further explained Congressional intent with respect to the incorporation of the TEFRA partnership procedures:

> The audit provisions are intended to generally follow the audit provisions made applicable to partnerships by the Tax Equity and Fiscal Responsibility Act of 1982. Thus, for example, rules relating to restrictions on assessing deficiencies, periods of limitation, and judicial review follow the corresponding partnership rules. However, Treasury regulations may modify those rules where appropriate to take account of the difference (whether or not tax-related) between a corporation and partnership. For example, the selection of a person to act on behalf of the corporation in the way the tax matters partner acts on behalf of a partnership must take into account that a corporation has no person to correspond to a general partner, as such (because the corporate shareholders are not liable for the corporation's debt, as is a general partner). As with partnerships, the regulations may treat certain corporate items as other than corporate items for purposes of these audit rules, where special enforcement problems arise.[900]

Accordingly, both the Code and the legislative history applied the TEFRA partnership audit procedures to S corporations to the maximum extent possible. The temporary regulations carried this out. These regulations specified which S corporations were subject to the unified audit procedures and provided a detailed definition of subchapter S items that paralleled the partnership item definition. Because these were the only areas specifically addressed by the temporary regulations, the general rule provided in former §6241 effectively incorporated the TEFRA partnership procedures for all other S corporation audit procedure issues.

B. Special Rules

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Areas in which the S corporation procedures varied from the TEFRA partnership audit procedures included: (1) the small S corporation exception that differed from the small partnership exception provided in §6231(a)(1)(B), (2) the persons eligible to serve as the tax matters person (the S corporation equivalent of the tax matters partner, both of which are com-

[893] Pub. L. No. 97-354.

[894] Former §6244, before repeal by Pub. L. No. 104-188, §1307(c)(1), effective for S corporation tax years beginning after Dec. 31, 1996.

[895] T.D. 8122, 52 Fed. Reg. 3001 (Jan. 22, 1987).

[896] Pub. L. No. 104-188, §1307(c)(1).

[897] §6037(c), added by Pub. L. No. 104-188, §1307(c)(2), effective for taxable years beginning after Dec. 31, 1996.

[898] Before repeal by Pub. L. No. 104-188, §1307(c)(1), effective for taxable years beginning after Dec. 31, 1996.

[899] Before repeal by Pub. L. No. 104-188, §1307(c)(1), effective for taxable years beginning after Dec. 31, 1996.

[900] S. Rep. No. 640, 97th Cong., 2d Sess. 25, *reprinted in* 1982-2 C.B. 718.

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monly referred to as the TMP), and (3) the definition of subchapter S items.

1. Small S Corporation Exception

The IRS discovered that a small S corporation exception of 10 shareholders would exclude the vast majority of S corporations from application of the unified audit procedures. Accordingly, the IRS determined that the small partnership exception of §6231(a)(1)(B) was one of the TEFRA partnership procedures which could not be incorporated into the S corporation procedures. The IRS originally adopted this position as an administrative practice, however, and not as a regulation. Because former §6241 applied the TEFRA partnership audit procedures to S corporations "except as provided by regulations," there was no authority for this administrative practice. The IRS subsequently issued temporary regulations to deal with this issue, but the regulations were effective only for S corporation returns due after January 30, 1987.[901]

The original IRS administrative position generated a split among courts as to whether any small S corporation exception existed in the absence of regulations. The Tax Court (at least initially) and the Fifth Circuit held that an exception existed.[902] Most other courts,[903] including the Tax Court in a later decision,[904] however, held that there was no exception.

The issuance of the temporary regulations rendered these decisions moot for S corporation tax years ending on or after November 30, 1986. Former Reg. §301.6241-1T(c)(2) adopted a small S corporation exception for S corporations which had five or fewer shareholders, each of whom was a natural person or estate. As with the small partnership exception, the determination of whether an S corporation qualified for the small S corporation exception was made every year, and the S corporation could elect to have the unified procedures apply in any year for which the procedures did not otherwise apply.[905] This temporary regulation clarified the small S corporation exception for all S corporation taxable years ending on or after November 30, 1986, until the TEFRA rules were revoked for S corporations.

2. Tax Matters Person (TMP)

The Tax Matters Person was the equivalent of the Tax Matters Partner under the TEFRA partnership audit procedures. In fact, both parties are commonly referred to as the TMP. The general rules for selecting a TMP for the S corporation were the same as selecting the TMP for a TEFRA partnership. There was a place for designating the TMP on the S corporation return (Form 1120-S). The general rules for designating a partnership TMP also applied to designations made when no TMP designation was made on the return or when the designated TMP failed or ceased to serve. Finally, the automatic designation rules of §6231(a)(7) also applied to S corporation TMP designations.

One major issue in applying the partnership rules to S corporations concerned the S corporation's selection of a TMP. As noted in the legislative history to the Subchapter S Revision Act of 1982, the designation of a TMP is one area in which complete incorporation of the partnership procedures was not possible, as an S corporation has no person who is the equivalent of a general partner in terms of authority and unlimited liability.[906] Thus, the application of the TMP designation rules for general partners under Reg. §301.6231(a)(7)-1 was uncertain because there were no general partner equivalents. Probably the best rule was to consider all shareholders as general partners for purposes of applying these rules. Accordingly, the consent of shareholders holding 50% of the S corporation shares would be required to make a TMP designation under these provisions.

An additional selection issue was whether a nonshareholder/officer was eligible to serve as TMP. Corporate officers are elected by the shareholders to act on behalf of the corporation in a variety of situations, many of which are more important to the corporation than the handling of an income tax audit. In addition, the corporate tax return must be signed by a corporate officer.[907] On the other hand, there is a notion expressed in §6226 that the parties to partnership litigation should have an interest in the outcome of the litigation, which a nonshareholder/officer would not have. Even in §6226, however, the requirement of having an interest in the outcome of the litigation is not applicable to petitions filed by the TMP.

The Tax Court addressed this issue in *Gold-N-Travel, Inc. v. Commissioner*.[908] In *Gold-N-Travel*, the court focused on the provisions of §6231(a)(7) for designating a TMP for a partnership and held that the TMP for an S corporation must be a shareholder. In *Gold-N-Travel*, the corporation had failed to designate a TMP on the S corporation return. The court held that the priority scheme in §6231(a)(7), which limits a partnership's TMP candidates to partners in the partnership, is extended to the TEFRA S corporation audit procedures. Accordingly, the first shareholder alphabetically out of the four equal shareholders in the S corporation was determined to be the TMP.

The result of the *Gold-N-Travel* opinion was that, where no TMP designation was made, the largest shareholder was responsible for conducting the S corporation audit proceeding even though that shareholder may not be an officer of the corporation.[909]

Note: Most TMP designations were made on the S corporation return (Form 1120-S), which required designation of an individual shareholder as TMP. There was no requirement in the Form 1120-S that the largest shareholder be designated.

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[901] Former Reg. §301.6241-1T(c)(2).

[902] *Arenjay Corp. v. Commissioner*, 920 F.2d 269 (5th Cir. 1991); *Blanco Invs. & Land, Ltd. v. Commissioner*, 89 T.C. 1169 (1987).

[903] *Twenty-Three Nineteen Creekside, Inc. v. Commissioner*, 59 F.2d 130 (9th Cir. 1995); *Home of Faith v. Commissioner*, 39 F.3d 263 (10th Cir. 1994); *Beard v. United States*, 992 F.2d 1516 (11th Cir. 1993).

[904] *E. State Cas. v. Commissioner*, 96 T.C. 773 (1991).

[905] Former Reg. §301.6241-1T(c)(2)(iv), former Reg. §301.6241-1T(c)(2)(v).

[906] S. Rep. No. 640, 97th Cong., 2d Sess. 26 (1982), *reprinted in* 1982-2 C.B. 718, 729.

[907] §6062.

[908] 93 T.C. 618 (1989).

[909] *See also Twenty-Three Nineteen Creekside, Inc. v. Commissioner*, 59 F.3d 130 (9th Cir. 1995); *Modern Computer Games, Inc. v. Commissioner*, 96 T.C. 839 (1991); *C&M Amusements, Inc. v. Commissioner*, T.C. Memo 1993-527. *But see Bugaboo Timber Co. v. Commissioner*, 101 T.C. 474 (1993) (statute extension signed by officer not the largest shareholder deemed valid); *Thermal Energy Concepts, Inc. v. Commissioner*, T.C. Memo 1993-541 (same).

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3. Subchapter S Items

The definition of subchapter S items[910] was substantially similar to the definition of partnership items discussed in III.B.1., above. There were three notable exceptions to this general rule. First, the items peculiar to partnership determinations (such as "hot asset" determinations, guaranteed payments, and optional basis adjustments) were excluded from the definition of subchapter S items. No similar items apply to S corporations.

Second, items necessary to determine the eligibility of the S corporation shareholders, the validity of the S corporation election, and the existence of any revocation or termination of the S corporation election were included as subchapter S items. In addition, while the allocation of subchapter S items among shareholders was itself a subchapter S item, the allocation of these items to alleged beneficial owners who were not shareholders of record was not a subchapter S item.[911]

Finally, there appeared to be a slightly different inclusion of the shareholder's basis in the stock or debt of the corporation in the subchapter S item definition than is applicable to partnership items. In determining the tax consequences of S corporation distributions, former Reg. §301.6245-1T(c)(3) excluded the shareholders' basis in stock or debt owed to the corporation from the subchapter S item definition. This was based on the fundamental definition of a subchapter S item, which limited those items to items which the S corporation was required to determine.[912] While the corresponding partnership item issue is not entirely clear, certain aspects of these issues are considered to be partnership items. See III.B.2.c., above, for further discussion of this issue.

In almost all other respects, former Reg. §301.6245-1T (which defines subchapter S items) duplicated verbatim the provisions of Reg. §301.6231(a)(3)-1 (which defines partnership items). Accordingly, the interpretation of partnership items and the associated problems discussed in III.B.1., above, applied with equal force to the similar determinations of subchapter S items.

4. Statute of Limitations

There were two statute of limitations issues concerning S corporations which were not presented for partnerships: (1) a corporate-level statute of limitations for non-TEFRA S corporations and (2) the statute of limitations for the corporate-level tax imposed by §1374 and §1375.

a. Non-TEFRA Statute of Limitations

For all S corporations not subject to TEFRA, the historic IRS statute of limitations practice for S corporation adjustments has been to treat the §6501 statute of limitations as applying at the shareholder level. As the tax is paid at the shareholder level, the IRS focuses on the shareholder's return as the relevant return for purposes of computing the limitations period of "three years after a return was filed." Accordingly, the IRS monitors the statute of limitations at the shareholder level, obtaining statute extensions (Form 872) directly from the shareholders and not from the corporation.

The circuit courts split on this issue. The Ninth Circuit in *Kelley v. Commissioner*[913] held that the reference to a "return" in §6501(a) was a reference to the S corporation return and, therefore, the statute of limitations had to be controlled at the corporate level. The Second,[914] Fifth,[915] and Eleventh[916] Circuits held that the limitations period begins on the date the individual files his return.

Resolving the split among the circuits, the Supreme Court, in *Bufferd v. Commissioner*[917] held that the three-year assessment period runs from the date of the shareholder's individual return, not from the date of the S corporation's return. The Court reasoned that the taxpayer's individual return is "the return" referred to in §6501(a), which states that the tax "shall be assessed within three years after the return was filed." The court noted that the S corporation's return does not contain all the information necessary to compute the tax, e.g., the taxpayer's adjusted basis in his S corporation stock and other items of income, loss, and credit.

In 1997, Congress amended §6501 to affirm the *Bufferd* decision and to clarify that the limitations period under §6501(a) begins to run from the filing of the return by the taxpayer, not from the filing of a return by any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.[918] As the TEFRA procedures no longer apply to S corporations, this is now the prevailing statute of limitations rule.

b. Corporate-Level Tax

There are two situations in which an S corporation can have a tax liability at the corporate level. First, §1374 provides a corporate-level tax when the S corporation sells assets which have "built-in gains" from tax years before the election of S corporation status. Second, §1375 imposes a corporate-level tax on certain S corporations which have excess passive income and earnings and profits left over from tax years before the S corporation election.

The tax paid by the corporation is characterized as a loss which flows through to the shareholders.[919] For this reason, the temporary regulations defined these items as subchapter S items.[920] Because it was unclear whether the TEFRA procedures applied to determinations involving these issues, the Internal Revenue Manual directed Revenue Agents to separately monitor the §6501 statute of limitations with respect to these

[910] Former §6245, before repeal by Pub. L. No. 104-188, §1307(c)(1), effective for taxable years beginning after Dec. 31, 1996; former Reg. §301.6245-1T.

[911] *Hang v. Commissioner*, 95 T.C. 74 (1990).

[912] *Dial U.S.A., Inc. v. Commissioner*, 95 T.C. 1 (1990); *Doe v. Commissioner*, T.C. Memo 1993-543, *aff'd on this issue*, 116 F.3d 1489 (10th Cir. 1997). Nevertheless, if subchapter S items affect shareholder basis, the Tax Court has jurisdiction if the items are required to be determined at the corporate level. *Univ. Heights at Hamilton Corp. v. Commissioner*, 97 T.C. 278 (1991).

[913] 877 F.2d 756 (9th Cir. 1989).

[914] *Bufferd v. Commissioner*, 952 F.2d 675 (2d Cir. 1992), *aff'd*, 506 U.S. 523 (1993).

[915] *Green v. Commissioner*, 963 F.2d 783 (5th Cir. 1992).

[916] *Fehlhaber v. Commissioner*, 954 F.2d 653 (11th Cir. 1992), *aff'g* 94 T.C. 863 (1990).

[917] 506 U.S. 523 (1993), *aff'g* 952 F.2d 675 (2d Cir. 1992).

[918] §6501(a).

[919] §1366(f)(2), §1366(f)(3).

[920] Former Reg. §301.6245-1T(a)(1)(vi)(G).

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items.[921] In *N.Y. Football Giants, Inc. v. Commissioner*,[922] the Tax Court held that the built-in gains tax must be determined in an S corporation proceeding, not a non-TEFRA deficiency proceeding.

[921] Former IRM 4226.31(13)(18).

[922] 117 T.C. 152 (2001). *See also KRP, Inc. v. Commissioner*, T.C. Memo 2002-126.

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XII. REMICs

A. Definition of a REMIC

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

A real estate mortgage investment conduit (REMIC) is an entity formed under the provisions of §860A through §860G for investment pools in real estate mortgages. *See* 741 T.M., *REMICs, Mortgage REITs, Mortgage Trusts and Other Real Estate Mortgage Securitization Vehicles*, for further discussion of the function and operation of REMICs.

For tax purposes, a REMIC is treated as the equivalent of a partnership. The income and loss of the REMIC flow through to the holders of the regular or residual interest.

B. Application of TEFRA to REMICs

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Because of their similarity to partnerships, REMICs are treated as partnerships for the purpose of applying the TEFRA partnership audit procedures.[923] The holders of the residual interest are treated as partners.[924]

Comment: The determination of the identity of a holder of a REMIC residual interest is not a partnership item for purposes of the TEFRA partnership audit procedures as applied to REMICs.

Accordingly, the TEFRA partnership audit procedures apply with the following special modifications:

1. the "small REMIC exception" applies only if there is at no time during the taxable year more than one holder of a residual interest;[925]

2. the REMIC return must be signed by a person (e.g., a corporate officer or general partner) who could sign the return absent the REMIC election;[926] and

3. for purposes of designating a TMP, all residual interest holders are treated as general partners in applying Reg. §301.6231(a)(7)-1.[927]

Subject to these modifications, a REMIC should be treated as the equivalent of a partnership for applying the TEFRA partnership audit procedures. Accordingly, the discussions contained in I. through X., above, apply with equal force to REMICs, with appropriate modification of the descriptive terms.

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[923] §860F(e).

[924] §860F(e). Reg. §1.860F-4(a), T.D. 9184, 70 Fed. Reg. 9218 (Feb. 25, 2005).

[925] Reg. §1.860F-4(a).

[926] Reg. §1.860F-4(c)(1).

[927] Reg. §1.860F-4(d). Under Reg. §1.860F-4(d), a residual interest holder of a REMIC may be designated as a TMP and, therefore, authorized to file an AAR on behalf of the REMIC. *See, e.g.*, CCA 201124023 (REMIC TMP, so designated under Reg. §1.860F-4(d), may file an entity-level AAR, even if the residual interest holder was not otherwise authorized to sign the original return under Reg. §1.860F-4(c)).

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XIII. Electing Large Partnerships

A. *Overview*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Before repeal by the Bipartisan Budget Act of 2015 (BBA),[928] for partnership tax years beginning before December 31, 2017, partnerships with 100 or more partners in the preceding year could elect to become "electing large partnerships" (ELPs).[929] Electing large partnership treatment reduced the burden on the partnership of reporting on the Schedule K-1 items that flowed through to the partners. Easing the reporting burden also facilitated information matching by the IRS. The BBA procedures borrow from the former rules for ELPs.

Comment: The IRS announced in IR-2023-166[930] that it will focus more attention and resources on large partnerships, the wealthy, and other high earners and increase its audit rates. The IRS will begin to use artificial intelligence to help compliance teams better detect tax cheating, identify emerging compliance threats, and improve case selection tools.

For a further discussion of the simplified flow-through provisions under former §771 through former §777 for electing large partnerships, see 710 T.M., *Partnerships — Conceptual Overview*, and 723 T.M., *Publicly Traded Partnerships.*

Former §6240 through former §6255 provided the audit procedures for ELPs. These audit procedures differed (significantly in some aspects) from the audit system established under TEFRA. Accordingly, the TEFRA audit procedures did not apply to a partnership that opted for ELP status unless that partnership also was a partner in another partnership not choosing ELP treatment — i.e., a tiered structure.[931]

B. *Mandatory Consistency*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

In contrast to the TEFRA rules, which allowed a partner to treat a partnership item in a different manner than the partnership treated the item so long as the partner notified the IRS of the inconsistent treatment, a partner in an ELP was required to treat all partnership items in a manner consistent with their treatment on the partnership's return.[932] If a tax underpayment resulted from a partner's inconsistent treatment of an item, it could be assessed and collected in the same manner as an underpayment resulting from a math or clerical error.[933]

C. *Flow-Through of Prior-Year Partnership Adjustments to Current Partners*

1. *General*

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The most significant difference between the TEFRA procedures and those for ELPs involved the year for which the partners were required to recognize partnership-level adjustments, whether those adjustments were initiated by the IRS or by the partnership. Under the ELP rules, a partnership adjustment had to be taken into account by the persons who were partners in the year or years for which the adjustment took effect (generally, the year in which the adjustment was made or finally determined).[934]

> *Example:* Partnership P deducted in full in 2010 and 2011 certain employee meal expenses. In 2014, it was determined that 50% of the meal expenses should have been disallowed. If P had been subject to TEFRA, the 50% disallowance for 2010 and 2011 had to be taken into account by the persons who were partners in 2010 and 2011, respectively. If P was an ELP, the amount of the 50% disallowance had to be taken into account as additional income by the 2014 partners (unless P elected to pay, or was otherwise liable for, the resulting tax, as described below).

The only exception to current-year flow-through for ELP adjustments concerned a change under §704 in a partner's distributive share of the amount of any partnership item shown on the partnership's return. In such case, the adjustment had to be taken into account by the partner for the partner's tax year for which such item was required to be taken into account.[935]

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[928] Pub. L. No. 114-74. For an additional discussion about the BBA, see XIV., below.

[929] Former §775.

[930] IRS News Release (IR-2023-166).

[931] Former §6240(b).

[932] Former §6241(a).

[933] Former §6241(b).

[934] §6242(a)(1), §6242(a)(1).

[935] §6241(c)(2)(A). Under §6241(c)(2)(B), the deficiency procedures of §6211 to §6215 did not apply to the assessment of any underpayments of tax covered by §6241(c)(2)(A), nor did they preclude the assessment or collection of an underpayment (or the allowance of a credit or refund for an overpayment) of tax covered by §6241(c)(2)(A). Section 6241(c)(2)(C) extended the statute for assessments and filing refund claims to the close of the period prescribed by §6248 for making adjustments with respect to the partnership tax year involved. Section 6241(c)(2)(D) provided that comparable rules applied in the case of tiered structures (i.e., where the partner whose distributive share was adjusted was another partnership or an S corporation).

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Example: An electing large partnership allocated a $1,000 §1231 loss to Partner X and a $500 §1231 loss to Partner Y for 2011. In 2014, it was determined that Partner X and Partner Y should have each been allocated a $750 §1231 loss for 2011 in accordance with §704. The $250 reduction in Partner X's loss and the $250 increase in Partner Y's loss had to be taken into account by each for 2011.

2. Definition of "Takes Effect"

A partnership adjustment "took effect" as follows: (i) in the case of a court decision arising under the ELP rules, when the decision became final; (ii) in the case of an adjustment pursuant to an ELP administrative adjustment request, when such adjustment was allowed by the IRS; and (iii) in any other case, when such adjustment was made.[936] Given that IRS administrative proceedings and judicial proceedings could be protracted, a considerable number of years could elapse between the tax year to which the adjustment related and the year during which that adjustment took effect. During this period, there could have been a substantial turnover in partners. In these situations, the tax cost or benefit of the adjustment was largely allocated to persons who were not partners in the year out of which the adjustment arose.

3. Partnership Liability for Tax; Tax Election to Pay

The partnership could elect to pay the imputed tax on the adjustment instead of passing the adjustment through to its partners.[937] The imputed tax, referred to as the "imputed underpayment," was calculated by: (1) netting all adjustments to the partnership's items of income, gain, loss, or deduction; and (2) treating any net increase in income as an underpayment equal to the amount of such net increase multiplied by the highest individual or corporate income tax rate in effect for the year to which the adjustment related.[938] For purposes of the netting computation, any net decrease in a loss was treated as an increase in income.[939] An adjustment to credits was taken into account as an increase or decrease (whichever was appropriate) in the amount of tax.[940]

There were also two situations in which the ELP was required to pay the tax at the partnership level. First, an ELP was liable for an imputed tax generated by a partnership adjustment even if it did not elect to pay the tax if the partnership did not fully take into account the adjustment in filing its partnership return for the year during which the adjustment took effect.[941] Second, the partnership was also liable if the adjustment involved a reduction in a credit which exceeded the amount of such credit determined for the tax year in which the adjustment took effect.[942]

4. Offsetting Adjustments in Subsequent Years

Regardless of whether the partnership adjustment flowed through to the partners, an adjustment had to be offset if it required another adjustment in a year after the adjusted year and before the year the offsetted adjustment takes effect.[943]

Example: Partnership P expensed a $1,000 item in Year 6. In Year 9, it was determined that the item should have been capitalized and amortized over a 10-year period. The adjustment to Year 9 is $700 (without adding interest and penalties), because the $900 adjustment for the improper deduction is offset by $200 of adjustments for amortization deductions. Those individuals who were partners in Year 9 must include an additional $700 in income for Year 9. P can amortize the remaining $700 of expenses in Years 9–15. P is also liable for four years of interest on the declining principal balance.[944]

5. Partnership Liability for Interest and Penalties

The ELP generally was liable for any interest and penalties that resulted from a partnership adjustment. Interest was computed for the period beginning on the return due date for the adjusted year and ending on the earlier of: (1) the return due date for the partnership taxable year in which the adjustment took effect; or (2) the date the partnership paid the imputed underpayment.[945] Penalties were determined on a year-by-year basis, based on an imputed underpayment. All accuracy penalties and defenses were determined as if the partnership was a taxable individual and were assessed in the same manner as if asserted against an individual.[946] Neither interest nor penalties were deductible by the ELP.[947]

D. Administrative Proceedings

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Under the ELP rules, a partner could not report any partnership items inconsistently with the partnership's return, even if that partner notified the IRS of the inconsistent treatment.[948] The IRS could treat a partnership item that was reported incon-

[936] §6242(d)(2).
[937] §6242(a)(2)(A).
[938] §6242(b)(4)(A).
[939] §6242(b)(4).
[940] §6242(b)(4)(B).
[941] §6242(a)(2)(B).
[942] §6242(a)(2)(C).
[943] §6242(a)(3).
[944] H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 672 (1997).
[945] §6242(b)(2). A taxpayer could deposit cash with the IRS that subsequently could be used to pay a tax underpayment. Interest was not charged on the portion of the underpayment that was deposited for the period that the amount was on deposit, and the deposit would not be considered a payment of tax until the deposit was used to pay a tax. §6603.
[946] §6242(b)(3), §6242(c)(3).
[947] §6242(e).
[948] Former §6241(a).

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sistently by a partner as a mathematical or clerical error and immediately assess any additional tax against that partner.[949]

As with the TEFRA unified audit procedures, the IRS could challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners.[950] Unlike TEFRA procedures, however, partners had no right individually to participate in settlement conferences or request a refund.

E. Designated Representative

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

An ELP had to designate a partner or other person to act on its behalf. If an ELP failed to designate a representative, the IRS could make the designation by appointing any one of the partners as the person authorized to act on the partnership's behalf.[951] After the IRS made this designation, the ELP could still designate a replacement for the IRS-designated partner.[952]

F. Notice Requirements

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

Unlike the TEFRA unified audit rules, the ELP provisions did not require the IRS to give notice to individual partners that an administrative proceeding had commenced or that a final administrative adjustment had been made.[953] Instead, the IRS could send notice of a partnership adjustment to the partnership itself by certified or registered mail.[954] Even if the partnership ceased to exist before the adjustment, the IRS could send notice by mailing it to the partnership's last known address.[955] The definition of "last known address" contained in Reg. §301.6212-2 applied in determining whether the notice was mailed to the partnership's last known address.[956]

G. Adjudication of Disputes Concerning Partnership Items

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

As in TEFRA partnership proceedings, an ELP could challenge the IRS's administrative adjustment in the Tax Court, the federal district court for the district in which the partnership's principal place of business was located, or the Court of Federal Claims.[957] A partnership with its principal place of business outside the United States was treated as being located in the District of Columbia.[958] Unlike the TEFRA unified proceedings, only the partnership — and not the partners individually — could petition for a readjustment of partnership items.[959] Before making such a challenge in the Court of Federal Claims or in U.S. district court, the partnership had to deposit the amount of the asserted tax liability or make a good-faith attempt to satisfy this requirement and timely correct any shortfall.[960]

If the partnership filed a petition for readjustment of partnership items, the court had jurisdiction to determine the tax treatment of all partnership items of that partnership for the taxable year to which the notice of partnership adjustment related. The court also had jurisdiction to determine the proper allocation of the partnership items among the partners. The court's jurisdiction was not limited to items adjusted in the notice.[961]

The ELP also could seek a refund by filing a request for an administrative adjustment of partnership items.[962] If the IRS did not allow any part of the administrative adjustment request, the partnership could seek judicial review in the Tax Court, federal district court for the district where the partnership's principal place of business was located, or the Court of Federal Claims.[963] The court generally had jurisdiction to determine only the disallowed partnership items and those items for which the IRS asserted adjustments as offsets to the adjustments that the partnership requested.[964]

H. Statute of Limitations

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership

[949] Former §6241(b).
[950] §6245(a).
[951] §6255(b).
[952] H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 672 (1997).
[953] H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 673 (1997).
[954] §6245(b)(1).
[955] §6245(b)(1), §6255(d).
[956] Reg. §301.6212-2(c).

[957] §6247(a). For Tax Court procedural rules, see Tax Court Rules 300–305.
[958] §6255(c).
[959] §6247(a). The Tax Court required that the IRS issue a notice of partnership adjustment and that the large partnership timely file the petition for readjustment. Tax Ct. R. 300(c)(1).
[960] §6247(b)(1).
[961] §6247(c).
[962] §6251.
[963] §6252. The Tax Court required as conditions for jurisdiction that the IRS disallowed some or all adjustments requested in the AAR and that the large partnership filed the petition for adjustment subject to the timing and notice requirements of §6252(b) and §6252(c). Tax Ct. R. 300(c)(2).
[964] Former §6252(d).

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tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

In general, the IRS had three years after the ELP filed its return or three years from the return's due date as determined without regard to extensions (whichever was later) in which to make an adjustment of partnership items.[965] This limitations period could be extended by agreement by the parties.[966]

The statute of limitations was unlimited if the partnership failed to file a return or filed a false or fraudulent return.[967] A six-year period of limitations applied if the partnership omitted an amount in excess of 25% of the reported gross income.[968] The statute of limitations was suspended by the filing of a bankruptcy petition during the period of the automatic stay imposed under the Bankruptcy Code and for an additional 60 days thereafter in the case of assessment, and six months thereafter in the case of collection.[969]

If the IRS mailed a notice of partnership adjustment for a taxable year to the ELP, the limitations period for making adjustments was suspended for the 90-day period during which the partnership could file a petition for readjustment of the partnership items for that taxable year, plus the period until the decision of the court became final if such a petition was filed, plus one year.[970]

The IRS could assess and collect any deficiency of a partner that arose from any adjustment to a partnership item subject to the limitations periods on assessments and collection that applied for the year that the adjustment took place.[971]

The ELP could seek an administrative adjustment of partnership items — a refund claim — if the request was made within three years of the later of the filing date of the partnership's return or the last day for filing the partnership's return, provided that the request was made before the IRS mailed a notice of partnership adjustment concerning that taxable year.[972] If the partnership and the IRS agreed to extend the limitations period for making assessments, the three-year refund period did not expire before the date which was six months after the expiration of the extension.[973] If the IRS denied the partnership's request for an administrative adjustment, the partnership could seek judicial review, provided its action was filed no earlier than six months after it filed the request with the IRS and no later than two years after the request was filed. The two-year period could be extended by agreement of the parties.[974]

If, after the ELP filed a petition for adjustment for disallowed partnership items but before the court heard the petition, the IRS issued a notice of partnership adjustment for the same taxable year, the court proceeding was treated as an action under former §6247 for readjustment of partnership items.[975]

I. Regulatory Authority

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

The Treasury Secretary had authority to issue regulations necessary for implementing the simplified audit procedures for ELPs.[976]

J. Due Date for Information Returns

Note: The TEFRA procedures were repealed by the Bipartisan Budget Act of 2015 (BBA), which applies to partnership tax years beginning after December 31, 2017. The TEFRA procedures continue to apply to audits for prior years. The BBA procedures were enacted under §6221 through §6235. The BBA rules often appear in a different Code section than the corresponding TEFRA rule. The citations to the Code in this portfolio are to the Code sections relevant to the TEFRA rules unless otherwise indicated.

An ELP had to provide information returns to its partners by the first March 15 following the close of the partnership's taxable year.[977] Also, because ELPs had more than 100 partners, they had to file Form 1065-B (and the associated K-1s issued to partners) electronically.[978] Failure to file in the required manner could have resulted in penalties under §6721.

For further discussion of the penalty for failure to timely file correct information returns, see 634 T.M., *Civil Tax Penalties.*

[965] §6248(a).
[966] §6248(b).
[967] §6248(c)(1), §6248(c)(3).
[968] §6248(c)(2).
[969] §6255(f).
[970] §6248(d).
[971] *See* §6501 (limitations on assessment and collection), former §6502 (collections after assessment).
[972] §6251(a).
[973] §6251(c).
[974] §6252(a), §6252(b).
[975] §6252(c)(2). Tax Ct. R. 305 required that the petitioner amend the petition to set forth errors alleged in the notice of partnership adjustment.
[976] §6255(g). *See* H.R. Conf. Rep. 220, 105th Cong., 1st Sess. 674 (1997).
[977] §6031(b).
[978] The form was obsoleted for tax years beginning after December 31, 2017.

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