The New Partnership Audit Rules—Turning the Taxation of Partnerships upside down

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Introduction

The rules governing federal income tax audits of partnerships will soon undergo fundamental and substantial change. The partnership tax world as we know it—in which partnerships are not subject to entity-level payment of federal income tax resulting from an Internal Revenue Service (IRS) audit adjustment—will soon be replaced. Under the new rules, a partnership generally will be subject to entity-level assessment and collection of tax resulting from an IRS audit, unless that partnership affirmatively elects different treatment for the tax year at issue.

The new partnership audit rules (New Rules) were enacted pursuant to the Bipartisan Budget Act of 2015, Pub. L. No. 114-74 (Budget Act), as corrected and clarified by the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113.[1] The Budget Act was enacted on November 2, 2015. It provides that the New Rules are generally effective for returns filed for partnership tax years beginning after December 31, 2017.[2] The New Rules are not yet effective and generally will not apply until the 2018 tax year.

There is an exception through which a partnership may elect to apply the New Rules to any partnership tax return filed for a partnership taxable year beginning after November 2, 2015.[3] The New Rules could be currently relevant to a partnership that affirmatively elects to apply them.

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[1] The New Rules refer to the I.R.C. §§ 6221 through 6241 that will be effective for tax years beginning after December 31, 2017.

[2] *See* Budget Act, § 1101(c)(1).

[3] *See id.*, § 1101(g)(4).

Why the New Rules Are Important

Even without an election to presently apply the New Rules, it is very important that tax advisors understand the manner in which the New Rules will change partnership taxation for the following three primary reasons.

1. The New Rules create a new position—the Partnership Representative which replaces the Tax Matters Partner (TMP) under the existing TEFRA (Tax Equity and Fiscal Responsibility Act of 1982) partnership audit procedures, The Partnership Representative carries a tremendous amount of power and can cause significantly different tax effects for current and former partners. Because of the Partnership Representative's unilateral authority to bind current and former partners of the partnership in a federal tax matter, it is important that partners start considering now who would be best suited for serving as the Partnership Representative.

2. The New Rules provide a default rule and an electable exception that result in drastically different tax effects to different current and former partners. As the effective date for the New Rules draws closer, partners may turn to the partnership's outside tax advisor for guidance regarding whether to acquiesce in the default rule or affirmatively elect to apply the exception. Different partners may have different interests in making that determination.

3. The New Rules contain open issues and traps for the unwary that have not yet been addressed by Treasury Regulations (Regulations) or other guidance. There are certain statutory provisions within the New Rules that can be interpreted as causing double taxation of the same adjustment. Until it is seen how the Treasury Department (Treasury) decides to address these issues, it is important to be aware of these potential traps in advising partners whether to apply the default rule or elected exception.

The General Effect of the New Rules

Section 6221 of the New Rules contains the general rule regarding partnership audits and resulting tax liability. It provides that any IRS adjustment to a partnership's tax item (i.e., income, gain, loss, deduction or credit) shall be determined, and the resulting tax shall be assessed and collected at the partnership level.[4] The partnership level assessment and

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[4] *See* I.R.C. § 6221(a) (2018).

collection of tax is an extreme departure from the treatment of partnerships under the audit rules that currently govern most partnerships (TEFRA Rules).[5] Under the TEFRA Rules, the tax of a partnership adjustment is collected from the partners of that partnership.

The Election out from the Applicability of the New Rules

Section 6221 contains criteria for partnerships that are eligible to elect out from the applicability of the New Rules.[6] If a partnership elects out of the New Rules, the tax liability resulting from ownership of an interest in a partnership will be determined at the partner level under present-law rules for deficiency proceedings. The TEFRA Rules will not apply in the event of an election out of the New Rules because the New Rules effectively repeal the TEFRA Rules.

A partnership is eligible to elect out of the New Rules, provided that the following five requirements are satisfied.

1. The partnership must affirmatively elect out of the New Rules for each specific tax year for which it does not wish to be subject to the New Rules.[7] Thus, an election out, once made for a specific partnership tax year, does not apply to any future years. Instead, the partnership must separately make the election out for each subsequent year for which it wishes to avoid application of the New Rules.

2. The partnership is eligible to elect out of the New Rules only if it is required to furnish no more than 100 Schedules K-1 to its partners.[8] There are currently ambiguities regarding the manner in which this 100 Schedule K-1 limit will apply. For example, if a married couple is treated as each owning an interest in a partnership pursuant to community property laws, will the partnership be treated as issuing one or two Schedules K-1 for purposes of the 100 Schedule K-1 limit? In addition, if an individual owns his/her interest in the

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[5] The TEFRA Rules refer to the currently applicable I.R.C. §§ 6221-6234 that were enacted under the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. No. 97-248) and that currently govern IRS audits of most partnerships.

[6] *See* I.R.C. § 6221(b) (2018).

[7] *See* I.R.C. § 6221(b)(1)(A) (2018).

[8] *See* I.R.C. § 6221(b)(1)(B) (2018).

partnership through an entity disregarded for federal income tax purposes (or a grantor trust), will the partnership be treated as issuing one Schedule K-1 to that partner or two separate Schedules K-1—one to the individual, and the other to the disregarded entity (or grantor trust)? Practitioners must wait to see whether these issues are addressed in forthcoming Regulations.

3. A partnership is eligible to elect out of the New Rules only if each partner is either: (1) an individual, (2) a Subchapter C Corporation, (3) any foreign entity that would be treated as a C Corporation if it were domestic, (4) a Subchapter S Corporation, or (5) an estate of a deceased person.[9] Notably, the aforementioned list does not include partnerships or trusts. Thus, according to the statutory language, a partnership will not be eligible to elect out of the New Rules if it has a partner that is itself a partnership or a trust. Congress, however, has authorized Treasury to prescribe election out rules for partnerships with other types of partners that are not explicitly listed as eligible partners under the New Rules.[10] Therefore, it is possible that forthcoming Regulations may provide for limited election out by a lower-tier partnership that has an upper-tier partnership or trust as its partner. Additionally, it is unclear whether a partnership will be eligible to elect out if it has an individual (or other type of eligible partner) who owns his/her interest in the partnership through a disregarded entity or grantor trust. It makes sense, conceptually, that the disregarded entity or grantor trust would be disregarded for the purpose of determining whether the partnership is eligible for the election out, but additional guidance from Treasury is needed for certainty on this issue.

4. The election out must be made with a timely return filed for the partnership tax year for which it is to take effect.[11] The election out must also include a disclosure of the name and taxpayer identification number of each partner of the partnership.[12]

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[9] *See* I.R.C. § 6221(b)(1)(C) (2018).

[10] *See* I.R.C. § 6221(b)(2)(C) (2018).

[11] *See* I.R.C. § 6221(b)(1)(D) (2018).

[12] See id.

5. The partnership must provide notice to each partner of the election out in the manner prescribed by Treasury.[13] Even if the partnership properly makes the election in its timely filed return and otherwise meets the criteria of eligibility for the election out, the partnership may still be subject to the New Rules if it fails to provide the requisite notice of the election out to its partners.

The statutory provisions involving the election out contain some special rules for partnerships with S Corporation partners.[14] The partnership is treated as meeting the eligibility criteria for the election out only if the partnership includes a disclosure of the name and taxpayer identification number of each person to whom the S Corporation partner is required to furnish a Schedule K-1 for the relevant tax year.[15] For purposes of determining whether the partnership satisfies the 100 Schedule K-1 limit, each of the Schedules K-1 issued by the S Corporation partner to its shareholders is counted towards that 100 schedule limit.[16] A partnership with an S Corporation partner that has two individual shareholders will be treated as issuing three Schedules K-1 that will count towards the 100 schedule limit—the first Schedule K-1 is issued from the partnership to the S Corporation partner, and two more Schedules K-1 are issued from the S Corporation to its shareholders.

The Partnership Representative

Under the New Rules, the partnership must designate a Partnership Representative to handle tax matters with the IRS.[17] The Partnership Representative is similar to TMP under the TEFRA Rules, but the Partnership Representative, in some ways, has broader authority than the TMP. The Partnership Representative is the only person who has authority to act on behalf of a partnership during a partnership audit.[18] Significantly, the

[13] *See* I.R.C. § 6221(b)(1)(E) (2018).

[14] *See* I.R.C. § 6221(b)(2)(A) (2018).

[15] *See* I.R.C. § 6221(b)(2)(A)(i) (2018).

[16] *See* I.R.C. § 6221(b)(2)(A)(ii) (2018).

[17] I.R.C. § 6223(a) (2018).

[18] See id.

Partnership Representative's actions are binding on all former and current partners.[19]

The Partnership Representative may be a partner (or other person) with a substantial presence in the United States.[20] A "substantial presence" is not defined for this purpose, and it will be interesting to learn whether Treasury utilizes the "substantial presence" test of I.R.C. § 7701(b)(3) (basically, at least 183 days of presence within the U.S. during the relevant year) for purposes of determining eligibility to serve as the Partnership Representative. Notably, the Partnership Representative is not required to be a partner of the partnership.[21] This is in contrast to the TMP, who is required to be a partner in the partnership.[22]

It will be very important for a partnership to designate its Partnership Representative. If it does not, the New Rules authorize Treasury to "select any person" as Partnership Representative for the partnership.[23] The New Rules do not place any limitation on the scope of persons from whom Treasury may select as Partnership Representative. If the partnership does not select its own Partnership Representative, Treasury will end up with unlimited discretion to designate the individual who will have the unilateral authority to make all decisions in the tax matter that will be binding on the partnership and its partners.

It cannot be emphasized enough that partners should start considering now the individual whom they think is best suited to serve as Partnership Representative on their behalf in the future. This is because of: (1) the broad power that will be held by the Partnership Representative; (2) the important economic consequences the Partnership Representative's decisions can have on current and former partners, which may favor one segment of partners to the detriment of a different segment of partners; and (3) Treasury's unlimited ability to designate the Partnership Representative in the absence of a designation by the partnership.

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[19] *See* I.R.C. § 6223(b) (2018).

[20] See id.

[21] *See* I.R.C. § 6223(a) (2018).

[22] *See* I.R.C. § 6231(a)(7) (2018).

[23] I.R.C. § 6223(a) (2018).

Notices of IRS Proceedings and Adjustments

The New Rules require Treasury to mail to the partnership and Partnership Representative certain notices relating to the partnership audit.[24] The required notices include: (1) a notice of any administrative proceeding (NAP) initiated at the partnership level with respect to an adjustment of a partnership item or any partner's allocable share thereof, (2) a notice of any proposed partnership adjustment (NPPA) resulting from the proceeding, and (3) a notice of any final partnership adjustment (NFPA) resulting from the proceeding.[25] At least 270 days must pass between the dates on which the NPPA and the NFPA are mailed.[26] In addition, if the partnership files an administrative adjustment request (AAR), the IRS cannot mail the NFPA until at least 270 days have passed from the mailing of the AAR.[27]

The New Rules do not contain any obligation on the part of any person to provide notice to the partners or otherwise keep them informed of the partnership audit. The TEFRA Rules, in contrast, require that Treasury generally must provide notice to each partner regarding the beginning of an administrative proceeding at the partnership level and the final partnership administrative adjustment resulting from that proceeding.[28] The TEFRA Rules and underlying Regulations also require the TMP to keep each partner informed of all administrative and judicial proceedings relating to the partnership adjustment.[29]

The Partnership Representative, in some ways, has more authority than the TMP. The partners may want to amend the partnership agreement before the effective date of the New Rules to impose obligations on the Partnership Representative to provide notices to the partners of certain events within the IRS proceeding, such as certain notices required under the TEFRA Rules. The partners could also choose to amend the partnership agreement to impose on the Partnership Representative the obligation to provide notices to the

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[24] *See* I.R.C. § 6231(a) (2018).

[25] See id.

[26] See id.

[27] See id.

[28] *See* I.R.C. § 6223(a).

[29] *See* I.R.C. § 6223(g); Treas. Reg. § 301.6223(g)-1.

current partners, as well as those persons who were partners during the year that is the subject of the IRS proceeding but are no longer partners.

Partnership-Level Adjustment

For purposes of making partnership adjustments, the New Rules introduce two new terms to the Code: the "Reviewed Year" and the "Adjustment Year." The Reviewed Year is defined as the partnership tax year in which the item being adjusted relates.[30] The Adjustment Year is generally defined as the year in which the NFPA is mailed unless the adjustment relates to an AAR or the partnership initiates judicial proceedings contesting the adjustment.[31] In these latter two cases, the Adjustment Year is defined as the year in which the AAR is made or the year in which the court decision is final, respectively.[32]

If the IRS makes an adjustment to a partnership item of income, gain, loss, deduction, or credit, or to a partner's distributive share from the partnership, the general rule is that the partnership is required to pay an "imputed underpayment" in the Adjustment Year (General Method).[33] Conversely, if the adjustment does not result in an imputed underpayment, the partnership must take into account the appropriate adjustment in the Adjustment Year as a reduction in non-separately stated income or as an increase in non-separately stated loss (whichever is appropriate) unless the adjustment is a credit, in which case it is taken into account as a separately stated item.[34]

If the composition of the partners in the partnership has changed since the Reviewed Year, the General Method may result in a mismatch between the partners who originally obtained the tax benefit in the Reviewed Year and the partners who bear the economic burden of the tax resulting from the IRS

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[30] I.R.C. § 6225(d)(1) (2018). The persons who were partners in the partnership during the Reviewed Year are hereafter referred to as the "Reviewed Year Partners."

[31] I.R.C. § 6225(d)(2) (2018). The persons who were partners in the partnership during the Adjustment Year are hereafter referred to as the "Adjustment Year Partners."

[32] See id.

[33] I.R.C. § 6225(a)(1) (2018).

[34] *See* I.R.C. § 6225(a)(2) (2018).

adjustment in the Adjustment Year. This potential mismatch, however, may be addressed through either the Amended Return Procedure or Push Out Election, which impose the tax burden of the IRS adjustment on the Reviewed Year Partners who obtained the tax benefit that was later disallowed.

For purposes of calculating the imputed underpayment under the General Method, all net adjustments to items of income, gain, loss, or deduction are generally multiplied by the highest tax rate in effect for the Reviewed Year as applicable to an individual or corporation.[35] In addition, if the adjustment results in a reallocation of the distributive share of any item from one partner to another, the adjustment must be taken into account by disregarding any decrease in items of income or gain and increases in items of deduction, loss, or credit.[36] Unless the partnership utilizes procedures to modify the imputed underpayment amount, as discussed below, a reallocation of a tax item could result in a tax liability imposed at the partnership level for tax that was already paid by the partner to whom the income was misallocated.

Under the New Rules, Treasury is required to establish procedures in which the imputed underpayment amount is modified under the General Method. Although Treasury is provided some discretion in establishing these procedures, some modifications to the imputed underpayment are required to be taken into account in the following situations.

1. Treasury is directed to modify the imputed underpayment amount if: (1) one or more Reviewed Year Partners file amended returns fully reflecting the adjustments made by the IRS; and (2) those Reviewed Year partners filing amended returns pay the tax associated with those returns (Amended Return Procedure).[37] However, if the adjustment reallocates the distributive share of any item from one partner to another, the Amended Return Procedure only applies if all partners affected by the reallocation adjustment in the Reviewed Year file amended returns.[38] Notably, under the Amended Return Procedure, the general three-year statute of limitations period for a claim for refund does not apply.[39]

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[35] *See* I.R.C. § 6225(b)(1)(A) (2018).

[36] *See* I.R.C. § 6225(b)(2) (2018).

[37] *See* I.R.C. § 6225(c)(2) (2018).

[38] *See* I.R.C. § 6225(c)(2)(B) (2018).

[39] *See* I.R.C. § 6225(c)(2)(A)(i) (2018).

2. Treasury is directed to establish procedures in which the imputed underpayment will be modified if the partnership can establish that the imputed underpayment would be subject to a rate of tax that is less than the maximum rate that would otherwise apply under the general rule. The partnership may be able to establish that the imputed underpayment can be reduced by demonstrating that the partnership income would have been ordinary income allocable to a partner who is a C Corporation, or a long-term capital gain, or qualified dividend allocable to a partner who is an individual including an S Corporation.[40]

3. Treasury is directed to establish procedures to apply where the partnership has a tax-exempt partner.[41] The calculation of the imputed underpayment is to be made without regard to the portion of the underpayment allocable to that tax-exempt partner.[42]

To qualify for a modified imputed underpayment, the partnership must submit any information or documentation supporting the modification to the IRS within 270 days of issuance of the NPPA unless the IRS agrees to an extension of time.[43] Significantly, any modification to the imputed underpayment is to be made only upon approval by the IRS.[44]

The "Push Out" Election

Rather than pay the imputed underpayment, the partnership may alternatively elect to transfer the partnership's tax obligation to its Reviewed Year Partners through making a timely election (Push Out Election).[45] If the Push Out Election is made, it is irrevocable unless the IRS agrees to revoke it.[46]

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[40] *See* I.R.C. § 6225(c)(4) (2018).

[41] *See* I.R.C. § 6225(c)(3) (2018).

[42] See id.

[43] *See* I.R.C. § 6225(c)(6) (2018).

[44] *See* I.R.C. § 6225(c)(7) (2018).

[45] *See* I.R.C. § 6226(a) (2018).

[46] *See* I.R.C. § 6226(a)(2) (2018) (flush language).

To make a valid Push Out Election, the partnership must: (1) make the election within 45 days after the date in which the NFPA is issued; and (2) furnish each Reviewed Year Partner and the IRS with a statement of that Reviewed Year Partner's share of any adjustments to income, gain, loss, deduction or credit as determined in the NFPA.[47] After the Push Out Election is made, the Reviewed Year Partners' taxes are increased by the aggregate of the adjustments as shown on the statements.[48] More specifically, if the adjustments relate to a taxable year of the partner that includes the Reviewed Year, the amount of tax owed is determined according to how the adjustments would *increase* the partner's tax liability for that taxable year.[49] If the adjustments relate to a taxable year of the Reviewed Year Partner that occurs after the Reviewed Year but prior to the Adjustment Year (Affected Year), then the amount of taxes owed is determined according to how that Reviewed Year Partner's tax would *increase* as a result of adjustments made to the Reviewed Year Partner's tax attributes.[50]

Because the statute only allows a Reviewed Year Partner to take into account increases in tax liability in determining the amount of his/her adjustment, the Push Out Election could lead to instances of double taxation. Consider, for example, a partner who is allocated a $500,000 deduction from a partnership in 2018 (which reduces that partner's outside basis) and sells the partnership interest for a $500,000 gain in 2019. If the IRS in 2020 makes an adjustment disallowing the $500,000 deduction for 2018 and the partnership utilizes the Push Out Election, the partner would owe additional tax in connection with that disallowance for 2018.

Conceptually, that partner should be allowed to increase the outside basis to take into account that the $500,000 deduction was disallowed. This increase in outside basis would prevent the recognition of taxable gain in 2019 from the sale of the partnership interest. In this manner, the increase in outside basis would prevent double taxation in connection with the same adjustment: once for 2018 in connection with the loss disallowance; and again for 2019 upon the sale of the partnership interest.

The statute provides, however, that the partner can only take into account adjustments for 2019 (an Affected Year) that would increase tax liability for

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[47] *See* I.R.C. § 6226(a)(1), (2) (2018).

[48] *See* I.R.C. § 6226(b)(1) (2018).

[49] *See* I.R.C. § 6226(b)(2)(A) (2018).

[50] *See* I.R.C. § 6226(b)(2)(B) (2018).

that year.[51] As a result, the partner may not be able to claim a refund for 2019 and may be taxed twice in connection with the $500,000 loss disallowance.

Compared to the imputed underpayment procedure of I.R.C. § 6225, the Push Out Election results in an effective transfer of the economic burden of the tax liability from the Adjustment Year Partners to the Reviewed Year Partners. Some of the Reviewed Year Partners may no longer be partners and may have no say whatsoever regarding whether the partnership will elect the Push Out Election.

Administrative Adjustment Requests

Under the TEFRA Rules, the TMP or a partner of the partnership could generally file an AAR.[52] The New Rules permit the filing of an AAR but only through the Partnership Representative.[53] The method in which the partnership adjustment is made depends on whether the adjustment results in an imputed underpayment or not.

If the AAR results in an imputed underpayment, any adjustment is determined and taken into account in the Adjustment Year under rules similar to those provided in I.R.C. § 6225 and I.R.C. § 6226.[54] In other words, the partnership may pay the imputed underpayment resulting from an AAR or elect to transfer the associated tax underpayment liability to its partners. If the partnership decides to pay the imputed underpayment resulting from an AAR, the Amended Return Procedure discussed above does not apply.[55] If the partnership elects to push out the imputed underpayment to its partners under rules similar to I.R.C. § 6226, the increased interest provision of I.R.C. § 6226(c)(2)(C) does not apply.[56]

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[51] See id.

[52] *See* I.R.C. § 6227.

[53] *See* I.R.C. § 6227 (2018).

[54] *See* I.R.C. § 6227(b) (2018).

[55] *See* I.R.C. § 6227(b)(1) (2018).

[56] *See* I.R.C. § 6227(b)(2) (2018).

On the other hand, if the AAR does not result in an imputed underpayment, the partnership is required to follow procedures similar to the Push Out Election under I.R.C. § 6226.[57]

Under the New Rules, an AAR must be filed within three years after the later of: (1) the date the partnership return was filed, or (2) the due date for the partnership return (without extensions).[58] In addition, no AAR may be filed after the IRS issues a NAP.[59]

Interest and Penalties

Under the Push Out Election, any penalties, additions to tax, or other additional amounts are determined at the partnership level and are to be paid by the partners.[60] Further, any interest on the imputed underpayment is determined at the partner level from the due date of the Reviewed Year partnership return taking into account any increase in tax attributable to changes in tax attributes for other tax years of the partners.[61] The interest rate charged to the partners on the underpayment is at the rate specified in I.R.C. § 6221(a)(2) except "5 percentage points" is substituted for "3 percentage points."[62]

If the Push Out Election is not applicable, two periods are relevant in determining the total amount of interest due. The first is the period in which the imputed underpayment of income tax exists, and the second is the period after notice and demand during which the imputed underpayment has not been paid.

For the first period during which the imputed underpayment exists, interest is computed beginning on the day after the return due date for the Reviewed Year and ending on the return due date for the Adjustment Year,

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[57] *See* I.R.C. § 6227(b)(2) (2018) (flush language).

[58] *See* I.R.C. § 6227(c) (2018).

[59] *See* I.R.C. § 6227(c)(2) (2018).

[60] *See* I.R.C. § 6226(c)(1) (2018).

[61] *See* I.R.C. § 6226(c)(2) (2018).

[62] *See* I.R.C. § 6226(c)(2)(C) (2018).

unless, the imputed underpayment is made earlier.[63] For the second period, if the imputed underpayment is not timely paid with the partnership's tax return for the Adjustment Year, the partnership is liable for interest calculated by treating the imputed underpayment as an underpayment of tax imposed in the Adjustment Year.[64]

In addition, if the partnership adjustment relates to the Reviewed Year, any penalty, addition to tax, or additional amount must be determined at the partnership level as if the partnership had been an individual subject to tax under chapter 1 of the I.R.C. for the Reviewed Year, and the imputed underpayment was an actual underpayment (or understatement) for such year.[65] If the partnership adjustment relates to an adjustment in the Adjustment Year, any penalty, addition to tax, or additional amount are determined by applying I.R.C. § 6651(a)(2) to such failure to pay, and by treating the imputed underpayment as an underpayment of tax for purposes of the accuracy-related and fraud penalties.[66]

Consistency Requirement

The New Rules require partners to treat each item of income, gain, loss, deduction, or credit attributable to the partnership in a manner which is consistent with how those items are treated on the partnership return.[67] If a partner reports an item inconsistently, the New Rules permit the Secretary to assess and collect the underpayment of tax under the summary assessment procedures of I.R.C. § 6213(b)(1). In other words, the resulting underpayment of tax may be assessed and collected as if the item was a mathematical or clerical error, and the IRS is permitted to make the assessment on a summary basis without affording the partner the option to challenge the assessment.[68] Additionally, the New Rules permit the IRS to impose an addition to tax against the partner for the inconsistent reporting.[69]

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[63] *See* I.R.C. § 6233(a) (2018).

[64] *See* I.R.C. § 6233(b) (2018).

[65] *See* I.R.C. § 6233(a)(3) (2018).

[66] *See* I.R.C. § 6233(b)(3) (2018).

[67] *See* I.R.C. § 6222 (2018).

[68] *See* I.R.C. § 6222(b) (2018).

[69] *See* I.R.C. § 6222(e) (2018).

There are numerous exceptions, however, to the IRS's ability to summarily assess and collect the tax under I.R.C. § 6213(b)(1). First, if the partnership has filed a return but the partner's treatment on his or her return is (or may be) inconsistent with the treatment of the item on the partnership return, the partner may file with the IRS a statement identifying the inconsistency.[70] Second, if the partnership has not filed a return, the partner may also file with the IRS a statement identifying the inconsistent treatment.[71] Third, if the partner can demonstrate to the IRS's satisfaction that the treatment of the item on the partner's return is consistent with the treatment of the item in a statement furnished to the partner by the partnership and makes an election, then the partner is to be treated as having filed a statement identifying the inconsistency.[72]

Any final decision made with respect to an inconsistent position in a proceeding in which the partnership is not a party is not binding on the partnership.[73]

The Statute of Limitations

The New Rules provide a limitations period within which the IRS generally must make an adjustment for any partnership tax year.[74] Specifically, the limitations period for making an adjustment generally expires on the later of:

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[70] *See* I.R.C. § 6222(c) (2018).

[71] See id.

[72] *See* I.R.C. § 6222(c)(2) (2018).

[73] *See* I.R.C. § 6222(d) (2018).

[74] *See* I.R.C. § 6235(a) (2018).

1) The date which is three years after the latest of:
   (a) The date on which the partnership return for such taxable year was filed,
   (b) The return due date for the taxable year,
   (c) The date on which the partnership filed an AAR with respect to the relevant tax year.
2) In the case of any NPPA, the date that is 330 days (plus the number of days of any extension to which the Treasury Secretary has consented) after the date of that notice.[75]

The statute of limitations for an adjustment also contains a special rule in the event that the imputed underpayment is modified in accordance with I.R.C. § 6225(c). The limitations period does not expire until 270 days after the date on which the partnership has submitted to Treasury all information required to be submitted in connection with the modification of the imputed underpayment.[76]

The New Rules also enable the partnership and Treasury to agree to extend the limitations period for making an adjustment, provided that the extension agreement is entered into while the limitations period is still open.[77] There is no statute of limitations for making a partnership adjustment if: (1) the partnership filed a false or fraudulent return with intent to evade tax, or (2) the partnership failed to file any return for that tax year.[78] A six-year statute of limitations applies if the partnership made a substantial omission of gross income from the partnership's return under I.R.C. § 6501(e)(1)(A).[79]

If the IRS issues a NPPA, the statute of limitations for making the adjustment will not expire until 330 days after the date of the notice.[80] The New Rules, however, do not explicitly establish any time frame by which the Service must issue the NPPA. Hopefully, forthcoming Regulations will

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[75] See id.

[76] See id.

[77] *See* I.R.C. § 6235(b) (2018).

[78] *See* I.R.C. § 6235(c)(1), (3) (2018).

[79] *See* I.R.C. § 6235(c)(2) (2018).

[80] *See* I.R.C. § 6235(a)(3) (2018).

impose a reasonable time frame in which the NPPA must be issued in connection with a particular partnership tax year.

If the IRS issues a NFPA, the statute of limitations period is generally suspended for the period during which a judicial action may be brought.[81] If a petition or complaint for judicial review is filed by the partnership, the statute of limitations is suspended until one year after the decision of the applicable court becomes final.[82]

Judicial Review of Partnership Adjustments

The IRS is generally precluded from assessing any underpayment of tax and initiating collection efforts until 90 days after the day on which the NFPA was mailed, and if the partnership files a petition, until the decision of the court has become final.[83]

Similar to the existing TEFRA rules, the New Rules afford the partnership three avenues to contest the proposed adjustment in the NFPA. The partnership may file a petition or complaint within 90 days after the date of the NFPA with: (1) the United States Tax Court, (2) the federal district court in which the partnership has its principal place of business, or (3) the U.S. Court of Federal Claims.[84] If the partnership elects to contest the tax in the federal district court or the U.S. Court of Federal Claims, it is required to deposit with the IRS the amount of the imputed underpayment on or before the date in which the petition is filed.[85] If the partnership is unable or unwilling to deposit the imputed underpayment, the partnership may file in the U.S. Tax Court.

Once the petition is filed, the court has jurisdiction to determine all items of income, gain, loss, deduction, or credit of the partnership for the partnership taxable year in which the NFPA relates.[86] The court has jurisdiction to determine the proper allocation of these items among the

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[81] *See* I.R.C. § 6235(d) (2018).

[82] See id.

[83] *See* I.R.C. § 6232(a) (2018).

[84] *See* I.R.C. § 6234(a) (2018).

[85] *See* I.R.C. § 6234(b) (2018).

[86] *See* I.R.C. § 6234(c) (2018).

partners, and the applicability of any penalty, addition to tax, or additional amount in which the partnership may be liable.[87]

Conclusion

Although the New Rules are generally not effective until tax years beginning in 2018, it is important that tax professionals start analyzing now the potential impact of the New Rules on their client partnerships. This is because the New Rules create important choices for partnerships regarding the manner in which the tax from IRS adjustments will be assessed and collected. Moreover, differently situated partners (former or current) may have differing views regarding whether to utilize the General Method or the Push Out Election. In addition, the New Rules create traps for the unwary in which the same adjustment may be taxed twice in certain situations. Until Treasury promulgates Regulations, it is unclear whether and in what manner Treasury will choose to address the troublesome issues that exist under the New Rules.

Advisors may help their partnership clients prepare for the effectiveness of the New Rules by initiating a discussion of the following four important issues:

1. Who will serve as the Partnership Representative and how will successors be selected?

2. To what extent will the Partnership Representative be required to provide notice to the partners regarding the status of the IRS audit of the partnership?

3. Which decisions by the Partnership Representative (if any) will be subject to approval by the partners?

4. Will Reviewed Year Partners who are no longer partners in the partnership have any right to receive notices regarding the status of the IRS audit and/or provide input regarding decisions of the Partnership Representative?

These are merely a few of the important issues on which clients will be seeking guidance from their advisors as the effectiveness of the New Rules approaches.

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[87] See id.