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The Devil Is in the Details: The New "Streamlined" Partnership Procedures

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> "The Devil is in the details, but so is the salvation."
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> — Hyman G. Rickover, Admiral, United States Navy

In the Bipartisan Budget Act of 2015[2] (the Bipartisan Budget Act),[3] Congress completely overhauled the procedures for examining partnership returns, litigating disputes, and collecting resulting deficiencies. Postured as a revenue raiser, the Bipartisan Budget Act promises additional revenue of $9.3 billion over 10 years, based on increased collections resulting from streamlined partnership audit rules (the New Rules).[4] The Bipartisan Budget Act repeals the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)[5] audit rules as well as the "electing large partnership (ELP) rules" enacted in 1997 and replaces them with this simplified regime for taxable years beginning after December 31, 2017.[6]

Notably, the Bipartisan Budget Act generally allows partnerships with 100 or fewer partners to elect out of the New Rules (thereby returning to the use of deficiency procedures to audit partners one-at-a-time), raising the question as to whether these rules will raise revenue after all. Considered together, while the New Rules should streamline audit procedures for partnerships to which they apply, they allow many partnerships with 100 or fewer partners to escape regular scrutiny. Implicit in the New Rules then is the assumption that the increased revenue from auditing large partnerships will more than overcome any lost revenue from the difficulties inherent in auditing partners in the "not as large" partnerships.

This article explains the New Rules and, where applicable, highlights some of the key differences with the TEFRA rules[7] of which taxpayers should be mindful and provides some drafting considerations for partnerships and their partners as they transition to the New Rules. We begin by describing the use of partnerships today, the IRS's recent audit activity of partnerships, and the premises on which TEFRA was based.

I. PARTNERSHIPS IN THE UNITED STATES TODAY

Over the last 10 years, the use of partnerships as a business form has substantially increased in the United States. For the 2013 tax year, partnerships filed more than 3.4 million tax returns representing more

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[2] Pub. L. No. 114-74, §1101, 129 Stat. 584 (2015) (enacting, among other provisions, new §6221 through §6241 of the Internal Revenue Code).

Unless otherwise specified, references to "§" are to the Internal Revenue Code of 1986, as amended, and references to "Reg. §" are to the Treasury regulations thereunder.

This article refers to §6221 through §6241 of the Internal Revenue Code, as amended by the Bipartisan Budget Act, as the "New Rules" and cites them as "BBA §."

[3] The House of Representatives voted 266 to 167 to approve the bill on October 28, 2015, and the Senate passed the bill by a vote of 64 to 35 on October 30, 2015. President Obama immediately issued a statement applauding the passage of the agreement and signed the bill on November 2, 2015.

[4] Staff of Joint Comm. on Taxation, 114th Cong., Estimated Revenue Effects of the Tax Provisions Contained in H.R. 1314, The "Bipartisan Budget Act of 2015," Scheduled for Consideration by the House of Representatives on October 28, 2015 (2015) (JCX-135-15). In addition, another $1.9 billion comes from amending the family partnership rules of §704(e).

[5] Pub. L. No. 97-248, 96 Stat. 324 (1982).

[6] Pub. L. No. 114-74, §1101(g)(4).

[7] This article refers to the prior audit rules under TEFRA as the "former provisions" and cites them as "TEFRA §."

than 27.4 million partners.[8] Large partnerships, defined by the IRS as partnerships with more than 100 partners, had just over half of these 27.4 million partners.[9] The income produced by partnerships is significant, with partnerships reporting a total of $1,478.5 billion in net income available for allocation to their partners in 2013.[10] For the second consecutive year, partners who are themselves classified as partnerships received the largest portion of this income, with those in 2013 receiving allocations totaling $491.6 billion.[11] Total assets for all partnerships increased for the fourth year in a row, with total assets reported rising to $24.2 trillion.[12] Ultimately, these results reflect that partnerships surpassed individuals and corporations as the top income recipients for the second consecutive year.[13]

Given these statistics, one would expect that partnerships and their partners would experience growing audit rates as well. However, historically this has not been the case. As determined in a series of reports issued by the Government Accountability Office (GAO), the IRS conducted field audits of less than 1% of partnerships in 2011 and 2012.[14] In addition, the GAO found that a large corporation was over 30 times more likely to be audited than a large partnership during that period.[15] Even in instances when a large partnership was audited, the IRS was unlikely to make adjustments to partnership income, with 64.2% of large partnership audits resulting in ''no change'' compared to 21.4% of large corporate audits resulting in ''no change'' in 2013.[16] The audit rate for all partnerships is even more dismal, with the IRS examining just 0.4% of all partnership returns filed in calendar years 2012 and 2013.[17]

These statistics highlight an issue on which tax scholars, the Treasury Department, Congress, and the President have all been focusing: the need for reform of the partnership audit procedures. Underlying the push for reform was the collective view that there must be substantial revenue going uncollected due to a low audit rate. Because of the flexibility provided to partnerships by the tax rules in subchapter K and the historic use of partnerships in tax shelters, the notion prevailed that there was no logical reason to think that partnerships would be more compliant than other taxpayers in reporting their income. Hence, the lack of partnership audit adjustments was attributed to the audit process (i.e., the difficulties inherent in the partnership audit procedures), rather than the substance (i.e., that partnerships were inherently more compliant in their tax reporting as compared to others tax filers).

II. HISTORIC TREATMENT OF PARTNERSHIPS ON AUDIT

In 1982, Congress enacted unified partnership audit and litigation procedures as part of TEFRA.[18] When enacted, TEFRA was expected to provide the IRS the tools it needed to increase its audit activity and improve taxpayer compliance.[19]

While there is a lot to complain about with regard to TEFRA and a prevailing consensus that the TEFRA procedures are not working,[20] at the time of enactment, TEFRA promised more efficient procedures to audit and adjust partnership returns. Before TEFRA, there were no entity-level audits of partnership returns, because partnerships are not taxpayers. Rather, partnerships file information returns — Forms 1065 — which reflect each partnership's distributive share of partnership income, gain, deductions, loss, and credits. Each partner then takes these items into account on its own return, some of which could also be

[8] Ron DeCarlo, et al., *Partnership Returns, 2013*, IRS Statistics of Income Bulletin (Fall 2015), available at https://www.irs.gov/PUP/taxstats/soi-a-copa-id1512.pdf.

[9] *Id.* at 1.

[10] *Id.* at 2.

[11] *Id.* at 4

[12] *Id*. at 2.

[13] *Id.* at 4.

[14] GAO, *Large Partnerships: Characteristics of Population and IRS Audits*, GAO-14-379R, at 20 (Mar. 19, 2014), http://www.gao.gov/assets/670/661772.pdf. In this report, the GAO defined ''large partnerships'' as those having 100 or more partners and $100 million or more in assets. *Id.*

[15] GAO, *Large Partnerships: With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency*, GAO-14-732, at 19 (Sept. 2014), http://www.gao.gov/assets/670/665886.pdf.

[16] *Id.* at 20. For further analysis of the reports issued by the GAO regarding partnership audit specifics, see Sheri A. Dillon & Sam Guthrie, *The TEFRA Swamp: Managing the Complexities of a Partnership Audit*, 31 Tax Mgmt. Real Est. J. 146 (Bloomberg BNA May 6, 2015).

[17] *Internal Revenue Service Data Book, 2014*, at 23 Table 9a (Publication 55B 2015, Washington, D.C., Mar. 2015). Data from calendar year 2013 are presented because, in general, examination activity is associated with returns filed in the previous calendar year.

[18] Pub. L. No. 97-248, 96 Stat. 324 (Sept. 3, 1982) (enacting, among other provisions, TEFRA §6221 through TEFRA §6232).

[19] *See* Staff of the Joint Comm. on Taxation, 97th Cong., General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, 267 (1983) (JCS-38-82).

[20] *See, e.g.,* Sheri A. Dillon & Sam Guthrie, *The TEFRA Swamp: Managing the Complexities of a Partnership Audit*, 31 Tax Mgmt. Real Est. J. 146 (Bloomberg BNA May 6, 2015); N. Jerold Cohen & William E. Sheumaker, *When It's Broke, Fix It! It's Time for TEFRA Reform*, 2012 Tax Notes Today 157-2 (Aug. 13, 2012); Peter A. Prescott, *Jumping the Shark: The Case for Repealing the TEFRA Partnership Audit Rules*, 11 Fla. Tax Rev. 503 (2011); and Burgess J.W. Raby & William L. Raby, *TEFRA Partnership Rules: The Solution Becomes the Problem*, Tax Notes, Aug. 7, 2000, p. 795.

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information returns.[21] As a result, the IRS could only adjust these partnership items through deficiency proceedings at the individual partner level, one taxpayer at a time. Not surprisingly, auditing partners one at a time led to inconsistent treatment of partners (suggesting a lack of fairness in the administration of the tax laws) as well as duplicative audits and litigation, straining the resources of the IRS and the courts.[22] Nevertheless, Congress was reluctant to enact unified audit procedures that would allow the IRS to audit partnerships and make adjustments to partnership items at the entity level, without providing most partners with participation rights and the right to opt out of partnership settlements.

In 1978, President Carter recommended to Congress that it enact legislation to permit a partnership to be treated as an entity for the purpose of determining tax liability.[23] Correspondingly, the Treasury Department proposed the first unified partnership-level audit procedures to Congress in 1978. Apparently persuaded by witnesses and other stakeholders at hearings on the proposals, Congress did not enact the bulk of the provisions proposed by Treasury at that time. Chief among the concerns raised was that adoption of an entity approach would ''severely impair the rights of individual taxpayers to determine their own tax liability,''[24] as well as ''prejudice the rights of partners and . . . be inequitable.''[25]

The problems with auditing partnership items only continued to grow, and in 1979, the American Bar Association Section of Taxation (ABA) offered its proposal for partnership-level audit proceedings.[26] Recognizing the ''due process'' concerns that had defeated the 1978 proposed legislation, the ABA proposal noted, ''[t]he trick is to improve and facilitate the administrative and judicial process for fixing the tax liability of persons who invest in these partnerships without impairing in any significant way the traditional rights they have enjoyed as taxpayers.''[27] The ABA had previously provided a draft proposal regarding entity-level audits of partnerships, but the government had viewed the proposal as allowing partners too much leeway for avoiding the results of partnership-level audits. The 1979 proposal was an attempt by the ABA to respond more effectively to the government's needs and concerns while protecting individual taxpayer rights. The ABA proposal explained:

> At the same time, the Government's original proposals did not take sufficient account of the rights of dissenting partners, and it is important that statutory changes accommodate, protect and preserve these rights. In short, no matter what policy and procedural changes may otherwise be wrought, individual partners . . . should be allowed to participate fully in the administrative and judicial process; to take a position different from that of a general partner or a designated partner representing the partnership; to dissent in certain important situations; and to reflect that dissent in a judicial forum which does not demand prepayment of tax as a condition of jurisdiction.[28]

Against this backdrop, Congress was persuaded to enact partnership-level audit procedures in 1982 as part of TEFRA, and many of the protections that the witnesses in 1978 and the ABA proposal sought were included in the legislation. TEFRA reflected a hybrid system of partnership-level and partner-level determinations, and as time would tell, the system often created more controversy over procedural issues than over the substantive tax determinations.[29] Eventually, the protections and due process provisions built into TEFRA led to its breakdown. With the explosion in the use of partnerships to conduct business operations, coupled with the sheer size of many large partnerships, the IRS simply couldn't keep up with the procedures, as evidenced by the very low audit rates of partnerships and the very high rate of no-change determinations when partnership are audited.[30]

Congress has now changed the rules, and it is clear that due process and an individual partner's right to determine its own tax liability are no longer the primary concern. As discussed below, partners in part-

[21] *United States v. Woods*, 134 S. Ct. 557, 562–63 (2013) (explaining historic audits of partners and noting that partners who are themselves partnerships also file information returns).

[22] *See id.*

[23] *Tax Reduction and Reform, Message to the Congress, January 20, 1978*, 14 Weekly Comp. Pres. Doc. 158, 168 (1978). The President also proposed that tax partnerships with 15 or more partners as corporations.

[24] *See The President's 1978 Tax Reduction and Reform Proposals: Hearings Before the House Comm. on Ways and Means*, 95th Cong., 2d Sess. at 2978 (statement of the American Petroleum Institute, Mid-Continent Oil and Gas Associate, Rocky Mountain Oil and Gas Association, and the Western Oil and Gas Association).

[25] *See id.* at 2392 (statement of Robert R. Statham).

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

[27] *Id.* at 551.

[28] *Id.* at 552.

[29] See III.I., below.

[30] See I., above. *See also* Amy S. Elliott, *'Largely Manual and Paper Driven' System Causes Lack of Audits*, 2014 Tax Notes Today 182-2 (Sept. 19, 2014).

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nerships subject to the New Rules will no longer have notice or participation rights and only a very limited right to dissent. Collection of revenue from such partnership audits undoubtedly will be far simpler, as the onus for payment is on the partnership. With regard to fairness in the administration of the tax law, the IRS inevitably will focus on large partnerships, while partnership items attributable to not-as-large partnerships may be overlooked. It is unclear what the revenue impact will be if the not-as-large partnerships elect out, but given the IRS's historical experience using the deficiency procedures to audit partnership items one partner at a time, it would not be surprising if IRS audits of these items decline.

This raises the question, what is the real cost of the New Rules both in terms of revenue and in terms of fairness?

III. THE "NEW NORMAL" — THE BIPARTISAN BUDGET ACT OF 2015

A. Overview of the Bipartisan Budget Act of 2015

Broadly, and as discussed in more depth below, the New Rules eliminate the ability of partners to participate in partnership examinations and empower a sole partnership representative, who need not be a partner, to control partnership examinations and bind all partners to a resolution of the partnership examination, whether it be by settlement, full concession, or litigation. Under this approach, the IRS will examine the partnership's items of income, gain, loss, deduction, and credit, and partners' distributive shares, for a particular year of the partnership (the "reviewed year").[31] Any adjustments will be taken into account by the partnership, not the individual partners, in the year the audit or any judicial review is completed (the "adjustment year").[32] The New Rules provide two mechanisms whereby the partnership can, in effect, shift all or part of any deficiency obligation to the persons who were partners in reviewed year, as discussed in detail below.

The New Rules will apply to all partnerships, other than those that are eligible to elect out and affirmatively do so.[33] Unlike prior proposals, the New Rules do not subject partners to joint and several liability for any liability determined at the partnership level.

Observation: While the New Rules do not provide for joint and several liability for unpaid taxes attributable to partnership items, the New Rules do not relieve general partners and other "responsible persons" of liability for unpaid taxes. In addition, the government still has tools available, such as transferee liability rules, etc., to impose tax on appropriate other partners in the partnership. In other words, a person who is liable for a partnership's debts may be liable for partnership-level income tax underpayments attributable to tax benefits claimed (and retained) by others.

The first IRS audits under the New Rules will likely begin no earlier than late 2019 or 2020, for returns filed in 2019 for the 2018 taxable year. However, partnerships that wish to apply the New Rules on an expedited basis may elect to apply them to tax years beginning after November 2, 2015.[34]

Additionally, on December 18, 2015, President Obama signed the Consolidated Appropriations Act, 2016,[35] which included the Protecting Americans From Tax Hikes Act of 2015 (the "PATH Act")[36] containing several technical corrections and amendments to the New Rules. These corrections and amendments took effect as if they were included in §1101 of the Bipartisan Budget Act.[37]

B. New Rules Apply to All Partnerships Unless Eligible to Elect Out

1. Application of New Rules

The New Rules will generally apply to any partnership required to file a return under §6031(a).[38] A partnerships with 100 or fewer partners in a year is eligible to elect out of the application of the new rules for that year, *if* all of its partners are individuals, C corporations, or foreign entities that would be treated as C corporations if they were domestic, S corporations, or estates of deceased partners.[39] Notably, any partnership that has a partnership as a partner (a tiered partnership) is not eligible to elect out. By contrast, where a partner is an S corporation, the New Rules count each S corporation shareholder as a partner in determining whether the partnership has more than 100 partners. To look through an S corporation, its shareholders' names and taxpayer identification numbers must be disclosed.[40]

The scope of the categories of entities that are included in the New Rules has some uncertainty. For

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[31] U.S. House of Representatives, *Bipartisan Budget Act of 2015, Section-by-Section Summary*, at 13, http://docs.house.gov/meetings/RU/RU00/CPRT-114-RU00-D001.pdf.

[32] *Id.*

[33] BBA §6221(b).

[34] *Id.*

[35] Pub. L. No. 114-113, 129 Stat. 2242 (2015).

[36] Pub. L. No. 114-113, Div. Q.

[37] *Id.*

[38] BBA §6241(1).

[39] BBA §6221(b).

[40] BBA §6221(b)(2)(A)(i).

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example, the category of partners that the New Rules describe as ''foreign entit[ies] that would be treated as C corporations [if they] were domestic'' is unclear.[41] Foreign entities that are not *per se* corporations under Reg. §301.7701-2(b)(8) default to corporate status if all members have limited liability, and domestic entities generally default to flow-through status.[42] Arguably, the New Rules could function to exclude all multimember foreign entities on the grounds that if these entities were domestic, they would be considered a partnership absent an affirmative election otherwise. This remains unclear, however.

Observation: Clarifying guidance on the treatment of foreign entities should be a top priority for the IRS and Treasury. As drafted, the New Rules can be interpreted to cause a partnership with a foreign corporation as a partner to always be (i) ineligible to elect out of the New Rules unless the foreign entity were a per se corporation, *or* (ii) eligible to elect out so long as all there are 100 or fewer partners, all of which were qualifying partners.

In addition to the uncertainty about foreign entities, there is uncertainty regarding partners that are grantor trusts or disregarded entities. Similar to the exclusion of partnerships from the list of types of partners a partnership may have to be eligible to elect out of the New Rules, disregarded entities and grantor trusts are also not listed. Given Congress's grant of authority to prescribe regulations or other guidance with respect to other partners not described by the legislation,[43] these uncertainties may be addressed in the coming years.

> *Observation:* While single member LLCs (SMLLCs) and grantor trusts are recognized as partners under state law, both are disregarded as separate from their owners for purposes of Subtitle A.[44] Nevertheless, both are treated as pass-through partners for purposes of TEFRA, which makes partnerships in which they are partners ineligible for the small partnership exception to TEFRA. It is uncertain whether a partnership that has a SMLLC or grantor trust as a partner will be eligible to elect out of the New Rules.
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> In any event, allowing partnerships with up to 100 partners to elect out of the New Rules leaves a broad swath of partnerships not covered by the New Rules and not even subject to the TEFRA rules. If history is a guide, using deficiency procedures to audit partnerships with fewer than 100 partners will be problematic for the IRS. Under TEFRA, a partnership was excluded from TEFRA only if it had 10 or fewer partners. Presumably there are many, many partnerships with 11 to 100 partners that will be eligible to opt out.[45] It is unclear what internal procedures the IRS will develop to audit these not-as-large partnerships. One option would be for the IRS to revert to pre-TEFRA techniques of identifying an issue on a single partner's return, tracking back to the Form 1065 (along with the new the ''election out statement'' as described below to identify the other partners), and then opening audits one by one, hoping that the partners' statutes of limitations are open.[46]

2. Election Out

For partnerships eligible to make the election out of the New Rules, that election must be made annually on a timely filed return.[47] In making this election, the partnership will be required to disclose the name and the taxpayer identification number of each partner in the partnership and notify each such partner of the election.[48] The New Rules direct Treasury to prescribe the manner in which partnerships must undertake these steps.[49] Notably, arrangements that take the position that they are not partnerships cannot make an election out, because in those instances a partnership return would not be filed.

Observation: An arrangement whose parties do not believe that they are partners for tax purposes cannot elect out of the new rules because a partnership return is not filed. This fact could be especially problematic if the IRS asserts that the arrangement is a partnership. In the absence of regulations to the contrary, the substantive result of the IRS's effort to treat the arrangement as a partnership could determine retrospectively whether the New Rules apply. At a minimum, the IRS should provide, by regulation or otherwise, that an arrangement for which no partnership return is

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[41] BBA §6221(b)(1)(C).

[42] Reg. §301.7701-3(b).

[43] BBA §6221(b)(2)(C).

[44] *See* Rev. Rul. 2004-88, 2004-2 C.B. 165; Rev. Rul. 85-13, 1985-1 C.B. 184.

[45] *See generally* Ron DeCarlo et al., *Partnership Returns, 2013*, IRS Statistics of Income Bulletin (Fall 2015), at 1, https://www.irs.gov/PUP/taxstats/soi-a-copa-id1512.pdf (explaining that partnerships with less than three partners comprised more than half (56.3%) of all partnerships in 2013 and accounted for more than a quarter (26.3%) of all partnerships with total assets of $100 million or more).

[46] *See* Michael W. Homer, *Auditing Partnership Tax Shelters: IRS Procedures and Tax Liability*, 60 Neb. L. Rev. 564, 572-76 (1981) (discussing the techniques developed by the IRS to audit partnership items pre-TEFRA).

[47] BBA §6221(b)(1)(D).

[48] *Id.*

[49] *Id.*

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filed is deemed to have elected out if it would otherwise be eligible to elect out.

In instances where the partnership qualifies and makes a valid and timely §6221(b) election out, all audits for that year and any resulting adjustment will be conducted partner-by-partner in partner-level deficiency proceedings. A determination for one partner will not be binding on any of the other partners, or on the partnership.

Observation: Just as with pre-TEFRA audits, partners will be subject to potentially different outcomes. As articulated by an IRS official, partnerships that elect out ''are back in the prehistoric days of partnership audits . . . and each partner can litigate separately and take its own position.''[50]

Observation: The New Rules could be a trap for unwary and the not well-advised partners. Under TEFRA, small partnerships were automatically *excluded* from TEFRA but had the opportunity to opt in.[51] Under the New Rules, the simplest and presumably least sophisticated two-person partnerships will be subject to partnership-level audit unless they affirmatively elect out.

C. Partner's Role Is Limited

1. Consistent Reporting Required

New §6222 provides that a partner's return must be filed consistently with the partnership return, including the manner in which the partnership treats each item of income, gain, loss, deduction, or credit.[52] In instances where a partner fails to report items consistently, any underpayment will be assessed and collected as if the underpayment were the result of a math error, with no right to petition the Tax Court and contest the tax liability in a prepayment or refund forum.[53] In the tiered partnership context, the failure of the upper-tier partnership to report consistently with the lower-tier partnership exposes the upper-tier partnership to tax as though the adjustment were a mathematical or clerical error.[54] For partners that fail to comply with the consistency requirements in §6222, the New Rules impose an accuracy related penalty under §6662.[55]

Observation: For partnerships that elect out of the new rules, the duty of consistency seemingly no longer applies given the repeal of TEFRA. This allows each partner to take its own position regarding items reported on the K-1, without providing the IRS notice of the inconsistent position. This could lead to inconsistent treatment of partners and opportunities to whipsaw the IRS.

A partner may take a position inconsistent with that of the partnership if it files a statement with its return identifying the inconsistency.[56] As a practical matter, many partners may need to undertake such a filing each year. For example, upper tier partnerships wishing to avoid the application of these provisions will be required to file Form 8082, *Notice of Inconsistent Treatment*, with their returns as a result of using estimates for income and loss from lower-tier partnerships in which they hold an interest. Estimates typically are used because a lower-tier partnership has not delivered a Schedule K-1 by the time the upper-tier partnership prepares its tax return. Historically, absent a material adjustment, a common administrative practice by such partnerships is to ''true up'' the estimated amounts in the upper-tier partnership's subsequent tax year. While the New Rules do not address this practice, the consistency requirement makes it even more important to make the proper disclosures in the upper-tier partnership's tax returns.

In instances where a partner files taking an inconsistent position using the identification procedures set forth in §6222(c), any final decision with respect to the inconsistent position in a proceeding at the partner level is not binding on the partnership (or the IRS).[57] The same filing requirement applies if the partnership has not filed a return, but the partner reports the item.[58]

The disconnect between the inconsistent treatment at the partner level and the nonbinding nature of such treatment in instances where the partner has followed the requirements of §6222(c)(1) can produce anomalous results. For example, assume partner A of the equal AB partnership believes the partnership should have deducted an item in Year 1 rather than Year 2, and files its return showing a corresponding lesser distributive share of income in Year 1. Partner A prevails in its separate proceeding with the IRS in Year 4. The partnership deducts the item in Year 2. If the partnership prevails in its Year 2 position, the same item will

[50] Matthew R. Madara, *New Partnership Tax Audit Regime Raises Interpretation Questions*, 149 Tax Notes (TA) 873, 873 (Nov. 16, 2015) (quoting Clifford Warren, special counsel, IRS Counsel of Associate Chief Counsel (Passthroughs and Special Industries)).

[51] TEFRA §6231.

[52] BBA §6222(a).

[53] BBA §6222(b).

[54] *See* BBA §6232(d)(1)(B).

[55] BBA §6222(e).

[56] BBA §6222(c)(1).

[57] BBA §6222(d).

[58] BBA §6222(c)(2).

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be deducted twice by Partner A. If the IRS successfully challenges the Year 2 deduction, Partner B loses out. The partnership may be able to file an amended return, using the procedures discussed more fully below, to request an administrative adjustment for Year 1, subject to the period of limitations set forth in §6227. Even if it can file an amended return, the result would be a deduction in the year during which the request is filed, a deduction which includes the amount Partner A deducted in Year 1. This outcome also results in the same item being deducted twice with respect to Partner A. While the IRS and Treasury will undoubtedly attempt to avoid these inconsistent results in drafting guidance and regulations, the delinkage of partner-level proceedings from partnership-level proceedings seem destined to produce results that are at times unfair to both taxpayers and the public fisc.

2. The "Partnership Representative"

The New Rules replaced the TEFRA concept of the "tax matters partner" (the TMP) with the new role of the "partnership representative." The partnership representative is vested with much greater powers over the tax affairs of the partnership than the powers that the TMPs have. Designated by the partnership in a manner to be prescribed by the Treasury, the partnership representative has the sole authority to act on behalf of the partnership with respect to audit and adjustment proceedings.[59] The partnership and all partners (including those that held an interest in the partnership during the reviewed year, but disposed of that interest before the adjustment year) are bound with respect to any actions undertaken by the partnership as part of the examination and all final decisions in the proceeding.[60]

The partnership representative must be a "person"[61] with a "substantial presence" in the United States and need not be a partner.[62] If a designation has not been made, Treasury is empowered to select any person as the partnership representative.[63]

While the partnership representative will have the authority to act on behalf of the partnership in audit and adjustment proceedings, the New Rules did not change or impact the requirements for who may sign a partnership return. These rules require the Form 1065 to be signed by a general partner or by an "LLC member manager."[64]

Observation: The New Rules represent a significant departure from TEFRA, and the powers of the partnership representative make it clear that any notions of "due process" rights for partners are no longer a concern. The partnership representative need not be a current or former partner in the partnership. Under TEFRA, the TMP had to be a partner in the partnership at the time of designation or in the year under audit and had to have the authority under state law to bind the partnership. Despite these requirements, the TMP's ability to bind the partners was not unlimited. For example, the TMP could not bind all partners to a settlement with the IRS.[65]

Observation: While the IRS will have the authority to designate a partnership representative in the absence of a designation by the partnership, the New Rules leave it to the IRS to explain the how this decision will be made. While many of the mechanisms found in Reg. §301.6231(a)(7)-1 regarding the designation of a TMP under TEFRA may inform the forthcoming guidance, the IRS will need to make changes to account for the fact that the former default rules sought to identify the general partner with the largest profits interest. Now that the partnership representative need not be a partner, the IRS has many more options as a designee partnership representative, including persons who serve as a compensated director or manager of the partnership's affairs and are not themselves partners.

Further, should the partnership representative not have the power to bind the partners under state law, and is not a party to the partnership agreement, it remains unclear what effect this could with regard to binding the partners with finality.

Observation: The role of the partnership representative is one with heavy responsibility going beyond the prior role of a TMP who in many aspects functioned as an information source on behalf of the partnership. The new role provides the partnership representative with power to bind the partnership and its partners in all audit and judicial proceedings. As such, liability coverage may be desirable to protect the representative from any claims that result from a partner or former partner disgruntled with the outcome of an audit.

3. Partner's "Role" in an Examination

As discussed above, the partnership representative is the only person empowered to act on behalf of the

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[59] BBA §6223(a).

[60] BBA §6223(b).

[61] Under §7701(a)(1), a "person" includes an individual, trust, estate, partnership, association, company or corporation. If an entity is designated as a partnership representative, arguably a responsible person, such as an officer, partner or trustee will be required to act on behalf of the partnership representative.

[62] BBA §6223(a).

[63] *Id.*

[64] Instructions to Form 1065; §6031; Reg. §1.6031(a)-1(a)(2).

[65] Under TEFRA, the TMP could not bind notice partners and could not bind non-notice partners (generally, partners with a less than 1% interests in the partnership) to the extent that such non-notice partners notified the IRS that it would not be bound by the TMP. TEFRA §6224(c)(3)(A).

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partnership, and, in his or her role as partnership representative, binds the partners with respect to all actions taken during the audit and adjustment proceedings and in litigation.[66] Further, the New Rules do not obligate the IRS to interact with any person other than the partnership representative. Thus, the New Rules eliminate ''due process'' rights found in TEFRA, such as the right to receive notice, participate in a proceeding, or independently negotiate with the IRS.

Observation: Under the New Rules, a partner who wants the IRS to consider its view about the tax treatment of any partnership items will need to obtain that right under the partnership agreement or by eliciting ad hoc cooperation from the partnership representative. There is no option, as under TEFRA, for a partner to opt out of a partnership settlement or participate as party in TEFRA litigation. While it is possible that a court would allow a partner with an interest in the outcome of litigation under the New Rules to participate, if only as *amicus curia*, actual intervention seems problematic. A partner wishing to obtain or enforce contract rights to participate in administrative proceedings under the New Rules will have to resort to non-tax litigation procedures, such as mandamus suits.

D. Determinations Are Made at the Partnership Level

1. Partnership-Level Payment

The New Rules fundamentally change the way partnerships are treated with respect to adjustments at the partnership level and eliminates some of the most complex provisions and concepts of the TEFRA regime, such as the concepts of ''partnership items,'' and ''affected items.'' Under the new regime, any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, and any partner's distributive share thereof, will be determined at the partnership level. Once determined, any tax attributable to that determination will be assessed and collected at the partnership level as well. Finally, the applicability of any penalty or addition to tax will also be determined and collected at the partnership level.[67] With respect to penalties, the New Rules do not provide for any partner-level defenses, which is another departure from current law.

a. The Mechanics of a Partnership Adjustment — the "Imputed Underpayment"

In cases where an examination results in an adjustment to any item of income, gain, loss, deduction or credit of the partnership, or any partner's distributive share thereof, which produces an underpayment, the partnership will be responsible for any underpayment of tax.[68] The partnership will be required to satisfy the ''imputed underpayment'' in the adjustment year[69] and it will be assessed and collected in the same manner as if it were a tax imposed for that year.[70] For example, assume that in 2019, B buys a partnership interest from A, and in 2020 the IRS increases the partnership's 2018 taxable income. Under the current regime, A would owe tax on its share of the increase in 2018 income. Under the New Rules, the partnership will be required to pay those taxes in 2020.

Observation: The ability to assess and collect tax at the partnership level alleviates what is perceived as a key shortcoming in the TEFRA audit process as developed over time (i.e., the IRS's inability to keep up with the sheer number and size of partnerships given the TEFRA procedures and its antiquated technology) and what well could be driving the estimated revenue of $9.3 billion. It is believed that the IRS has forgone substantial revenues due to its inability to flow through adjustments to partnerships that have hundreds or thousands of partners and to collect on those underpayments of tax.

Observation: However, recent administrative practice has alleviated much of the burden on the IRS and collected some revenue that otherwise may have gone uncollected. In certain circumstances, such as where the revenue is beyond a de minimis amount and the number of partners is substantial, the IRS and the partnership have agreed to a partnership-level payment to resolve the TEFRA audit. In such a case, a closing agreement is entered into by the partnership and the IRS, and how the tax liability is economically borne is left to the partnership and the partners to determine.

While the New Rules provide for the ability for the partnership to request modifications to the tax imposed under new §6225, the imputed underpayment generally will be calculated by netting all adjustments within each reviewed year, and multiplying any resulting positive amount by the highest rate of tax in effect for the reviewed year under §1 (individuals) or §11 (corporations).[71] Under procedures to be specified by the Secretary, the imputed underpayment amount may be reduced to reflect any payments made by a

[66] BBA §6223(b).

[67] BBA §6221(a). In instances where a partnership ceases to exist before a partnership adjustment takes effect, the adjustment will be taken into account in procedures set forth in regulations to be promulgated by Treasury. BBA §6241(7).

[68] BBA §6225(a).

[69] BBA §6225(a)(1).

[70] BBA §6232(a). If an administrative adjustment is requested, to which BBA §6227(b)(1) applies, the underpayment is to be paid when the request is filed. See III.E., below, for a discussion of the New Rules as they pertain to administrative adjustment requests.

[71] BBA §6225(b)(1)(A).

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partner on an amended return that properly reflects the adjusted items for the year under review.[72] In addition, the underpayment amount can be reduced to the extent it is allocable to a partner that would not owe tax because it is a tax-exempt entity, such as a partner that is a pension fund.[73]

The New Rules also call for certain modifications to the applicable highest tax rate imposed on the underpayment. It provides that the applicable highest tax rate is to be reduced to account for income allocated to C corporations and for capital gain and qualified dividend income allocated to individuals.[74] Generally, such computation will be based upon each partner's distributive share of the income.[75] However, in instances where the adjustment relates to more than one item and the partners' shares of such items are not the same, the partner's distributive share used to compute the correct applicable highest tax rate will be based on each partner's distributive share of the net gain or loss of the partnership on a hypothetical sale of all of its assets.[76]

Observation: Although this new procedure is helpful in that it more closely computes the "true" imputed underpayment of tax due by considering the classification of the current partners and their respective tax rates, an economic mismatch still persists to the extent that the current partners are bearing the tax burden for the tax benefits enjoyed by their former partners in prior tax years.

Information necessary to make the modifications described above must be submitted to the IRS within the 270-day period beginning on the date the notice of proposed partnership adjustment is mailed under §6231, unless the period is extended with IRS consent.[77]

Additionally, the New Rules empower Treasury to issue regulations or other guidance to provide for additional procedures to modify the imputed underpayment amounts on the basis of other factors.[78] Commentators, including Senate Finance Committee Chairman Orrin Hatch (R-UT), specifically mentioned the need for Treasury to specify a procedure to reduce the underpayment to account for passive losses of the partnership to which §469(k) applies, as the passive loss of a partnership can only be used to offset passive income from that same partnership.[79] The PATH Act added to the New Rules a procedure for publicly traded partnerships to reduce the amount of imputed underpayment by the portion of such underpayment attributable to a net decrease in "specified passive activity loss" allocable to certain partners that are affected by the passive activity loss rules.[80]

Any payments required to be made, including those for the imputed underpayment, any additions to tax, and interest thereon, will not be deductible.[81]

Observation: The New Rules have the effect of imposing an entity-level deficiency tax on partnerships, similar to that imposed on corporation. A key difference, however, is that interest is deductible by corporations. Here, the New Rules go beyond pure procedural changes and create a substantive economic difference in determining the ultimate amounts owed to the public fisc following a partnership audit without a corresponding change in the substantive tax law.

Observation: IRS officials have commented recently about initiatives to audit a greater number of returns with a focus on a smaller number of issues.[82] That approach, coupled with the framework of the New Rules, may provide an additional incentive for the IRS to examine a larger number of partnerships and potentially reduce the size of the overall audit adjustment to encourage the partnership to pay the imputed underpayment rather than undertaking the administrative burden of utilizing one of the mechanisms provided in the New Rules to shift the liability.

Absent the partnership and partners' utilization of one of the two mechanisms that the New Rules provide to shift the burden of the liability back to the reviewed year partners, discussed in detail below, adjustments that result in an imputed underpayment will be borne by adjustment year partners, rather than reviewed year partners. As a nondeductible but very real cash expense, the payment should result in a reduction to basis under §705(b) and a reduction in the partners' capital accounts allocated under the substantial economic effect rules of §704(b).

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[72] BBA §6225(c)(2). See III.D.3., below, for a discussion of the New Rules as they pertain to amended returns filed by partners.

[73] BBA §6225(c)(3).

[74] BBA §6225(c)(4)(A).

[75] BBA §6225(c)(4)(B)(i).

[76] BBA §6225(c)(4)(B)(ii).

[77] BBA §6225(c)(7).

[78] BBA §6225(c)(6).

[79] 161 Cong. Rec. S7601, S7636-37 (statement of Rep. Hatch).

[80] §6225(c)(5), added by Pub. L. No. 114-113, Div. Q, §411(a)(2). "Specified passive activity loss" is defined as the lesser of the passive activity loss of a partner that is separately determined with respect to the partnership under §469(k) with respect to the partner's tax year in which the reviewed year of the partnership ends, or the passive activity loss so determined with respect to the tax year in which the adjustment year of the partnership ends. §6225(c)(5)(B).

[81] BBA §6241(4).

[82] Andrew Velarde, *ABA Section of Taxation Meeting: Official Sheds More Light on LB&I Changes*, 148 Tax Notes (TA) 1470 (Sept. 28, 2015) (reporting on comments made by Sergio Arellano, Acting Deputy Commissioner (Domestic), Large Business & International).

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b. The Mechanics of a Partnership Adjustment — the "Imputed Overpayment"

If the net adjustments in a reviewed year do not result an imputed underpayment, the adjustment will be taken into account as a reduction of income in the adjustment year.[83] In effect, this means that the IRS will not refund an imputed overpayment to the partnership. Rather, for the adjustment year, the partnership will reduce the income that it reports to its partners as residual taxable income under §702(a)(8), or in the case of a credit, as a separately stated item.[84] Because this decrease in income has no corresponding economic effect at the partnership level, it is unclear how it will be allocated, but in the aggregate, the partners' bases will be reduced by the decrease.

c. The Mechanics of a Partnership Adjustment — Adjustments to Distributive Shares

If the result of an examination is a reallocation of income or deductions from one partner to another (i.e., there is no net adjustment to the partnership's income for the year), the adjustment will produce an imputed underpayment for the reviewed year to the extent any partner's share of income is increased (or loss decreased). The correlative adjustment reducing the income (or increasing the loss) for the other partner, will reduce the §702(a)(8) income in the adjustment year.[85] This scheme puts pressure on partnership allocation provisions, as the treatment will result in phantom income and cause the partnership to incur a cash tax liability even if it correctly determined its taxable income and the net income reported on the Form 1065 does not change.

2. Alternative Partner-Level Payment — Shifting the Adjustment through Election

Partnerships can elect to shift the monetary burden for an imputed underpayment imposed under §6225 to persons who were partners in the reviewed year.[86] This election must be made by the partnership no later than 45 days after the date of the notice of final partnership adjustment and is irrevocable without IRS consent.[87]

Observation: While 45 days to make such an election is, in and of itself, a very short period and could make it difficult for a partnership to determine whether it is in its partners' best interests to pay the imputed underpayment or to shift it to former partners, this short period is mitigated by the fact that the notice of final partnership adjustment must be preceded by a notice of proposed partnership adjustment mailed at least 270 days before the final partnership adjustment notice.[88]

If this election is made, the partnership will provide to each person who was a partner in the reviewed year a statement showing that partner's (or former partner's) share of the adjustment to the partnership's income, gain, loss, deduction, or credit.[89] Each partner, or former partner, receiving such a statement then must increase its tax for the year in which the statement is received (i.e., the current year) by the additional tax that would have been due in the reviewed year.[90] The partner or former partner must also consider any intervening years as if the adjustment had been taken into account on the partner's return for the reviewed year and all later returns up to and including the current-year return were filed consistently with that adjustment, adjusting tax attributes accordingly.[91]

When this statement is issued, the recipient must pay any additional taxes, without regard to the partner's statute of limitations for the year under audit. Although the partner's added taxes are computed regarding the reviewed year, as discussed above, these taxes are paid as part of his or her current income tax liability for the year in which the statement is received. This makes the respective partners' statutes of limitation irrelevant, as the taxes are simply "additions to tax" for the current year.

Penalties are determined in a similar fashion and passed through to the partners in a manner similar to income adjustments.[92] Interest will be determined at the partner level and will be calculated from the due date of the return for the tax year to which the increase is attributable.[93] As a toll charge for the use of these provisions, the New Rules impose an interest rate hike of two percentage points on an imputed underpayment, imposing interest under §6621(a)(2) by substituting "5 percentage points" for "3 percentage points."[94] Thus, the partners in a partnership that makes an election under §6226 would incur a penalty in the form of a higher interest rate on any understatement of tax.

Taxpayer-favorable adjustments will not produce refunds that are eligible to be claimed through the election under §6226. A partner whose tax liability for the reviewed year would decrease cannot claim the benefit on his or her own return. Rather, those adjust-

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83 BBA §6225(a)(2).

84 BBA §6225(a)(2)(A), §6225(a)(2)(B).

85 BBA §6225(b)(2).

86 BBA §6226(a).

87 BBA §6226(a)(1).

88 See §6231(a) and the discussion in III.F., below.

89 BBA §6226(a)(2).

90 BBA §6226(b)(1).

91 BBA §6226(b)(2), §6226(b)(3).

92 BBA §6226(c)(1).

93 BBA §6226(c)(2)(A), §6226(c)(2)(B).

94 BBA §6226(c)(2)(C).

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ments not producing an imputed underpayment will continued to be governed by §6225(b)(2) and produce §702(a)(8) deductions in the adjustment years.

Observation: The election under §6226 is likely to be very popular, because it shifts the tax liability out of the partnership for the adjustment year and onto the partners who were partners in the year for which the adjustment arose. Without this election, the partnership's current partners in the adjustment year would bear the economic cost of prior-year tax savings enjoyed by reviewed-year partners. Additionally, it is likely that partnership creditors will insist that these elections be made. Any imputed underpayment required to be paid at the partnership level could impact creditors' rights as there is always the possibility that a partnership could lack sufficient assets to pay a current partnership-level tax and continue to meet its debt obligations.

In the case of reallocations of distributive shares, attention must be paid to whom the benefit of the reduction to §702(a)(8) income in the adjustment year is allocated. Presumably, it should go to the partner who should have received the deduction, or reduced income, in the reviewed year, because to do so will bring capital accounts into balance. As an example, consider the equal partnership of AB. The AB partnership specially allocates a $100 deduction to A in Year 1. The IRS disallows the special allocation in Year 4, issuing a notice of final partnership adjustment. The partnership representative elects partner-level payment under §6226 within 45 days of receipt of the notice. Partner A must recompute his tax for Year 1 by increasing taxable income by $50 and must pay the tax plus interest (calculated at the two-percent higher rate) in Year 4. Partner B's income was overstated in Year 1 by $50, but this is reflected by reducing AB's income by $50 in Year 4. This reduction should be specially allocated to B, or B's successor, in a properly drafted partnership agreement.

Observation: It is unclear whether, in the case of a tiered partnership, the election to pass through an adjustment under §6226 is available at each tier or whether an upper-tier partnership that receives a statement from a lower-tier partnership may elect to pay the tax on the adjustment. If it is, complications may arise in multi-tiered partnerships where there are dissolved or foreign partnerships, as it can be difficult to identify the partnership representative that should receive information and the person responsible for payment of the liability.

Finally, guidance with respect to payments and assessments that occur pursuant to an election under §6226 may be needed to address what occurs in instances where the partner receives the statement passing through the underpayment but does not file its return for the year in which the statement was received reflecting the necessary liabilities that result.

3. Alternative Partner-Level Payment — Shifting the Adjustment through Partners' Amended Returns

As discussed above, in instances where an imputed underpayment exists, that amount may be modified by reduction to reflect any payments made by a partner on an amended return that properly reflects the adjusted items for the year under review. This modification presents an opportunity for the reviewed-year partners to take the adjustments into account on their respective returns for the reviewed year and to pay the corresponding tax liability. To the extent reviewed-year partners file amended returns and pay their portion of the liability, the partnership's imputed underpayment liability will be reduced. The amended returns of these partners must be filed within 270 days after the notice of proposed adjustment is issued, absent IRS consent to extend this period. This mechanism will be available only to shift the imputed underpayment liability, not to shift taxpayer favorable adjustments to reviewed year partners.

The New Rules direct the Treasury Secretary to establish procedures for the modification of imputed underpayments in these instances. It is likely that in so doing, the Secretary will place the burden of verification of the filing of the amended returns and payment of the liability on the partnership. Additionally, while the New Rules do not provide a mechanism for the partnership to require the filing of amended returns and payment of corresponding tax by reviewed year partners or the provision of information by the partner to the partnership regarding amended returns and payment of a liability under these provisions, a carefully drafted partnership agreement could require such action.

Observation: While a partnership agreement could attempt to compel its partners to file amended returns, it is unclear what verification procedures could be put in place that would satisfy both the IRS and the partners. It is unlikely that partners would be willing to share their amended returns or any other taxpayer confidential information that could substantiate filing and payment of their underpayments of tax liability with the partnership. It is possible that the IRS would be satisfied with a signed statement from the partner to the partnership verifying, under penalties of perjury, that it filed the requisite amended return and paid the additional tax due. Such statement could be submitted with the partnership's payment of the imputed underpayment of tax or with a statement in lieu of such underpayment.

E. Amended Partnership Returns

Partnership amended returns are filed by making an administrative adjustment request (AAR). The AAR

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may be filed by the partnership, requesting an adjustment in the amount of one or more items of income, gain, loss, deduction, or credit of the partnership for any partnership taxable year.[95] If the AAR results in an imputed underpayment, the partnership can pay the tax under rules analogous to §6225.[96] The New Rules do not, however, provide for the partnership to modify the imputed underpayment based upon the filing of an amended return and payment of the corresponding tax by the affected partners. Nevertheless, the New Rules do permit the partnership to shift the liability to the partners in an election similar to that under §6226.[97] Additionally, they allow the partnership to make this similar election without the imposition of the increased interest (200 basis point bump) incurred by the partners occurring with the election under §6226.[98] In the case of an adjustment that does not result in an imputed underpayment, then the partnership may use only the §6226 amended statement procedure.

Observation: The New Rules are silent as to whether a partnership may initiate litigation if the IRS disallows the adjustments in an AAR.

Partnerships may file an AAR no later than three years after the date on which the partnership filed its return, or the last day for filing the partnership return for the year (without regard to extension), whichever is later.[99] In no event may the partnership file an AAR after a notice of administrative proceeding with respect to the taxable year is mailed under §6231.[100]

Observation: Under TEFRA, any partner could file an AAR on its own behalf.[101]

Under the New Rules, a partner's only opportunity to dissent is to treat a partnership item on its return inconsistently with the partnership return and to file a statement with the IRS identifying the inconsistent treatment. It is not clear whether the inconsistent treatment and statement thereof can be made on and filed with a partner's amended return.

F. Notices

Pursuant to the New Rules, the IRS must mail to the partnership and the partnership representative: (1) notice at the beginning of any administrative proceeding, (2) notice of any proposed partnership adjustment, and (c) notice of any final adjustment.[102] Any notice of final partnership adjustment cannot be mailed earlier than 270 days after the date on which the notice of proposed adjustment was mailed.[103] If the partnership files a petition for judicial review of the notice of final partnership adjustment, the IRS is precluded from issuing another notice with respect to that taxable year, absent showing of fraud, malfeasance, or misrepresentation.[104] A notice of partnership adjustment may be rescinded with the consent of the partnership.[105] If rescinded, the notice is treated as if it were never issued, which allows the IRS to issue a notice at a later time.[106]

Observation: Under TEFRA, should the IRS fail to timely mail the requisite notice to a partner, the remedy was that the partner could elect out of TEFRA, and its items would be determined in a partner-level proceeding.[107] It is unclear what remedy, if any, exists under the New Rules should the IRS fail to timely mail a notice to the partnership. Moreover, under TEFRA, the IRS could issue only one notice of final partnership adjustment (FPAA) and thus had no ability to rescind the FPAA and issue another. This limitation on the IRS generated unnecessary litigation. For example, when the IRS identified a potential partnership it suspected worthy of partnership items adjustments close to the expiration of the statute of limitations, it would issue an FPAA to protect the statute and preserve any potential issue. Thus, matters (or at least issues within the overall matters) that could well have been resolved during the IRS administrative process wound up as undeveloped cases in expensive litigation.

G. Assessment, Collection, and Payment

As discussed above, imputed underpayments will be assessed and collected like regular income taxes.[108] The New Rules provide for one exception in the case of AARs where the partnership does not elect to shift the liability to the partners under rules similar to those in §6226. In this instance, the imputed underpayment must accompany the AAR when filed.[109]

No assessment may be made before the 90th day after the day on which the notice of final partnership adjustment was mailed or, if a petition for judicial re-

[95] BBA §6227(a).

[96] BBA §6227(b)(1).

[97] BBA §6227(b)(2).

[98] *Id.*

[99] BBA §6227(c).

[100] *Id.*

[101] TEFRA §6226(d).

[102] BBA §6231(a)(1), §6231(a)(2), §6231(a)(3).

[103] BBA §6231(a).

[104] BBA §6231(b).

[105] BBA §6231(c).

[106] *Id.*

[107] *See* TEFRA §6223(e); Reg. §301.6223(e)-2.

[108] BBA §6232(a).

[109] *Id.*

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view was filed under §6234, the decision of the court has become final.[110] Finally, in instances where no proceeding was brought under §6234 during the 90-day period, the amount for which the partnership is liable under §6225 cannot be increased.[111]

H. Judicial Review

A partnership that receives a notice of a final partnership adjustment under §6231 may file a petition with respect to the adjustments within 90 days.[112] The partnership may petition the Tax Court,[113] the district court of the United States for the district in which the partnership's principal place of business is located,[114] or the United States Court of Federal Claims.[115] In instances where the partnership seeks to file an action in the latter two of the three options listed above, the partnership must deposit the imputed underpayment with the IRS as a prerequisite.[116]

The court in which an action is filed has the jurisdiction to determine all partnership items, including allocations, as well as penalties and additions to tax.[117]

Observation: Under TEFRA, any notice partner could seek judicial review and all partners could become notice partners either by forming a notice group or by timely providing information to the IRS. Further, TEFRA did not require a full payment as a prerequisite to refund litigation. Rather, under TEFRA, only the partner who filed the claim had to its pay tax due. Commonly, litigation was pursued by the partner with smallest tax liability. This partner would pay the requisite liability and then file the refund action. Given the barrier that full payment could present for some partnerships or taxpayers, under the New Rules it is likely that actions in Tax Court may become more prevalent.

I. Statute of Limitations

The New Rules simplified the statute of limitations for making adjustments by providing that the period of limitations runs at the partnership level. This period will expire on the later of:

1. The date that is three years after the latest of: (a) the date on which the partnership return for the taxable year is filed,[118] (b) the return due date,[119] or (c) the date on which the partnerships filed an AAR,[120] or
2. If the imputed underpayment was modified under §6225(c) for a reduction due to tax-exempt partners, special rates or amended returns with payment by partners, the date 270 days after all of required information was submitted to the IRS,[121] or
3. 330 days after the date of any notice of proposed partnership adjustment.[122]

The New Rules contain provisions similar to those governing other returns, including the ability of the IRS and the partnership to extend the statute by mutual consent,[123] the unlimited period of limitations in instances of a fraudulent return,[124] or a failure to file a return,[125] and the six-year statute in instances where the partnership has a substantial omission from gross income under §6501(e)(1)(A).[126]

In instances where a notice of final partnership adjustment is mailed, the statute is suspended for the period during which a petition may be filed under §6234, and, if filed, until the court's decision is final, and for one year after.[127]

Observation: Under TEFRA, the courts were split as to whether one partnership-level statute of limitations applied to the adjustment of partnership items. In fact, the TEFRA statute of limitations rules have been labeled as ''without question, TEFRA's most litigated and significant unresolved issue of statutory interpretation.''[128] Nearly 10 years ago, one commentator went so far as to suggest that, at that point in time, over 10,000 hours and $100 million in fees and other costs had been spent studying, auditing, and litigating the correct meaning of the TEFRA assessment provision in old §6229.[129] Under the New Rules, it is clear that there is only one partnership-level statute of limi-

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[110] BBA §6232(b).
[111] BBA §6232(e).
[112] BBA §6234(a).
[113] BBA §6234(a)(1).
[114] BBA §6234(a)(2).
[115] BBA §6234(a)(3).
[116] BBA §6234(b).
[117] BBA §6234(c).
[118] BBA §6235(a)(1)(A).
[119] BBA §6235(a)(1)(B).
[120] BBA §6235(a)(1)(C).
[121] BBA §6235(a)(2).
[122] BBA §6235(a)(3). As originally enacted, the Bipartisan Budget Act provided for 270 days after the date of any notice of proposed partnership adjustment. The PATH Act provided a technical correction amending §6235(a)(3) to strike ''270 days'' and insert ''330 days.'' Pub. L. No. 114-113, Div. Q, §411(c).
[123] BBA §6235(b).
[124] BBA §6235(c)(1).
[125] BBA §6235(c)(3).
[126] BBA §6235(c)(2).
[127] BBA §6235(d)(1), §6235(d)(2).
[128] Petition for a Writ of Certiorari at 16, *Irvine v. United States*, 134 S. Ct. 1777 (2014), 2014 WL 825177, at *16.
[129] Darryll K. Jones, *The Labyrinthine and Expensive Partner Limitations Period*, 112 Tax Notes (TA) 681, 683 (Aug. 21, 2006).

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tations. This clarity will eliminate the procedural confusion and resulting litigation that occurred under TEFRA regarding the applicable statute of limitations.

Observation: Additionally, it is interesting that the New Rules permit the triggering of a new three-year period of limitations by the filing of an AAR. Contrast this approach with a different approach taken with respect to the statute of limitations as it applies to an amended return of a corporate or individual taxpayer. In instances where a Form 1120X or 1040X is filed, the statute of limitations is not extended for an additional period, with the limited exception found in §6501(c)(7). In this limited instance, an amended return filed within the 60-day period prior to the expiration of the period of limitations on assessment reflects that the taxpayer owes an additional amount of tax, the period for assessment is then extended 60 days from the date the IRS receives the amended return.[130]

IV. CONSIDERATIONS IMPACTING PARTNERSHIPS AND THEIR PARTNERS GOING FORWARD AND CONCLUDING THOUGHTS

As a result of the New Rules, all existing partnership agreements must be modified, and all new agreements should be drafted with the new regime in mind. While there will be additional considerations to be taken into account once the IRS issues implementing guidance and regulations, there are many threshold issues that a partnership and its partners should begin to consider now.

Depending on the partner's role *vis-à-vis* the partnership, the focus when considering changes prompted by the New Rules may differ. For example, in the context of an investment fund, the sponsor will likely focus on retaining flexibility and control given the absence of guidance on how the New Rules will ultimately work. An investor, on the other hand, will focus on ensuring that it does not bear tax liabilities, directly or indirectly, that are inconsistent with its tax status, as well as retaining information and consent rights.

As the IRS begins to issue guidance, common terms will emerge. One set of likely terms will address the applicability of the New Rules and the ability to elect out, including whether the partnership will elect out of the regime, and whether its members will be limited in a manner to ensure the partnership remains eligible to elect out. Along with these provisions, partnerships will need to consider whether a set of information-sharing provisions is necessary, such as requiring partners to share information regarding their classification[131] and the identity of any ultimate owner.[132] A second set of likely terms will center on governance, specifically, the role of the partnership representative, including how one is appointed, removed and replaced, and criteria for the role and duties of the position. An additional set of terms will likely address the implications of an imputed underpayment and how it is treated for capital account maintenance to ensure that the payment is properly allocated to the partners who should bear the burden of the tax,[133] as well as mechanisms to shift liability from the partnership to the partners, including the election under §6226. Common to all of these terms will be provisions determining a partner's right to notice, participation, and consent, which may serve to limit specified actions that could otherwise be taken by the partnership representative, such as the power to extend the statute of limitations, concede or settle proposed adjustments, initiate litigation, or elect out of the partnership payment default rule.

In addition to causing modifications or new considerations for partnership agreements, the New Rules will also cause partners to engage in strategies to reduce their exposure in connection with purchases or transfers of partnership interests. In order to avoid inheriting a partner's tax liabilities from past years, a transferee partner will need to engage in more due diligence in reviewing a partnership's tax and audit history. Further, a transferee partner may require (i) an indemnification from the transferor partner or partnership, (ii) a reserve or escrow fund to be established, or (iii) the partnership to elect out of the default rule requiring a partnership-level payment of tax.

While important to understand the New Rules as well as appreciate the differences from the TEFRA regime, the path forward will remain unclear until implementing guidance is issued and partnerships, their partners, and the IRS begin to function within the framework that is provided. Will the New Rules and their far simpler approach to audit and collection of resulting liabilities indeed result in the $9.3 billion in revenue over the next 10 years? In the end, the devil *is* in the details, and only time will tell if the New Rules have provided the much needed salvation.

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130 §6501(c)(7).

131 For example, whether a partner is a tax-exempt entity.

132 This would be relevant if a partner is an S corporation.

133 For example, if the partnership is paying the imputed underpayment of tax, and such tax has been reduced due to the presence of tax-exempt partners, the allocation provisions and capital account maintenance provisions should be drafted to ensure that the tax-exempt partners receive the benefit attributable to their status.

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