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New York State Bar Association
Tax Section

Report on Proposed Regulations Implementing the Centralized Partnership Audit and Collection Regime

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Report on Proposed Regulations Implementing the Centralized Partnership Audit and Collection Regime

I. INTRODUCTION

This report[1] comments on proposed regulations (the "Proposed Regulations")[2] implementing Section 1101 of the Bipartisan Budget Act of 2015 (the "BBA"),[3] which contains rules for a new centralized partnership audit and collection regime.[4] Treasury released the text of the Proposed Regulations on January 19, 2017, but prior to being published in the Federal Register, the text was withdrawn pursuant to an executive order.[5] The Proposed Regulations were re-released on June 13, 2017.

The BBA completely changed the way that the IRS audits partnerships and assesses and collects any resulting income tax deficiencies. The BBA repealed the partnership audit procedures and the rules for electing large partnerships enacted as part of the Tax Equity and

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[2] REG-136118-15; Internal Revenue Bulletin 2017-28.

[3] On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q ("PATH Act"). Section 411 of the PATH Act corrected and clarified certain amendments made by the BBA. The amendments under the PATH Act are effective as if included in section 1101 of the BBA and therefore are subject to the same effective dates as set forth in section 1101(g) of the BBA. The Tax Technical Corrections Act of 2016 (the "TTCA"), H.R. 6439 and S. 3506 (Dec. 6, 2016), proposes important "clarifications" to the BBA, but has not yet been enacted.

[4] On May 25, 2016, the New York State Bar Association submitted Report No. 1347 on the Partnership Audit Rules of the BBA (the "Prior Report").

[5] Memorandum for the Heads of Executive Departments and Agencies from Reince Priebus, Assistant to the President and Chief of Staff, "Regulatory Freeze Pending Review" (Jan. 20, 2017).

Fiscal Responsibility Act ("TEFRA") and the Taxpayer Relief Act of 1997,[6] and replaced those procedures with new rules under which audits of partnerships and partners are conducted at the partnership level with limited involvement of the partners, and any resulting income taxes are generally assessed and collected by imposing an "imputed underpayment" on the partnership which the partnership must pay.

Congress enacted these sweeping changes to partnership audits and assessments in response to problems that the IRS experienced under TEFRA. Specifically, TEFRA required the IRS to pass audit adjustments to partnership items through to the ultimate partners. This procedure forced the IRS to identify potentially large numbers of partners, often through tiers of partnerships, in order to determine the proper share of the adjustment for each ultimate partner. The involvement of partners who had the right to be notified of, and intervene in, the partnership proceedings further complicated TEFRA audits. As the number and size of partnerships grew, and partnership allocations became more elaborate, and the complexity of the audit and assessment process increased, challenging the IRS's resources and practical ability to audit partnerships.[7]

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[6] The Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248 ("TEFRA"), established the unified partnership audit rules. These rules required that the tax treatment of all "partnership items" be determined at the partnership level, and not at the partner level as under prior law, subject to certain exceptions for certain small partnerships.

[7] *See* United States General Accountability Office ("GAO"), Report to Congressional Requestors, "Large Partnerships: With Growing Numbers of Partnerships, IRS Needs to Improve Audit Efficiency," GAO-14-732 (Sept. 2014) (the "GAO Report"), cover page, summary; Treasury Inspector General for Tax Administration ("TIGTA"), "Improvements Are Needed to Ensure That Procedures Are Followed During Partnership Audits Subject to the Tax Equity and Fiscal Responsibility Act of 1982," Reference Number 2014-30-082 (Sept. 26, 2014). The Prior Report summarized the three main difficulties highlighted in the GAO and TIGTA reports: (i) identifying the correct Tax Matters Partner; (ii) flowing the adjustments through to the ultimate taxpayer once the IRS had issued a Final Partnership Administrative Adjustment; and (iii) complying with the burdensome notice and participation requirements with respect to the partners. Prior Report at 17.

The provisions of the BBA go a long way toward addressing the problems encountered under TEFRA by allowing the IRS to assess and collect tax attributable to partners at the partnership level. The Proposed Regulations include helpful procedures for modifying the imputed underpayment, pushing the imputed underpayment out to partners, and filing administrative adjustment requests to amend the partnership return. We commend Treasury for developing a comprehensive framework to implement the BBA's new approach to partnership taxation.

II. EXECUTIVE SUMMARY

Many provisions in the Proposed Regulations are based on judgments regarding the proper balance between the often competing goals of enhancing the IRS's ability to audit partnerships and collect any resulting taxes; assessing the correct amount of tax on the correct taxpayer; and allowing the partners to participate in the audit and collection process. In this report, we provide comments on ways in which we believe the balance among these competing goals should be adjusted to protect the ability of the IRS and taxpayers to assess the correct amount of tax on the correct taxpayers while avoiding unnecessary burdens for both the IRS and taxpayers. Our primary recommendations are summarized below.

A. Modification of the Imputed Underpayment. One way in which partnerships and their partners can ensure that the correct tax is paid by the correct taxpayers is to modify the imputed underpayment by filing amended returns. However, partners will often have significant items on their tax returns that are not related to the partnership at issue, and may resist amending their returns merely to modify a partnership adjustment. Accordingly, we recommend that, in lieu of filing an amended return, partners be permitted to modify the imputed underpayment by filing an information

statement relating only to the proposed partnership adjustments and paying any additional tax due.

B. Push-Out of the Imputed Underpayment. A partnership's ability to push an imputed underpayment out to its partners is an essential tool for assessing the correct tax liability on the correct taxpayers. Many partnerships have one or more tiers of pass-through partners. Accordingly, we recommend that partnerships be permitted to push an imputed underpayment out through tiers of upper-tier pass-through partners on the condition that the partnerships and partners furnish the IRS with sufficient information to identify the direct and indirect partners, track the adjustments through the tiers of partnerships, and confirm that all taxes are properly reported and paid.

C. Administrative Adjustment Requests. Partnerships should be encouraged to file Administrative Adjustment Requests to correct their tax liability voluntarily without forcing the IRS to expend limited resources on unnecessary audits. Accordingly, we recommend that certain rules for calculating the imputed underpayment as part of an Administrative Adjustment Request be more liberal in order to encourage taxpayers to self-report underpayments as often as possible instead of waiting for the IRS to initiate an audit.

D. Partnership Representatives. The Proposed Regulations restrict when a Partnership Representative can resign or be replaced. However, there are circumstances in which a Partnership Representative will die, cease to exist, become incompetent, or become adverse to the partnership. When this happens, there may not be anyone who can make decisions or otherwise act for the partnership. Accordingly, we recommend

that a Partnership Representative that dies, ceases to exist, is incompetent, or is adverse to the partnership be permitted to resign or be replaced at any time.

E. Administrative and Judicial Review of IRS Determinations. The Proposed Regulations authorize the IRS to make important determinations regarding a partnership's election out of the BBA, election to push out an imputed underpayment, or request to modify an imputed underpayment. We recommend that the Proposed Regulations clarify that there will be access to administrative and judicial review of these determinations by the IRS.

F. Elections Out. The broad scope of the BBA will create situations in which the amount of the imputed underpayment is different from the tax liability that would have arisen if the taxpayers had correctly reported their income in the first place. Further, there will be situations in which the economic burden of the imputed underpayment will be imposed on taxpayers that are different from the taxpayers who presumably benefited from the original underreporting. To the extent that Treasury adopts our recommendations in this report, which are intended to help ensure that the correct tax is imposed on the correct taxpayers, we are less concerned about the broad scope of the BBA and partnerships' ability to opt out of the BBA. Nevertheless, to minimize the circumstances in which anomalies created by the BBA will arise, we recommend that Treasury consider allowing partnerships with a limited number of partners to elect out of the BBA, even if a small number of those partners are partnerships, trusts, disregarded entities, or nominees. To ameliorate the resulting burden on the IRS, we recommend that an electing partnership be required to provide the IRS with adequate identifying information for each of its direct and indirect

partners, including a last known address on which the IRS can rely for purposes of issuing a statutory notice of deficiency or Final Partnership Adjustment ("FPA").

G. Other Recommendations. We also make a number of recommendations regarding miscellaneous issues.

III. Discussion of the Scope of the Centralized Partnership Audit and Collection Regime

Section 6621(a) defines the scope of the new partnership audit regime. Specifically, Section 6621(a) provides that any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year (and any partner's distributive share thereof) shall be determined, and any tax attributable thereto shall be assessed and collected, at the partnership level. Proposed Regulation Section 301.6221(a)-1(b) defines these items broadly to include:

> [A]ll items and information required to be shown, or reflected, on a return of the partnership under section 6031, the regulations thereunder, and the forms and instructions prescribed by the Internal Revenue Service (IRS) for the partnership's taxable year, and any information in the partnership's books and records for the taxable year.

This definition of partnership items includes all items reflected on the partnership return as well as all information included in the partnership's records, regardless of whether (i) the items or information would affect the income that the partnership reports, or (ii) the particular tax characteristics of the separate partners would affect the ultimate tax liability. The result is that a partnership may have an imputed underpayment arising from the adjustment of an item at the partnership level even though the partnership reported the correct amount of taxable income and the amount of any imputed underpayment may be different from the tax liability that would have arisen if the partnership and the partners had prepared their returns in accordance with the audit adjustments in the first place (the "Correct Return Position").

Further, the imputed underpayment is assessed and collected at the partnership level in the year of the adjustment as opposed to the year under review. This means that in situations where the adjustment-year partners are different from the reviewed-year partners, the imputed underpayment will shift the economic burden of the imputed underpayment away from the reviewed-year partners, who incorrectly reported the item in the first place, to the adjustment-year partners who may not have any connection to the incorrectly reported items.[8]

The following examples illustrate these issues:

> **Example 1**. Partnership is composed of two partners, A and B, both of whom are unmarried individuals. A and B each has a 50% interest in each of Partnership's items of income and deduction. Partnership reports no income for the taxable year. Outside of Partnership, A and B each has adjusted gross income for the taxable year in excess of the applicable amount under section 68 relating to limitations on itemized deductions. A and B each has $40,000 in itemized deductions subject to reduction under section 68. Assume A and B each pays tax at the highest marginal rate of 40%. The IRS determines that the Partnership has additional income of $100,000.

Under Proposed Regulation Section 301.6225-1, the net adjustment is $100,000. To compute the imputed underpayment through the centralized audit regime, this amount is multiplied by the highest marginal rate of 40% for an imputed underpayment of $40,000, which is required to be paid by the partnership. If deficiency procedures applied, A and B would each have $50,000 of additional income. Under Section 68, A and B would each have an additional reduction in itemized deductions of $1,500 ($50,000 x 3%), and therefore total additional taxable income of $51,500 ($50,000 + $1,500), for a tax liability of $20,600 each ($51,500 x 40%) or $41,200 in total. In this example, the same adjustment leads to inconsistent results because partners audited under the deficiency procedures are subject to the itemized deduction limitations

[8] The difference between the imputed underpayment and the Correct Return Position is discussed in the Prior Report beginning at 31.

under Section 68 while partnerships audited under the centralized partnership audit regime are not subject to those limitations.[9]

> **Example 2.** Partner A receives a distribution from Partnership and claims sufficient basis in his partnership interest to absorb the distribution without reporting any gain. A's basis calculation includes his share of nonrecourse liabilities of the partnership. The IRS determines that A's share of nonrecourse liabilities is lower and, therefore, A had a lower basis and should have reported gain. A has a large net operating loss carryover from prior years. A sold his partnership interest to X in the year before the audit.

Under the partnership audit regime, A's share of nonrecourse liabilities is an "item of income, gain, loss, deduction, or credit," because the determination of A's share requires review of the partnership's books and records.[10] The adjustment would result in an imputed underpayment for Partnership under Proposed Regulation Section 301.6225-1(c) based upon A's gain from the distribution even though Partnership did not underreport its income in the tax year at issue. Further, the amount of the imputed underpayment does not correspond to the Correct Return Position because, in computing the imputed underpayment, the IRS does not consider the net operating loss carryover and other items on A's individual return. Finally, if Partnership is not able to modify or push out the imputed underpayment, X will bear the economic cost of the tax even though X was not a partner during the reviewed year, and A will avoid any reduction in A's loss carryover from the additional income.

These examples illustrate how the imputed underpayment can differ from the Correct Return Position and can shift the economic burden from the reviewed-year partners to the

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[9] Of course, A and/or B could file amended returns to modify the imputed underpayment, or Partnership could push out the liability to A and B so that the itemized deduction limitation would be taken into account. However, the parties would have no incentive to do so in Example 1. We are concerned that, over time, taxpayers will learn to exploit the differences between the imputed underpayment and the Correct Return Position to a much greater degree than illustrated by this example.
[10] Prop. Reg. § 301.6221(a)-1(b).

adjustment-year partners. We are concerned that this aspect of the BBA will create new complexities and ambiguities. In some cases, the results may be unfair, for taxpayers or the IRS, and the anomalies may create opportunities for taxpayer abuse. In addition, the creation of audit and collection procedures under which the IRS can assess and collect an imputed tax liability from the partnership is a significant change from the historic tax treatment of partnerships and will upset settled expectations and existing legal obligations on which significant economic decisions have been based.[11]

By broadly interpreting the scope of the BBA, the Proposed Regulations expand the number of partnerships and partners that will encounter the problems described above. We recognize that the BBA and the Proposed Regulations contain procedures that operate as relief valves designed to bring the imputed underpayment closer to the Correct Return Position and to place the economic burden of the tax liability on the partners involved in the initial misreporting. These procedures include modifications of the imputed underpayment, push-out elections, and administrative adjustment requests. We believe these procedures should be as broad and as flexible as possible in order to minimize the instances in which the wrong amount of tax is assessed and/or the wrong taxpayer bears the burden of an imputed underpayment. To the extent that Treasury adopts the recommendations in this report, which are intended to help ensure that the correct taxpayers pay the correct amount of tax, we would have less concern regarding the broad scope of the BBA.

[11] In the Prior Report, we discussed these issues and recommended that that the scope of the BBA be limited to those items that would affect a partnership's tax return. Prior Report at 7.

IV. COMMENTS ON THE PROPOSED REGULATIONS

A. Section 6225: The Imputed Underpayment

Section 6225 is a central feature of the BBA. This section calculates the "imputed underpayment," which is the partnership's tax liability resulting from audit adjustments. The general rule is that the partnership must pay the imputed underpayment.[12]

The imputed underpayment is calculated by: (i) taking into account the applicable internal revenue laws, including both rules of tax benefit and those of disallowance or limitation; and (ii) multiplying the total netted partnership adjustment (or adjustments) determined by the IRS for each reviewed year under examination by the highest rate of federal income tax in effect for the reviewed year. Only net positive adjustments are used to determine an imputed underpayment.

Under Section 6225(c) and the Proposed Regulations, the partnership may modify the imputed underpayment in seven ways: (i) reviewed-year partners may file amended returns that take into account the partnership adjustment or portion of partnership adjustment; (ii) a partnership may request modification based on the status of its tax-exempt partner(s); (iii) the partnership may request that a lower tax rate be applied to the portion of the total netted partnership adjustment allocable to a C corporation or an individual with respect to capital gains and qualified dividends; (iv) publicly-traded partnerships may request to modify an imputed underpayment in the case of a net decrease in a specified passive activity loss for specified partners; (v) a partnership may request modification of the number and composition of imputed underpayments; (vi) qualified investment entities described in Section 860 may distribute deficiency dividends after the notice of proposed partnership adjustment under Section 6231 (the

[12] Prop. Reg. § 301.6225-1(a).

"NOPPA") has been issued, and the IRS will treat the amount allowed as a deficiency dividend deduction under Section 860(a) as having been taken into account by a partner similar to amended return modification; and (vii) the IRS may take into account any closing agreement entered into by partners pursuant to Section 7121 and will allow appropriate modification based on the contents of the closing agreement.[13] Section 6225(c)(5) authorizes the Secretary to develop other methods for modification of the imputed underpayment.

1. Treasury Should Adopt the TTCA's Alternative Procedure to Filing Amended Returns

Modifying the imputed underpayment by filing amended returns is an important mechanism that helps the IRS and taxpayers reach the Correct Return Position. However, we are concerned that, in practice, it will be difficult to convince many partners to file amended returns. Taxpayers who have substantial, non-partnership-related activity reported on their returns will be reluctant to recertify the entirety of their original return under penalties of perjury, subject other aspects of their returns to potential IRS review, and trigger potential requirements to file state and local amended returns simply to address a partnership adjustment.

Section 203 of the TTCA proposed a helpful modification that would allow a partner to file an information statement relating to the proposed partnership adjustment(s) and pay any additional tax owed in lieu of filing an amended return. This procedure has come to be known as the "push in" modification.[14]

We believe that Section 6225(c) authorizes Treasury to promulgate regulations to implement a push-in modification and we recommend that it do so because the push-in

[13] Sections 6225(c)(1)-(8); Prop. Reg. § 301.6225-2(d)(1)-(8).
[14] This so-called "push in" procedure is discussed in Tax Notes, "'Brilliant' Substitute Offered for BBA's Flawed Push-Out Method" (Nov. 21, 2016) (crediting Diana L. Wolman and Todd Gluth with making this recommendation).

modification would provide a more efficient and effective method for arriving at the Correct Return Position than filing amended returns. Further, we believe that adoption of the push-in procedures would reduce the burden on the IRS by encouraging partners to come forward and resolve partnership audits in a cooperative manner early in the process.

Specifically, we recommend a push-in modification, pursuant to which any reviewed-year partner, including partners of upper-tier partnerships, would deal directly with the IRS exam team during the partnership audit and provide information on any tax attributes at both the partnership and partner level to substantiate the Correct Return Position for that partner with respect to the reviewed year and any intervening year. It is important to allow the push-in partner to engage directly with the IRS outside the presence of the partnership or its agents when substantiating the Correct Return Position because many partners will not want to provide the details of their financial affairs to the Partnership Representative or the partnership. The push-in partner would pay the net additional taxes directly to the IRS. Once the partner pays the tax, the imputed underpayment would be adjusted to remove any items allocable to that partner. The partnership would pay any remaining imputed underpayment to the IRS after all partners who elected to push-in have paid. We also recommend that push-in partners who establish that they are owed a refund receive such refund, but only after all push-in partners have paid their tax and the partnership has paid any remaining imputed underpayment. This "pop-out" of a refund would supplement or replace the need for such partners to file amended returns or rely on Proposed Regulation Section 301.6225-3, which allows an adjustment that does not result in an imputed underpayment to be taken into account only in the adjustment year.[15]

[15] Proposed Regulation Section 301.6225-3 states that an adjustment that does not result in an imputed underpayment is taken into account as a reduction in non-separately stated income or as an increase in non-separately stated loss for the adjustment year.

2. *Additional Comments Under Section 6225*

a. Treasury Should Allow an Additional Modification for Adjustments that Reallocate Distributive Shares

Section 6225(b) contains rules for grouping and netting of partnership adjustments for purposes of determining the imputed underpayments. Section 6225(b)(2) provides that, with respect to adjustments that reallocate the distributive share of any item from one partner to another, such adjustments shall be taken into account by disregarding any decrease in an item of income or gain or any increase in an item of deduction, loss, or credit.

These netting rules create an imputed underpayment in a situation where the IRS determines that a partnership correctly reported its income but allocated it to the wrong partner. Specifically, if an adjustment reallocates the distributive share of an item from one partner to another, the reallocation is treated as two separate subgroupings, one for the partner from whom the item is reallocated and another for the partner to whom the item is reallocated. A subgrouping with a net non-positive adjustment is disregarded for purposes of calculating the imputed underpayment.[16] The subgrouping with a net positive adjustment is netted with other positive adjustments and then multiplied by the highest tax rate in order to generate the imputed underpayment.[17]

The original version of Proposed Regulation Section 301.6225-1(f) contained Example 3, which was deleted from the reissued Proposed Regulations. Although the example was deleted, it nonetheless illustrates how a reallocation from one partner to another results in an imputed underpayment. Prior Example 3 assumed that each partnership and its partners are calendar year taxpayers and that the highest rate in effect is 40%.

[16] Prop. Reg. § 301.6225-2(d)(3)(ii).
[17] Prop. Reg. § 301.6225-1(d)(2)(ii).

	Ordinary Income to A	Depreciation Deduction to A	Ordinary Income to B	Depreciation Deduction to B
Partnership reports in 2019 tax year	$0	$0	$30	($70)
IRS determines	$30	($70)	$0	$0
Adjustment	$30	($70)	($30)	$70

The net adjustment in the reallocation subgrouping is divided into two subgrouping, one for partner A and one for partner B. The net adjustment for partner A is ($40), while the net adjustment for partner B is $40. For purposes of determining the imputed underpayment, A's net non-positive adjustment is ignored. B's $40 adjustment is multiplied by the 40% rate, resulting in an imputed underpayment of $16.

Section 6225(b) mandates the creation of an imputed underpayment in such a situation. However, as the Proposed Regulations acknowledge, there are two alternative methods to account for the net non-positive adjustment in order to approximate the Correct Return Position. First, the default rule under the Proposed Regulations is that any such net non-positive adjustment is taken into account as a reduction in non-separately stated income or an increase in non-separately stated loss in the partnership's *adjustment* year under Proposed Regulation Section 301.6225-3. While this method provides some relief for what would otherwise be an inequitable result, it is still an imperfect solution because there is no guarantee that such a reduction in income or increase in loss in the adjustment year will be allocated to the partner that previously picked up the gain. Indeed, that partner may not even be a partner of the partnership in the adjustment year.

Second, the proposed Regulations alternatively allow the imputed underpayment in the reviewed year to be modified if both the "reallocated from" and the "reallocated to" partners file

amended returns.[18] This alternative method will produce the Correct Return Position but it requires the partner entitled to the benefit of a downward adjustment to obtain the cooperation of another partner who will have to file an amended return and pay the tax. In many cases, it will be difficult to obtain the cooperation of, and payment from, all of the partners in these situations. Further, as discussed above, some partners will hesitate to use the cumbersome amended return procedure.[19]

We believe that the Proposed Regulations should provide an additional modification method in the case of adjustments that reallocate distributive shares. While it is essential to ensure that the full amount of tax has been paid, it should not matter to the IRS whether the tax is paid by the partners or by the partnership itself. Accordingly, we recommend that the partner to whom the net non-positive adjustment is allocated be permitted to file an amended return or a push-in certification to claim a refund of tax arising from such adjustment, on the condition that the partner to whom the adjustment is allocated, *or the partnership*, has paid the tax from the net positive adjustment. This relatively simple procedure will protect the IRS's ability to collect the correct amount of tax while avoiding an overpayment of tax in many situations.

b. Treasury Should Revise the Modification for Adjustments that Recharacterize Capital Gain as Ordinary Income

As is the case with respect to reallocations of distributive shares of items, the recharacterization of capital gain as ordinary income creates an imputed underpayment of the entire amount of an income item, multiplied by the highest applicable rate, without providing any benefit for the tax previously paid by the partners at capital gain rates. Again, this is because the

[18] Prop. Reg. § 301.6225-2(d)(2).

[19] The push-out alternative does not provide a remedy. Although the partnership could push out the adjustment under Proposed Regulation Section 301.6226-2(f)(iii), this will not generate the Correct Return Position because under the push-out rules, a partner cannot reduce previously reported tax. *See* Prop. Reg. § 301.6226-3.

net non-positive adjustment of a reduction in capital gain is ignored for purposes of calculating the imputed underpayment.[20] We believe that the statute does not mandate such a harsh result.[21]

In the case where adjustments are attributable to a partner entitled to the capital gain or qualified dividend rate for such adjustment, the Proposed Regulations provide for a modification to incorporate such lower rate.[22] This rate modification procedure should be revised to provide that an individual partner may file an amended return or push-in certification to establish that he or she paid tax on the recharacterized gain at a lower rate with the result that the relevant part of a net positive adjustment would be subject to tax only at the difference between the highest individual rate and such lower rate.

In addition, this rate modification procedure should allow a corporate partner to demonstrate that it paid tax on the capital gain (that is, it was not offset by capital losses), with the result that the relevant part of the net positive adjustment would be subject to tax at a 0% rate, as corporate tax rates on capital gains equal rates on ordinary income. An example of the way in which this modification procedure should work is provided below.

> **Example.** Partnership XYZ has three partners, X, Y and Z. XYZ reported $150 of capital gain to each of X, Y and Z. X paid tax of $10 on the $50 of gain allocated to her, while Y, a corporation, paid $17.5. Z, another corporation, paid no tax on the $50 allocated to it as it had a $100 capital loss in that year.
>
> In an administrative proceeding, it is determined that the $150 reported as capital gain was ordinary income. X and Y file push-in certifications demonstrating that they paid $10 and $17.5 of tax on their respective allocation of gain. Z files a push-in certification demonstrating that it is a corporation. The imputed underpayment for XYZ is $27.5, comprised of $10 with respect to X and $17.5 with respect to Z.

[20] Prop. Reg. § 301.6225-1.
[21] *Cf.* Section 6225(b)(2).
[22] Prop. Reg. § 301.6225-2(d)(4).

c. Treasury Should Allow Additional Time to File an Amended Return or Push-In Certification

Section 6225(c)(2) requires payment before the IRS will approve of a modification by amended return, and the Proposed Regulations provide that the payment must be made on or before 270 days after the date the NOPPA is mailed, and on or before the expiration of the period of limitations under Section 6501 for the year of the amended return.[23] In many cases, one or both of these periods will have expired before the FPA is issued or before there is a final determination.

As a result, partners may effectively be deprived of the pre-payment forum of Tax Court to challenge the adjustment. For example, if the IRS issues a NOPPA to the partnership, and the partnership believes the NOPPA is incorrect and intends to challenge it, but the filing of amended returns would reduce the imputed underpayment, the reviewed-year partners would have to file the amended returns and pay any tax due before the issuance of the FPA. The partnership may decide to challenge the FPA in Tax Court, but at this point, reviewed-year partners would have already amended their returns and paid the full amount of tax, penalties, and interest due. Accordingly, those partners would have had to pay even though they have not yet had Tax Court review.

Section 6234(c) does not clearly state whether the Tax Court has jurisdiction to order a refund of the partner's payment of tax, penalties, and interest if the Tax Court does not uphold the adjustments in the FPA.[24] Section 6512(b) allows the Tax Court to determine an

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[23] Prop. Reg. §§ 301.6225-2(d)(ii) and (v).

[24] Section 6234(c) states that: "A court in which a petition is filed in accordance with this section shall have jurisdiction to determine all items of income, gain, loss, deduction, or credit of the partnership for the partnership taxable year to which the notice of final partnership adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under this subchapter."

overpayment but it may not provide the Tax Court with jurisdiction to order refunds of a *partner's* overpayment of tax in a proceeding challenging the adjustment of *partnership* items.[25]

Alternatively, if the reviewed-year partners forgo the filing of amended returns and payment of tax within the time limits described above, and the partnership seeks review in Tax Court, but is unsuccessful and the adjustments in the FPA are affirmed, the partnership would no longer be able to reduce the imputed underpayment by having the reviewed-year partners amend their returns.

To avoid situations in which a partner is either forced to pay before the partnership receives its pre-payment review in the Tax Court (and with a questionable ability to obtain a refund), or is forced to forgo seeking modification of the underpayment, we suggest that the Proposed Regulations be revised to state that consent to extend the 270-day period and the normal statutes of limitations will be freely granted in these situations. Alternatively, we suggest that the Proposed Regulations be revised to allow taxpayers to seek modification of the underpayment by filing an amended return or push-in certification within 60 days after there has been a final determination. This would be similar to the push-out rules, which allow a partnership to wait to provide statements to the reviewed-year partners until 60 days after the final determination, *i.e.*, a Tax Court decision.

The IRS has authority to consent to extensions of the 270-day period within which a payment must be made and the statute of limitations under Section 6501. However, if the IRS does not freely consent to extensions of both of these limitation periods, there will be many cases

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[25] The Tax Court's jurisdiction is expressly limited by statute, and cannot be expanded by regulation or agreement of the parties. *Chai v. Comm'r*, 851 F.3d 190, 195 (2d Cir. 2017); *GAF Corp. v. Comm'r*, 114 T.C. 519, 521 (2000).

in which taxpayers will not be able to reduce the imputed underpayment through amended returns or push-in modifications after Tax Court review.

d. Treasury Should Require Payment of a Deficiency Dividend by a Qualified Investment Entity Within 60 Days of a Final Determination

Under the centralized partnership audit and collection regime, qualified investment entities ("QIE's") may distribute deficiency dividends after issuance of the NOPPA, and the IRS will treat the amount allowed as a deficiency dividend deduction as having been taken into account by a partner similar to amended return modification.[26] In the Preamble, Treasury asked for comment as to whether these rules are adequate, given that the NOPPA is issued prior to review by IRS Appeals or the Tax Court.

We suggest that the Proposed Regulations be revised to require payment of a deficiency dividend no later than 60 days after the date the partnership adjustments are finally determined. In this way, the rules regarding distributions of deficiency dividends will mirror the rules for furnishing push out statements to the partners in Proposed Regulations Sections 301.6226-2(b)(1) and (c), which appropriately provide that the partnership is not required to act until the adjustments are finally determined.

e. Treasury Should Provide Procedures for Processing Reviewed-Year Partners' Amended Returns

An amended return claiming a refund may be filed after the expiration of the statute of limitations under Section 6511.[27] These amended returns may appear to be untimely and we are concerned that, unless the IRS develops a procedure for processing these returns, IRS Service

[26] Prop. Reg. § 301.6225-2(d)(7).
[27] Prop. Reg. § 301.6225-2(d)(2)(v)(B).

Centers will automatically reject them, causing confusion and uncertainty about whether the amended return has, in fact, been filed, and if so, whether it was timely.[28]

The Proposed Regulations do not specify any particular manner of filing, and we suggest that the Proposed Regulations direct reviewed-year partners to file the amended return with the IRS personnel handling the partnership's exam, so that this person can make sure that the return is filed and properly processed. Alternatively, the Proposed Regulations could direct taxpayers to include a banner on the top of the amended return stating, in red ink, "Filed Pursuant to Section 6225(c)," to alert the Service Center that this amended return should not be automatically rejected if it is otherwise untimely under Section 6511.

f. Treasury Should Provide Procedures for Modifications Based on Closing Agreements

The Proposed Regulations allow modifications based on a Closing Agreement between partners and the IRS.[29] This is one way to make a modification if the statute of limitations has expired and modification by amended return is no longer available.

The use of closing agreements to reduce the imputed underpayment may be an important tool for both the IRS and taxpayers, but we are concerned that it will be used only in rare circumstances because entering into a closing agreement is within the discretion of the IRS and there are no procedures for requesting and implementing closing agreements. For example, it is not clear how a partner can request a closing agreement from the IRS personnel handling the audit, especially because the Partnership Representative has the sole authority to deal with the IRS. We also believe that some taxpayers will have confidentiality and privacy concerns and

[28] In our experience, IRS Service Centers regularly reject amended returns filed after the statute of limitations has expired, even when those amended returns report additional tax and include a payment of the tax.
[29] Prop. Reg. § 301.6225-2(d).

will not want to negotiate the details of their tax return through a Partnership Representative. We recommend that Treasury provide guidance that outlines procedures for partners to work directly with the IRS to enter into closing agreements as part of the partnership audit.

B. Section 6226: The "Push-Out" Election for Tiered Partnerships

As an alternative to the partnership level assessment required by Section 6225, under Section 6226, a partnership can push the audit adjustments out to the reviewed-year partners if it files a timely election. The result of a push-out election is that the partnership will transfer liability for the tax on the audit adjustments to the reviewed-year partners.[30] The partnership must make the push-out election within 45 days of the date that the IRS mails the FPA.[31] As part of the election, the partnership must provide the IRS with information adequately identifying each reviewed-year partner (including a correct TIN) and the adjustments to which the election applies.[32]

Once the audit of the partnership is complete, the source partnership must deliver to the IRS and each direct partner for the reviewed-year a statement of the audit adjustments no later than 60 days after the date the adjustments become final.[33] That statement must contain sufficient information to enable each direct partner to determine the amount of tax that would be payable by the partner as a result of the audit adjustments. The direct partner can report the adjustments in the same manner as if each adjusted item was originally allocated to the direct partner on the partnership return for the reviewed-year or intervening year.[34] The Proposed Regulations also require the statement to include a safe-harbor amount for each direct partner in

[30] Prop. Reg. §§ 301.6226-1(a), (b).
[31] Section 6226(a)(1).
[32] Prop. Reg. § 301.6226-1.
[33] Prop. Reg. § 301.6226-2(b).
[34] Prop. Reg. § 301.6226-2(f).

the reviewed-year.[35] The safe-harbor amount is computed in the same manner as the imputed underpayment under Proposed Regulation Section 301.6225-1, taking into account only the partner's share of the adjustment items. A direct partner has the option to pay the safe-harbor amount (which also includes interest and penalties), or pay the tax as it would have been computed if the partner's share of the adjustments had been reported on the partner's original tax return taking into account any tax attributes of the particular partner.

1. *Treasury Should Allow Partnerships to Push Adjustments Through Upper-Tier Pass-Through Partners in Tiered Partnerships*

The Proposed Regulations reserved on the issue of whether partnerships will be permitted to push adjustments through upper-tier pass-through partners in tiered partnerships[36] and therefore leave considerable uncertainty with respect to rules that will soon become effective. The Preamble requests comments "on how the IRS might administer the requirements of Section 6226 in tiered structures," and "on reducing noncompliance and collection risk in tiered structures, while at the same time limiting the administrative costs to the IRS."[37] This is of utmost concern because tiered partnerships represent a large number of the partnerships that the centralized partnership audit and collection rules will cover. As the GAO reported, the number of large partnerships (with 100 or more partners) has tripled since 2002, and over two thirds of those partnerships had more than 1,000 direct and indirect partners and six or more tiers.[38]

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[35] Prop. Reg. § 301.6226-2(g).

[36] For these purposes, tiered partnerships include any structure in which a pass-through entity for income tax purposes is a partner or member.

[37] Multiple governmental reports describe issues that the government has faced in collecting taxes from tiered partnerships, in which the IRS would be required to trace items of income, gain, loss, deduction and credit up the chain of ownership of such partnerships to collect taxes from the ultimate partners of tiered partnership structures.

[38] *See* GAO Report, Summary at 1-14.

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The current uncertainty regarding how push-out elections will work for tiered partnerships is harmful to the administration of the tax law. We believe that the treatment of tiered partnerships must be addressed as soon as possible in order for the statutory provisions to achieve their objectives. The push-out provisions in Section 6226 should be interpreted to minimize the anomalies, complexities, and difficulties that can arise when what traditionally has been understood to be partner-level tax is assessed and collected at the partnership level. Accordingly, we recommend that the Proposed Regulations adopt the method proposed in the TTCA, which expressly permits push-out elections to the upper tiers of multi-tiered partnerships.[39]

In situations involving direct partners that are ultimate taxpayers – taxpayers subject to tax under chapter 1– the push-out rules protect the interests of the government, ensure collection of the appropriate tax from the appropriate taxpayers, and offer taxpayers a choice: the partners can compute the amount of tax (as well as interest and penalties) that would be due; or, the direct partner can simply pay the safe-harbor amount without further effort. Consistent with the views expressed in our Prior Report,[40] we think a workable procedure can be devised that will allow partners that are pass-through entities to apply the rules of Section 6226 so that the ultimate taxpayers will determine and pay the taxes due as a result of adjustments at the source

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[39] *See* TTCA, section 204 (amending section 6226(b)(4)). Section 204 of the TTCA states: "(a) In general.— Section 6226(b) is amended by adding at the end the following new paragraph: (4) TREATMENT OF PARTNERSHIPS IN TIERED STRUCTURES.—
(A) IN GENERAL.—If a partner which receives a statement under subsection (a)(2) is a partnership or an S corporation, such partner shall, with respect to the partner's share of the adjustment—
(i) file with the Secretary a partnership adjustment tracking report which includes such information as the Secretary may require, and
(ii) either—
(I) pay the imputed underpayment under rules similar to the rules of section 6225 (other than paragraphs (2)(A), (6), (7), and (9) of subsection (c) thereof), or
(II) furnish statements under rules similar to the rules of subsection (a)(2)."

[40] Prior Report at 105-120.

partnership. In other words, each upper-tier partner should have the burden either to pay the tax or the safe-harbor amount, or to push the adjustments out so that its partners must choose to pay the tax or the safe-harbor amount or push the adjustments out in turn to their partners. This position is consistent with the BBA and the TTCA, and is a better interpretation of Section 6226 than that stated in the General Explanation of Tax Legislation Enacted for 2015 (the "Bluebook").[41]

At the same time, we think that the failure to adopt a procedure that allows adjustments to be pushed out through tiers of partners will lead to the chaotic situation in which significant amounts will be payable by lower-tier partnerships when in fact no tax is due because, for example, the partners of upper-tier partnerships who have partners with specific characteristics where no tax would be due, because, for example, the partners of upper-tier partnerships are foreign or have losses or credits on their separate returns. The prospect of this situation is likely to cause widespread confusion and dislocations in commercial transactions. We believe that the regulations can be crafted to minimize the burden on Treasury and the IRS by requiring partnerships and their partners to report sufficient information to the IRS to facilitate the assessment and collection of tax.

We believe Treasury has authority under the statute to allow upper-tier partnerships to push the imputed underpayment out to their partners. The language in Section 6226(a)(2), which

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[41] The Bluebook states the view that the push-out under section 6226 stops at the source partnership's direct, first-tier partners, regardless of whether such partners are pass-through entities. The Bluebook explains that any pass-through partners that receive a section 6226 Statement must pay the tax attributable to the adjustment with respect to the reviewed year and the intervening years "calculated as if it were an individual for the taxable year that includes the year of the statement." Although not entirely clear, the Proposed Regulations appear to have adopted this approach. *See* Prop. Reg. § 301.6241-1(a)(9) (the term "reviewed-year partner" means any person who <u>held</u> an interest in a partnership at any time during the reviewed year), while "[t]he term indirect partner means any person who has an interest in a partnership through their interest in one or more pass-through partners (as defined in paragraph (a)(5) of this section)."

requires "the partnership . . . [to] furnish to each partner of the partnership for the reviewed year . . . a statement of the partner's share of any adjustment to income, gain, loss, deduction or credit . . ." can be read to mean that the source partnership is required to provide the statement to its direct partners. This language can also be read more broadly to authorize the source partnership to provide the statements to the ultimate partners, either directly or indirectly through its pass-through partners and their pass-through partners, as case may be.

In addition, Section 6226(b) requires each partner to adjust the partner's tax imposed by chapter 1 based on the statement received from the source partnership, but because pass-through entities are not subject to tax under chapter 1, it is not clear what taxes, if any, partners that are pass-through entities are required to pay under Section 6226. The statute makes no mention of treating a pass-through partner as an individual in determining the amount of tax. Indeed, as noted in the Preamble to the Proposed Regulations, the push-out election is not limited to partners that are, themselves, taxpayers.

We agree with the position in the TTCA that the push-out election should not be limited to direct partners but should extend through tiers of upper-tier pass-through entities. Further, as discussed in our prior report, we recommend that each pass-through entity be given the same option that direct partners have either to push the liability out to its partners or to pay its safe-harbor amount.[42]

2. *Treasury Should Require Push-Out Statements and Payment Certifications to Minimize the IRS's Examination Burden*

We believe that the IRS' legitimate concerns regarding the burden of confirming that all partners have correctly reported and paid any tax due can be addressed by requiring each partnership and each partner to provide the IRS with sufficient information so that it can confirm

[42] *See* Prior Report at 115-120.

that all tax has been paid. We recommend a two-stage reporting scheme in which partnerships first provide their partners and the IRS with a push-out statement, and then each partner provides the partnership in which it is a direct partner and the IRS with a payment certification confirming that the tax or safe-harbor amount has been paid or that the adjustments have been pushed out.

Regarding the first stage, we suggest that each partnership be required to provide its direct partners and the IRS with a push-out statement similar to the one described in Proposed Regulation Section 301.6226-2. The push-out statement would enable each partner of the partnership either to compute its own tax liability or safe-harbor amount, or to pass similar information on to its partners. The push-out statement provided to the IRS could identify each direct partner, and indicate whether that direct partner is a pass-through entity and whether it will pay its share of the adjustments or safe-harbor amount, or will elect to push out the adjustments to its partners. In the event the partner elects to push the liability out, that partner would have to provide its partners and the IRS with a push-out statement containing the same information with respect to its direct partners.

Regarding the second stage, to ensure that the IRS has sufficient information to confirm that all tax has been reported and paid, we suggest that each partner be required to provide the partnership of which it is a direct partner and the IRS a payment certification in which the direct partner certifies, under penalties of perjury, that it has paid the tax attributable to its share of the adjustments or the safe-harbor amount, or has pushed the adjustments out to its upper-tier partners. The payment certification also should identify and provide contact information for the Partnership Representative of any of its direct partners that are pass-through entities.

When the IRS collects all the push-out statements and payment certifications described above, it should have a complete "map" that will enable it to identify the ultimate taxpayers,

track the adjustments through tiers of partnerships, and confirm that the correct amount of tax has been reported and paid. We believe that this "map," which states how each direct and indirect partner will address its obligations, will alleviate much of the burden on the IRS by enabling it more readily to confirm compliance.

Under our suggested approach, all of the push-out statements and payment certifications described above would be provided to the IRS before the due date, with extensions, of the source partnership's tax return for the reporting year.[43] To the extent that a pass-through entity fails to obtain a payment certification from any of its direct partners, the pass-through entity would be required to pay the safe-harbor amount attributable to that partner. We believe that these procedures place the burden on the partnerships and the partners to insure that the tax attributable to the adjustments is paid.

3. Treasury Should Allow Pass-Through Entities to Submit the Push-Out Statements and Payment Certifications Directly to the IRS

We believe that Treasury can allow partnerships to push adjustments through upper-tier pass-through partners and can collect all the information necessary to confirm that all taxes have been reported and paid while, at the same time, preserving the privacy of upper-tier partnerships and their partners. There are good commercial reasons why an upper-tier partnership may not want the lower-tier partnership of which it is a partner to obtain the allocation information and the information of its partners. For instance, a fund of funds, which is organized as a partnership for United States federal income tax purposes, that invests in a private equity fund (also organized as a partnership for United States federal income tax purposes) would not want to

[43] The "reporting year" is the date on which the partnership furnishes the statements to the reviewed-year partners with respect to their shares of the adjustments pursuant to Proposed Regulation § 301.6226-2. Prop. Reg. § 301.6226-3(a).

share with the private equity sponsor the identity of its investors and how the gain, losses, income, and deductions are being allocated among its investors.

We believe that this non-tax concern for financial privacy can be accommodated within the ambit of our suggested scheme for submitting push-out statements and payment certifications. Under our recommendation, each pass-through entity would be required to prepare a push-out statement identifying its partners and indicating whether each partner intends to pay its share of the adjustment or safe-harbor amount or whether it intends to push the adjustments out to its partners. The push-out statement need only be provided by a partnership to the partnership's direct partners and the IRS. Similarly, each direct partner of a partnership would be required to prepare a payment certification stating that it has paid its share of the adjustments, paid the safe harbor amount, or pushed the adjustments out to its partners. The payment certification need only be provided by each direct partner to the partnership in which it is a direct partner and to the IRS. There would be no need for the push-out statements or payment certifications to be provided to lower-tier partnerships, and, for the reasons discussed above, it would be preferable not to include such a requirement.

The entire reporting scheme we propose is possible without disclosing to lower-tier partnerships the identity of their indirect partners or the terms of their underlying arrangements. In other words, allowing the direct partners to maintain the confidentiality of their partners' private financial information should not impede compliance with the BBA or IRS enforcement.

C. Section 6227: Administrative Adjustment Requests

Section 6227 provides that a partnership may file a request for an administrative adjustment of one or more items of income, gain, loss, deduction, or credit for any taxable year ("AAR"). The AAR is essentially an amended return for the partnership.

The partnership can take into account and pay adjustments requested in an AAR under rules similar to the imputed underpayment rules of Section 6225. Alternatively, the partnership can elect to push out the adjustments under rules similar to the push-out rules of Section 6226. If the partnership elects to push out the adjustments requested in an AAR, the provisions in Section 6226 regarding the election to pay the safe-harbor amount, interest on the safe-harbor amount, and the increased rate of interest do not apply. Further, the normal rule for pushouts wherein a "correction amount" cannot be less than zero is disregarded. Therefore, an AAR can claim a refund to be paid to a reviewed-year partner.[44]

A partnership may not file an AAR more than three years after the later of (i) the date on which the partnership return for the year was filed; or (ii) the last day for filing the partnership return for such year (determined without regard to extensions).[45] In no event may the partnership file an AAR after the IRS has mailed a notice of administrative proceeding with respect to the partnership taxable year.

1. The Rules Governing AARs Should Be More Flexible

An AAR is the sole method for a partnership subject to the centralized partnership audit and collection regime to amend a prior return on its own initiative. AARs should be strongly encouraged because they allow partnerships to correct prior errors and reach the Correct Return Position without requiring the IRS to initiate an audit, thereby reducing the burden on the IRS. Partnerships that become aware of an error on a previously filed return will consider filing an

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[44] *See* Prop. Reg. § 301.6227-3(b)(3), Example 2.

[45] We believe that the time within which a partnership must file an AAR should be subject to extension by agreement. A partnership would be particularly eager to obtain an extension to file an AAR with respect to partnership taxable years immediately following a taxable year that is subject to an administrative proceeding if the proceeding made adjustments that would give rise to overpayments of tax in later years. However, allowing an extension of the time to file an AAR by agreement may require an amendment to the statute.

AAR to correct the error because AARs can constitute a qualified amended return for purposes of avoiding civil penalties, and because the AAR rules allow the partnership to push out adjustments to partners without requiring the partners to pay a penalty rate of interest. Partnerships also will file AARs to allow partners to claim tax refunds.

Despite these reasons to encourage the use of AARs, the Proposed Regulations contain language that may discourage the filing of an AAR. The Proposed Regulations should be more flexible regarding the types of modifications that are allowed in an AAR. Proposed Regulation Section 301.6227-2(c) lists four specific modifications that can be requested in an AAR by cross-referencing Proposed Regulation Section 301.6225-2(d), and the Proposed Regulations expressly exclude all other modifications in an AAR. The list of permissible modification requests does not include the catch-all category for other modifications that the IRS determines are accurate and appropriate in Proposed Regulation Section 301.6225-2(d)(9). We believe that this is an unnecessary restriction on AARs. We recommend that Proposed Regulation Section 301.6227-2(c) be modified to allow the catch-all category in Proposed Regulation Section 301.6225-2(d)(9), on the condition, of course, that the IRS approves of the relevant modification upon review of the AAR.

In addition, the Proposed Regulations can be read to require partnerships to choose between making a single imputed underpayment under rules similar to Section 6225, or to push out all the adjustments to its partners under rules similar to Section 6226. For example, Proposed Regulation Section 301.6227-2(a) states that the determination of whether adjustments requested in an AAR result in "an imputed underpayment" shall be determined in accordance with rules in Proposed Regulation Section 301.6225-1. Further, Proposed Regulation Section 301.6227-2(c) states that, in lieu of paying "the imputed underpayment," the partnership may elect to have the

reviewed-year partners "take into account the adjustments requested in the AAR." It is not clear whether these references to "an" imputed underpayment and "the" imputed underpayment imply that there can be only one imputed underpayment in an AAR, or whether more than one imputed underpayment can be calculated in an AAR.

We believe that, in order to encourage partnerships to file AARs, it is important to give partnerships the flexibility to create multiple imputed underpayments in a single AAR, some of which the partnership could pay, and some of which the partnership could push out to its partners. In addition, we believe that partnerships should be able to push out any adjustments that do not result in an imputed underpayment as part of the same AAR. Accordingly, to encourage the use of AARs to the fullest extent possible, we suggest that the language of the Proposed Regulations clarify that a single AAR can result in multiple imputed underpayments, some of which can be paid while others are pushed out, and that adjustments that do not result in an imputed underpayment can be pushed out.

D. Section 6223: The Partnership Representative

The BBA replaced the Tax Matters Partner ("TMP") with the Partnership Representative ("PR") to address difficulties that the IRS had in identifying the correct TMP and complying with the notice and participation requirements under TEFRA.[46] Section 6223(a) now requires all partnerships to designate a partner or other person who has a substantial presence in the United States as the PR. The PR does not have to be a partner of the partnership. Proposed Regulation Section 301.6223-1(b)(3) provides that, if a PR is not an individual, the partnership must appoint a specific "'designated individual" through whom the PR will act.

[46] The GAO and TIGTA Reports identified the following problems under TEFRA: (i) identifying the correct TMP; (ii) flowing adjustments through to the ultimate taxpayers; and (iii) complying with the burdensome notice and participation requirements with respect to the partners.

The PR has sole authority to act on behalf of the partnership, and the actions of the PR bind the partnership and all partners of such partnership. Except for a partner who is a PR, no partner or any other person may participate in an examination or other proceeding under these rules without the permission of the IRS. No state law, partnership agreement, or other agreement may limit the authority of the PR as between the partnership and the IRS.

A partnership must designate a PR separately for each taxable year, and a designation for one taxable year is not effective for any other taxable year. The PR designation remains in effect until terminated through the PR's resignation, revocation of the designation, or the IRS's determination that the designation is no longer in effect. However, the original PR designation may not be changed, either by resignation or by revocation, until the IRS issues a NOPPA to the partnership. The only exception is that the partnership or the PR may change the initial designation of the PR with the filing of an AAR. However, a partnership may not file an AAR solely for purposes of changing a PR, and there are time limits on when an AAR can be filed.

1. The Rules Regarding Resignations and Revocations of Designations of a PR Should Be More Flexible

The Preamble requested comments on additional circumstances that warrant allowing a PR or partnership to change the PR designation. As an initial matter, we believe that a partnership should be permitted to replace a designated individual of a PR at any time. There will be situations in which a designated individual of a PR will leave the PR or pass away. As long as a PR designation is in effect for an entity, the partnership should be allowed to change the designated individual at will, provided that the partnership names a new designated individual at the time of the change. The IRS will not be prejudiced because the PR designation will remain in effect throughout.

In addition, the Proposed Regulations provide that a PR may resign and a partnership may revoke a PR designation only after the IRS issues a NOPPA to the partnership or when an AAR is filed that makes adjustments to the tax liability reported by the partnership. Presumably, these restrictions on when a resignation or revocation can occur is intended to make it easier for the IRS to monitor who is serving as a PR. While this is an important goal, we believe it is crucial to allow a PR to resign or a partnership to revoke a designation if the PR no longer has a substantial presence in the United States or no longer has the capacity to act as defined in the regulations, even if such events occur prior to the issuance of a NOPPA and without adjusting the taxes reported by the partnership. Otherwise, a partnership could have a PR that is absent from the United States, dead, incarcerated, liquidated, or otherwise incompetent. There also may be circumstances in which a partnership becomes adverse to its previously designated PR such that the PR will cease to act in the partnership's best interests.

It may impose unworkable burdens on a partnership with a non-existent, non-functioning, incompetent, or adverse PR to be forced to wait until it receives a NOPPA to designate a new PR because the PR has important functions prior to issuance of the NOPPA. For example, a problematic PR might not handle notices appropriately, such as the NOPPA itself. Further, a PR is the only person authorized to take certain actions prior to the issuance of a NOPPA, such as making an election out under Section 6221. While the IRS is entitled to rely on a PR designation regardless of whether the PR is non-functioning, incompetent, or adverse, a PR that is unable or unwilling to act in the partnership's best interests could severely prejudice a partnership. There is no risk to the IRS that the partnership will not have a PR because if a partnership revokes a designation, it must designate a successor PR, and there are procedures in place to ensure that a successor PR is designated if a PR resigns.

We are mindful of the burden imposed on the IRS by requiring the IRS to monitor changes in PR designations. To minimize that burden, we suggest that the IRS monitor designations of a PR in the same way that it currently monitors the last known addresses of taxpayers.[47] Form 8822 provides a method for a taxpayer to give the IRS clear and concise notification of a change of address, and the IRS could use similar procedures to keep track of a change of designated individuals and PRs. While maintaining and updating this information may be slightly more burdensome than keeping track of the last known address, we believe that this limited burden outweighs the burdens on partnerships that cannot promptly replace a non-existent, non-functioning, incompetent, or adverse PR.

2. Additional Comments Under Section 6223

a. Treasury Should Change the Effective Date of a Determination that a Designation Is Not in Effect

There is a technical problem with the effective date of a determination by the IRS that a designation is not in effect. The designation of a PR remains in effect until the date on which the designation of the PR is terminated by, among other things, a determination that the designation is not in effect.[48] If the IRS determines that a designation of a PR is not in effect for any of the reasons listed in the regulations, the IRS will notify the partnership and the most recent PR and provide that partnership with an opportunity to designate a successor PR. The determination that a designation is not in effect is effective on the date the IRS mails the notification. The partnership may designate a successor within 30 days of the date of the notification and if the

[47] For example, the IRS must send notices to a taxpayer's last known address. *See Abeles v. Comm'r*, 91 T.C. 1019 (1988) (the phrase "last known address" is the address on the taxpayer's most recently filed and properly processed tax return, unless the taxpayer has given the IRS clear and concise notification of a different address). *See also* Treas. Reg. § 301.6212-2(a); Rev. Proc. 2001-18.
[48] Prop. Reg. § 301.6223-1(a).

partnership fails to designate a successor, the IRS will designate a successor.[49] However, because the determination that a designation is not in effect becomes effective on the date the IRS mails the notification and the partnership has 30 days to designate a successor, there could be a period of time of up to 30 days when there is no designated PR. This could create a problem if a statute of limitations were to expire during the period when no PR designation is in effect. Accordingly, we suggest that, if the IRS determines that a PR designation is not in effect, such determination is not effective until either the partnership designates a successor PR within the 30-day period or the IRS designates a successor PR after the 30-day period.

b. Treasury Should Require the IRS to Designate an Existing Partner of the Partnership as PR if Possible

The PR has broad authority to affect the partners by, among other things, extending the statute of limitations, handling an audit, settling a Tax Court case, or making a push-out election under Section 6226. It is very possible that a partner may never even know that these events are occurring until after the fact. When a partnership designates a PR, it can require full communication and impose other obligations on the PR by contract. However, if the IRS designates a PR, it is not clear that the PR will have any obligation, whether contractual, fiduciary or otherwise, to the partners. Accordingly, we recommend that, in cases when the IRS designates a PR, the IRS should be required to designate an existing partner of the partnership at the time of the designation unless there is no partner with a substantial presence in the United States. If there is no partner who can serve as the PR, the IRS should designate a current employee of the partnership. If there is no current partner or employee who can serve as the PR, only then should the IRS be permitted to designate a non-partner or non-employee as the PR.

[49] Prop. Reg. § 301.6223-1(f)(1).

E. Comments on Administrative and Judicial Review

The Proposed Regulations describe various determinations that the IRS may need to make to apply the BBA procedures, such as determining whether to invalidate an election out, to allow a request for modification of an imputed underpayment, and to invalidate a push-out election. All of these determinations can have meaningful consequences, and taxpayers should have an opportunity to respond to and appeal these determinations to the Appeals Division of the IRS. Further, there is no indication in the BBA that the IRS has the sole discretion to make these determinations or that judicial review is not available. Thus we anticipate that there will be an opportunity for Tax Court review.[50]

1. Determinations of Invalid Elections Out Should Be Subject to Administrative and Judicial Review

The Preamble states that the IRS intends to police the election-out rules to make sure that only eligible partnerships elect out. The Proposed Regulations state only that "if the IRS determines that an election under this Section for a partnership taxable year is invalid, the IRS will notify the partnership in writing and the provisions of subchapter C of chapter 63 will apply to that partnership taxable year."[51] It is not clear, however, whether the partnership will have an opportunity to respond to the IRS's notification of the invalid election, and/or have a right to review of this decision.

The effect of an election out is so consequential that we believe the determination of whether an election out is invalid should not be in the IRS's sole discretion, but should be subject

[50] *See e.g., Bowen v. Mich. Acad. of Family Physicians*, 476 U.S. 667, 670 (1986) ("[f]rom the beginning 'our cases [have established] that judicial review of a final agency action by an aggrieved person will not be cut off unless there is persuasive reason to believe that such was the purpose of Congress.'"); *Sharkey v. Quarantillo*, 541 F.3d 75, 83 (2d Cir. 2008) (there is a "strong presumption" that "Congress intends judicial review of administrative actions.").
[51] Prop. Reg. § 301.6221(b)-1(e)(2).

to judicial review. There is no clear congressional statement that the IRS's determination that an election out is invalid is not subject to review, and we therefore assume that Treasury did not intend to make these determinations unreviewable. To avoid any confusion, we recommend that the Proposed Regulation remove the clause "if the IRS determines," and simply state, "if an election is invalid. . . ."

We also believe that the taxpayer should be permitted to seek interim review of the invalidation of the election with IRS Appeals before the audit proceeds under the centralized partnership audit and collection regime. Although a partnership could challenge the invalidation of the election with Appeals after the IRS issues a NOPPA, and/or with the Tax Court after the IRS has issued an FPA, delaying review until after the IRS has completed the audit under the centralized partnership audit and collection regime is inefficient, and creates pitfalls for both sides. For the IRS, if an exam proceeds under the centralized procedures, and the Tax Court later determines that the election out was valid, the IRS may no longer be able to assess tax against the individual partners, as the statutes of limitations for assessment may have already expired. For partnerships, the lack of prompt review of the invalidation of the election will waste resources and upset settled expectations of taxpayers entering into partnerships.

We understand that it would be burdensome for the IRS to review the return of every partnership that elects out, and that the IRS is likely only to review an election as part of its examination of the partnership's return for a particular tax year or years. Accordingly, we do not suggest that the IRS be required to invalidate the election within a particular time frame, but instead, that it provide the partnership with notice and an opportunity to respond before the IRS makes a final decision to invalidate the election.

2. Denials of Requests for Modification of Imputed Underpayment Should Be Subject to Administrative and Judicial Review

The IRS must approve any request for modification of the imputed underpayment under Section 6225(c)(7). The IRS's review of the requests for modification, including the requests for additional information and the determination of whether to approve all or part of a request for modification, is part of the partnership's administrative proceeding, and is not an examination, inspection, or other administrative proceeding with respect to any other person, *i.e.*, the individual partner, for purposes of Section 7605(b).[52] The partnership must substantiate the facts supporting its request for modification "to the satisfaction of the IRS."[53] The necessary documentation and information will depend on the facts and circumstances of the particular modification request, and may include tax returns, partnership operating documents, certifications, and other information. The IRS will deny a request for modification if the partnership does not provide the information that the IRS determines is necessary to substantiate a request for modification in a timely manner.[54]

The Proposed Regulations do not provide guidance as to the IRS's discretion to deny requests for modification except that the IRS will deny a request if the partnership does not provide information in a timely manner. The IRS's discretion to deny requests for modification should be limited to circumstances where there has been a material failure to comply with the filing or substantiation requirements, or failure to satisfy a particular requirement for modification, such as one partner not being a valid tax-exempt entity, or a claimed lower rate not actually applying to the item at issue. The IRS should not have general discretion to deny requests for modification merely because it is in the best interest of the IRS to do so.

[52] Prop. Reg. § 301.6225-2(c)(1).
[53] Prop. Reg. § 301.6225-2(c)(2)(i).
[54] *Id.*

Further, we suggest that the Proposed Regulations require the IRS to notify a partnership of its intent to deny a modification, and provide the partnership with an opportunity to respond. We do not believe this additional procedure would jeopardize the IRS's ability to adjust the partnership's taxable year under Section 6235(a)(2) in a timely manner, because the partnership would not be considered to have provided "everything required to be submitted" to the IRS until the partnership had responded to the IRS's notice of disapproval. Of course, IRS denial of a request for modification should be subject to review by the Tax Court.

3. Determinations of Invalid Push-Out Elections Should Be Subject to Administrative and Judicial Review

If the IRS determines that an election is invalid, the partnership bears sole responsibility for paying tax (and additions to tax) for any imputed underpayment to which the election related "as if the election were never made."[55] If the IRS determines that an election under Section 6226 is invalid, it is required to notify the partnership and the Partnership Representative within 30 days of the determination that the election is invalid, along with any and all reasons for this adverse determination.

The IRS can determine that push-out election is invalid because, for example, the election is not timely or the taxpayer failed to provide the required information. The Proposed Regulations do not provide guidance as to the IRS's discretion to determine that a push-out election is invalid. We suggest that the Proposed Regulations require the IRS to notify the partnership of its intent to determine that an election is invalid, and provide the taxpayer with an opportunity to respond prior to making a final determination. Moreover, if the IRS determines that an election is invalid, the partnership should be able to seek review of that decision in the Tax Court.

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[55] Prop. Reg. § 301.6226-1(c)(2).

4. Determinations that a Designation of a PR Is Not in Effect Should Be Subject to Administrative Review

Proposed Regulation Section 1.301-6223.1(f) allows the IRS to determine that a designation of a PR is not in effect. In such case, the IRS must give the partnership notice and opportunity to designate a successor within 30 days and if the partnership does not designate a successor within 30 days, the IRS will designate a successor. The Proposed Regulations appear to give the IRS complete discretion to determine whether a PR designation is in effect. However, the IRS may be incorrect in its determination. Accordingly, the regulations should allow a partnership to contest and administratively appeal an IRS determination that a designation is not in effect. The regulations could avoid causing any prejudice to the IRS by providing that an IRS determination that a PR designation is not in effect is presumptively correct unless and until IRS Appeals overrules the determination.

F. Section 6621: Election Out of the BBA

Section 6221(b) provides that a partnership may elect out of the BBA for the taxable year if, "for such taxable year, the partnership is required to furnish 100 or fewer statements under Section 6031(b) with respect to its partners" and "each of the partners of such partnership is an individual, a C corporation, any foreign entity that would be treated as a C corporation were it domestic, an S corporation or an estate of a deceased partner." In the case of a partner that is an S corporation, the partnership must furnish to the IRS a statement for each shareholder with adequate identifying information, and each such statement is counted toward the 100 statement limit referred to above. If a partnership makes this "election out," any proposed adjustments will be determined, and any tax will be assessed and collected at the partner level pursuant to the ordinary deficiency procedures that apply to other taxpayers, rather than under the repealed

TEFRA rules. Congress delegated authority to Treasury to allow partnerships with other kinds of partners to elect out of the BBA.

In Notice 2016-23, the IRS requested comments regarding "whether any type of partner, other than those types of partners specifically identified in Section 6221(b)(1)(C), should be treated under rules similar to the special rules applicable to S corporations." In the Preamble, Treasury and the IRS noted that commenters had requested that entities such as disregarded entities, trusts, partnerships, and partners that use nominees should be considered eligible partners, but that they "declined to exercise the authority under Section 6221(b)(2)(C) to expand the types of entities that are eligible partners for purposes of the election out or to create separate election-out provisions for specific partnership structures" because any expansion of the election out provisions would impose additional administrative burdens on the IRS.

This approach is implemented in Proposed Regulation Section 301.6221(b)-1(b), which provides that only "eligible partnerships" with "eligible partners" may elect out. An "eligible partnership" is a partnership with 100 or fewer eligible partners. An "eligible partner" is defined in accordance with the statute as an individual, a C corporation, a foreign entity that would be treated as a C corporation if it were a domestic entity, an S corporation, or an estate of a deceased partner.[56] The following types of entities are not "eligible partners": partnerships, trusts, foreign entities other than those described above, disregarded entities, nominees or other similar persons that hold an interest on behalf of another person, or estates of individuals other than a deceased partner.[57] This means that partnerships with even one of these entities as a partner are prohibited from electing out of the BBA.

[56] Prop. Reg. § 301.6221(b)-1(b)(3)(i).
[57] Prop. Reg. § 301.6221(b)-1(b)(3)(ii).

1. Treasury Should Consider Expanding the Definition of Eligible Partner for Smaller Partnerships

As discussed above, given the broad scope of the BBA, there will be many situations in which the amount of an imputed underpayment will differ from the underpayment that would have arisen from the Correct Return Position. Further, the burden of paying the imputed underpayment will fall on reviewed-year partners who may be different from the adjustment year taxpayers who presumably benefited from any underpayment of tax. This aspect of the BBA will generate unfair tax results, both for taxpayers and the IRS, and will create opportunities for taxpayer abuse. In addition, the assessment and collection of tax at the partnership level is a significant change from the historic tax treatment of partnerships and will upset settled expectations and existing legal obligations.

The Proposed Regulations do a good job of ameliorating some of these concerns by allowing taxpayers to get to the Correct Return Position by modifying the imputed underpayment, making push-out elections, and filing AARs. We have made several recommendations in this report that are intended to facilitate taxpayers' ability to work with the IRS to determine the correct tax liability and impose that liability on the correct taxpayers. To the extent that Treasury adopts our recommendations, we have less concern about the broad scope of the BBA and the limitations on partnerships' ability to elect out. Nevertheless, we believe Treasury should consider allowing certain smaller partnerships to elect out of the BBA, even if they have a limited number of pass-through entities or nominees as partners, in order to minimize the problems described above, at least until procedures have been developed to get the BBA working fairly and effectively. We are mindful of the burden that is imposed on the IRS by allowing any partnership to elect out of the BBA, but we believe that the burden of allowing certain smaller partnerships to elect out is no greater than the burden that already exists under the

statute, and we believe that the burden of auditing partners of partnerships that elect out can be reduced, at least in part, by requiring electing partnerships to provide identifying information on which the IRS can rely, as described below.

The Proposed Regulations do not allow a partnership to elect out if it has any partner that is a pass-through entity (other than a subchapter S corporation) or a nominee. While we understand the desire to draw a bright line to limit the universe of partnerships that can elect out of the centralized audit regime, there does not appear to be anything unique about a partnership with another partnership, trust, disregarded entity, nominee, or estate as a partner that makes these partnerships *per se* more difficult to audit outside the BBA regime than partnerships with large numbers of individuals or corporations as partners. Under the Proposed Regulations as currently drafted, there will be many situations in which partnerships with relatively complex structures will be permitted to elect out of the centralized partnership audit regime, while smaller, simpler partnerships will be subject to the regime, as illustrated by the following examples:

> **Example 3.** Partnership is composed of two partners, Individual and S Corporation. S Corporation has 98 shareholders. Each of 98 individuals has formed a separate limited liability company ("LLC") disregarded for Federal income tax purposes as an entity separate from that individual,[58] and each of such LLC's is one of the 98 shareholders of S Corporation. Partnership *is eligible* to elect out.
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> **Example 4.** Same as Example 3, except that one of the shareholders of S Corporation, in lieu of being a disregarded entity, is a complex trust, as permitted by section 1361(c)(2)(A)(ii) or (iii). The complex trust has numerous beneficiaries, and, depending on the circumstances, including whether the complex trust's share of the income of Partnership constitutes "distributable net income" and what distributions, if any, the complex trust

[58] An LLC disregarded as separate from an individual shareholder is a permitted S corporation shareholder. *See* Priv. Ltr. Ruls. 200816002, 200816003, 200816004 (Jan. 14, 2008).

makes to its beneficiaries, the share of the income of Partnership allocated to the complex trust through S Corporation may affect the tax liability of some or all of such beneficiaries or of the complex trust itself. Partnership *is eligible* to elect out.

Example 5. Partnership is composed of 100 partners, 99 of which are individuals and one of which is the estate of a decedent. The estate has numerous beneficiaries, and, depending on the circumstances, including whether the estate's share of the income of Partnership constitutes "distributable net income" and what distributions, if any, the estate makes to its beneficiaries, the share of the income of Partnership allocated to the estate may affect the tax liability of some or all of such beneficiaries or of the estate itself. Partnership *is eligible* to elect out.[59]

In contrast, the following examples illustrate how partnerships with far less complex structures, which are less burdensome for the IRS to audit than those described above, are prohibited from electing out:

Example 6. Partnership has two equal partners, A, an individual, and C, a disregarded entity, wholly owned by B, an individual. Partnership *is ineligible* to elect out.[60]

Example 7. Partnership has two equal partners, E, an individual, and UTP, a partnership. UTP has two equal partners, F, an individual, and G, F's spouse. Partnership *is ineligible* to elect out.

Example 8. Partnership has two equal partners, Trust M, a fully revocable trust established by Individual N, and Trust O, a fully revocable trust established by Individual N's spouse, Individual P.[61] Each trust is treated as "owned" by its grantor under subchapter J of chapter 1 of the Code. Partnership is *ineligible* to elect out.

As the above examples illustrate, the mere existence of an upper-tier pass-through entity does not necessarily make an audit of a partnership more complex. Moreover, we believe that prohibiting any partnership with a partner that is another partnership, trust, estate, disregarded

[59] Prop. Reg. § 301.6221(b)-1(b)(2)(iii), Example 5.
[60] Prop. Reg. § 301.6221(b)-1(b)(3)(iv), Example 3.
[61] The use of fully revocable trusts as vehicles through which individuals hold substantially all or large parts of their assets is common in California and other states.

entity, or nominee from electing out will prevent legitimate business structures as partnerships from organizing themselves to fit within the definition of an "eligible partnership," even where the total number of ultimate taxpayers is small and manageable.[62] Finally, we believe that prohibiting partnerships with disregarded entities, trusts, and nominees as partners from electing out will lead to unintentional foot-faults and confusion.

We understand that some of the most significant problems the IRS encountered when auditing partnerships under TEFRA were difficulties in identifying partners, tracking partnership adjustments through to partners, and assessing and collecting the taxes from those partners.[63] Instead of addressing these problems by prohibiting all partnerships with any pass-through or nominee partners from electing out of the BBA, we recommend a more nuanced approach that specifically targets the identified problems. Our first suggestion is to allow a partnership to elect out, even if it has a limited number of pass-through or nominee partners and a limited number of tiers of pass-through partners. For example, an eligible partnership could be defined as a partnership with 100 or fewer eligible partners, no more than 5 or 10 of which are partnerships, trusts, estates, disregarded entities, or nominees, and with no more than 2 or 3 tiers of pass-through entities.[64] This flexibility could even be further restricted to smaller partnerships with, for example, no more than 25 or 50 direct or indirect partners, so that only smaller partnerships

[62] We note that permitting partnerships with 100 eligible partners – however eligible partner is defined – to elect out is likely to be unmanageable, but this is dictated by the statute.
[63] GAO Report at 24-30.
[64] Of course, there may be circumstances in which the presence of tiered partnerships will introduce additional complexity into an audit, as compared to the presence of a partner that is an S corporation because of the existence of special allocations. However, limiting the number of partnerships and tiers involved will limit the added complexity. Further, we believe that any incremental increase in the burden of auditing such structures is necessary to avoid excessive restrictions on taxpayers' ability to organize and reorganize themselves in accordance with business requirements.

that have some limited number of pass-through entities or nominees as partners would be permitted to elect out.[65]

To help reduce the burden on the IRS of auditing electing partnerships and their partners[66] under the normal deficiency procedures, we also suggest that the IRS require a partnership that is electing out to provide a statement with respect to each direct and indirect partner, including the taxpayer identification numbers and a "last known address" on which the IRS can rely for purposes of issuing notices, including a statutory notice of deficiency, or an FPA, so that the IRS can easily identify and locate the partners and assess tax against them.[67] We believe that allowing smaller partnerships with some limited number of pass-through partners to elect out of the BBA, on the condition that the electing partnership provide adequate identifying information, including a last known address on which the IRS can rely for purposes of assessing tax, will (i) conserve IRS resources by assisting the IRS to easily identify, audit, and assess partners in partnerships that elect out; and (ii) provide taxpayers with the flexibility to

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[65] In the Prior Report, we suggested that the IRS could approach Congress to lower the election-out threshold for all partnerships, thereby limiting the election out to smaller partnerships regardless of what kinds of partners are involved. Prior Report at 140. When we suggested that the right to elect out should be limited to smaller partnerships, we also recommended that Treasury interpret the scope of the BBA more narrowly than it has done in the Proposed Regulations in order to reduce the number of situations in which the imputed underpayment will differ from the Correct Return Position. Prior Report at 64. Because Treasury has interpreted the BBA more broadly, it is even more important to develop procedures to allow the taxpayers and the IRS to determine the correct tax and impose that tax on the correct taxpayer and we believe it may be appropriate to allow smaller partnerships to elect out of the BBA, even if they have a limited number of pass-through partners, at least until the procedures in the BBA and the Proposed Regulations have been developed in a fair and workable manner.

[66] While some indirect partners may balk at disclosing their identity to the lower-tier source partnership, providing identifying information would be the price they would have to pay in order to elect out.

[67] *See* Treas. Reg. § 301.6212-2(a) (generally, the taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed federal tax return, unless the IRS is given clear and concise notification of a different address). *See also AtlaSierraVista Inc. v. Comm'r*, 62 T.C. 367, 274 (1974). The Proposed Regulations could cross-reference Treasury Regulation Section 301.6212-2(a) to provide the definition of "last known address," or add a separate provision defining it in a manner that would be administrable for the IRS. In cases when time and resources are limited, the IRS could simply issue a statutory notice of deficiency or FPA to a partner to ensure that the tax will be assessed.

organize smaller partnerships with a limited number of pass-through entities when such structures are appropriate or necessary for business reasons.[68]

2. Additional Comments Under Section 6221

a. Treasury Should Provide a Rule for Spouses Holding Interest as Community Property

Proposed Regulation Section 301.6221(b)-1(b)(2)(iii), Example 2, involves Spouse 1 who holds title to an interest in Partnership, which interest constitutes community property of Spouse 1 and Spouse 2. The Example states, "[b]ecause Spouse 2's community property interest in Spouse 1's partnership interest is not taken into account for purposes of determining the number of statements Partnership is required to furnish under Section 6031(b), Partnership is required to furnish a statement to Spouse 1, but not to Spouse 2." No operative provision in the Proposed Regulations states that one spouse's community property interest in the other spouse's partnership interest is not taken into account for this purpose. If this is intended to be the rule, we suggest the Proposed Regulations state the rule expressly, rather than allude to it in an example.

b. Treasury Should Include Procedures to Notify Partners of an Election Out

The Proposed Regulations require that the partnership provide notice of the election out to its partners within 30 days of making the election, but do not provide any details as to the form of this notice, how long the partnership must maintain proof of having provided notice, or the consequences, if any, that result if the partnership fails to provide the required notice. We suggest that the IRS formalize this procedure by adding a box to the Form K-1 indicating that the partnership has elected out of the centralized partnership audit and collection regime. This

[68] This suggestion will also help smaller partnerships avoid foot-faults and unintentional disqualifications by partners who unknowingly contribute their partnership interests to a disregarded entity or trust.

would make notification clear and predictable, and simple for both the partnership and the IRS to verify. Further, we do not believe that an inadvertent failure to provide a timely notice should invalidate the entire election. Accordingly, we recommend that the Proposed Regulations require the IRS to notify a partnership of its failure to provide timely notice to its partners and allow the partnership a reasonable period of time to address any errors.

c. Treasury Should Define the Term "Timely Filed Return"

Section 6221(b)(1) and Proposed Regulation Section 301.6221(b)-1(c)(1) state that the election out must be submitted with the partnership's "timely filed return." Neither the statute nor proposed regulation specifies whether the return must be the partnership's original return or if the "timely filed return" includes amended returns that are filed under Section 6511. We believe that it is more consistent with the statutory regime to interpret this provision as requiring the election to be made on a timely filed original return or on an amended return filed before the due date for the original return (rather than on an amended return filed after the deadline for an original return, but timely under Section 6511). We believe that requiring the election to be made, either on an original or amended return, filed before the due date for the original return, will reduce uncertainty, for both partnerships and partners and the IRS, as to whether the centralized audit and collection procedures apply to the partnership for the tax year issue.

d. Treasury Should Provide Rules for Revoking an Election Out

Proposed Regulation Section 301.6221(b)-1(c) states that an election, once made, may not be revoked without consent of the IRS. The Proposed Regulations should explain how a partnership requests consent of the IRS to revoke an election. Treasury Regulations often

include instructions as to the time and manner of requesting revocation of an election.[69] Further, we suggest that the Proposed Regulations provide some guidance regarding the standards that the IRS will use to grant or deny such requests.

[69] *See e.g.*, Treas. Reg. § 1.528-8(f)(1) (election to be treated as a homeowner's association); Treas. Reg. § 1.897-3(f)(1) (election by foreign corporation to be treated as a domestic corporation); Treas. Reg. § 1.1295-1(i)(2) (qualified electing fund election).