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Acquisition, Dispositions & Structuring Techniques Corner

Additional Final Regulations Issued Under the Centralized Partnership Audit Rules Increase the Size and Reach of the "BBA Monster" That Congress Created

By Jerry August*

In T.D. 9844, December 21, 2018, Treasury and the IRS issued final regulations under Code Sec. 6221 through Code Sec. 6241 in implementing the centralized partnership audit regime. The regulations affect partnerships for taxable years beginning after December 31, 2017, and ending after August 12, 2018, as well as for partnerships that made an election-in to apply the new rules for partnership tax years beginning between November 2, 2015, and January 1, 2018. The final regulations adopt, with modifications and changes, portions of the proposed regulations (REG-136118-15) issued in August 2018.[1] The final regulations address approximately five statements delivered at a public hearing held on September 18, 2017, and an added statement made at a public hearing held on October 9, 2018, as well as numerous written comments to the June 2017 NPRM (notice of proposed rule-making), December 2017 NPRM and 2018 NPRM. In addition to addressing the statements and comments, editorial revisions were made to clarify language in the NPRMs, correct errors or grammatical mistakes and correct errors in cross-references.

Legislative and Administrative Background to the Centralized Partnership Audit Regime

In November 2015, as part of the Bipartisan Budget Act of 2015 (the "BBA"),[2] as amended by the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"),[3] a new set of tax procedural rules were enacted into law with respect to partnership audits, moving from a two-dimensional set of rules and limitations with respect to auditing partnerships and their partners to a centralized or consolidated partnership regime. The new BBA partnership audit rules became generally

effective for taxable years of partnerships beginning after 2017, subject to an elective phase-in rule for tax years commencing on or before December 31, 2017. The IRS lobbied Congress for the new regime since it felt disadvantaged under the "two-tier" partnership audit provisions of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA").[4] Based on the general effective date for taxable years of partnerships beginning after 2017, Treasury and the IRS had two years to issue guidance under the BBA.

The final regulations address important parts of the centralized partnership audit regime but clearly do not address all important provisions and areas where definitive guidance is needed.

While the new rules may have had a specific purpose in mind—*i.e.*, dramatically improving the administration of the tax law with respect to auditing partnerships and collecting tax revenues from resulting understatements of partnership income tax—the statutory language which is relatively clear and crisp nevertheless hides the substantial difficulties and ambiguities in attempting to apply the new rules, which have essentially three methods of audit and payment models. The election-out model, which is limited to partnerships having 100 or fewer eligible direct partners, which election is made on an annual basis by the partnership representative, results in the application of general deficiency, refund and assessment and collection procedures at the individual partner level. The second model is referred to by some as the "default" model, which results in the assessment and collection of any deficiency in partner-level income tax for the "reviewed years" under audit from the partnership in the year in which the audit is concluded and settled or as may later occur as the result of an appeal or final judicial decision. The third model starts with the default model, but provides that the partnership representative may elect to push-out to each reviewed year partner its pro rata portion of the adjustments reflected in the imputed underpayment amount, which is to be assessed and collected as tax and additions to tax from the reviewed year partners instead of from the partnership. The IRS may agree to issue separate imputed underpayment amounts to the partnership which, through its partnership representative, can elect to push out several but not all of the imputed underpayment assessments.

The central characteristics of a centralized partnership audit from a timeline perspective are: (i) a notice of administrative proceeding ("NOPA") is issued by the IRS to the partnership and the partnership representative; (ii) in accordance with Code Sec. 6223, only the partnership representative can participate in the audit for the partnership and all direct and indirect partners unless and only to the extent permitted by the IRS; (iii) at the end of the audit the IRS issues a notice of proposed partnership adjustment ("NOPPA"), which sets forth the amount of the aggregate "imputed underpayment" or, alternatively, one or more separate independent NOPPA and then a general or residual NOPPA; (iv) within 270 days from the mailing of the NOPPA, the partnership, again through the partnership representative, may request a modification to the amount of the "imputed underpayment"; (v) after review of the proposed modifications under Code Sec. 6225(c), the IRS must issue by mail a notice of its final partnership adjustment ("FPA") within 270 days after the mailing of the NOPPA;[5] (vi) within 45 days after the date that the FPA is issued by the IRS, the partnership representative may elect to "push out" the audit adjustments attributable to the NOPPA or one or more of the individual audit adjustments attributed to a separate imputed underpayment determination, with the resulting taxes, penalties and interest payable by the reviewed-year partners based on their respective percentage interests in the items subject to the adjustments, with further adjustments for subsequent years ending before the adjustment year; (vi) the partnership representative, on behalf of the partnership, may challenge an FPA by filing a readjustment petition in the Tax Court, applicable federal district court, or the Court of Federal Claims within 90 days of the mailing of the notice of the FPA; and (viii) the IRS is permitted to assess and collect the imputed underpayment after 90 days of the mailing of the notice of FPA, or if a petition is filed, the date the decision of the court becomes final.[6] The full payment rule, which is modified to a limited extent in this context, still applies for purposes of an applicable federal district court or Court of Federal Claims obtaining jurisdiction to review the case.[7]

Checking the BBA Centralized Partnership Audit Rules Scorecard: Multiple Layers of Guidance

The first rule-making under the BBA was the "election-in" rule for tax years beginning after November 2, 2015, and before January 1, 2018.[8] The ability to make an

"early" election into the new centralized audit rules is authorized under section 1101(g)(4) of the BBA. Under Temporary Reg. §301.9100-22T, which was issued on August 5, 2016, partnerships were instructed on the time, form, and manner for a partnership to make an early election-in.

On June 14, 2017, a notice of proposed rulemaking ("June 14 NPRM") set forth rules pertaining to (1) the scope and election out of the new regime, (2) consistency in reporting by partners, (3) the powers and duties of the partnership representative, (4) partnership adjustments made by the IRS and determinations of the amount of the partnership's liability, *i.e.*, the imputed underpayment, (5) the filing of administrative adjustment requests ("AARs"), and (6) the election for partners to take the partnership adjustments into account (Code Secs. 6221 through 6227 and Code Sec. 6241).[9] The June 14 NPRM reserved comment on a number of items, including how passthrough partners take into account adjustments to basis, capital accounts and tax attributes under the push-out election in Code Sec. 6226 and similar rules under Code Sec. 6227 with respect to AARS. Included in the items reserved in the June 14 NPRM were (1) rules pertaining to partners that are foreign entities; (2) adjustments to partners' outside bases and capital accounts and a partnership's basis and book value in property; and (3) rules coordinating the AAR rules in Code Sec. 6227 with creditable foreign taxes incurred by a partnership.

On November 30, 2017, the government issued a notice of proposed rulemaking (REG-119337-17) (November 2017 NPRM) proposing rules regarding international provisions under the centralized partnership audit regime, including rules relating to the withholding of tax on foreign persons, the withholding of tax to enforce reporting on certain foreign financial or non-foreign financial accounts, and the treatment of creditable foreign tax expenditures of a partnership.[10]

On December 19, 2017, proposed regulations were issued with respect to rules governing push-out elections under Code Secs. 6226 and 6227, including rules for tiered partnership structures, as well as relevant administrative and procedural provisions, including rules pertaining to the assessment and collection of tax, interest and penalties, statutes of limitation and judicial review of partnership adjustments.[11] The December 2017 NPRM also provided rules addressing how passthrough partners take into account adjustments under the alternative to the partnership's payment of the imputed underpayment described in Code Sec. 6226 and under rules similar to Code Sec. 6226 when a partnership files an AAR pursuant to Code Sec. 6227.

Final regulations with respect to elections out of the centralized partnership audit rules were issued on January 2, 2018, which was one day after the statutory provisions became operative for calendar-year partnerships.[12] Then, on February 2, 2018, proposed regulations were issued with respect to adjusting tax attributes, including basis and property inside the partnership, as well as capital accounts.[13]

On March 23, 2018, the Bipartisan Consolidated Appropriations Act ("BCCA"),[14] was enacted into law. In addition to making technical corrections to the partnership audit rules, the BCCA adopted a "pull-in" procedure rule which permits the modification of an imputed underpayment without requiring the filing by individual partners of an amended return. This welcome addition to the BBA is reflected in Code Sec. 6225(c)(2)(B). The pull-in procedure results in partner payments and information that may be collected by the IRS. This procedure permits the partnership representative to be forwarded the necessary information required by the IRS in approving of the pull-in modification.[15]

But this law takes away important procedural and substantive due process rights that are inherent and long-standing in our tax administration system. Someone ought to go back to Congress and get them to listen.

On August 9, 2018, Treasury and the IRS issued final regulations[16] under Code Sec. 6223 providing rules relating to partnership representatives and final regulations under Reg. §301.9100-22 providing rules for electing into the centralized partnership audit regime for taxable years beginning on or after November 2, 2015, and before January 1, 2018.[17]

On August 17, 2018, Treasury and the IRS issued a proposed rulemaking,[18] notice of public hearing, and withdrawal and partial withdrawal of notices of proposed rulemaking[19] that withdrew the regulations proposed in the June 2017 NPRM, the November 2017 NPRM, the December 2017 NPRM, and the February 2018 NPRM, with the proposed regulations reflecting the technical corrections enacted in the BBCA as well as other changes as discussed in the preamble to the August 2018 NPRM.

Written public comments were received in response to the August 2018 NPRM, and a public hearing regarding the proposed regulations was held on October 9, 2018.

In the Preamble to the final regulations just issued, it is stated that:

> After careful consideration of all written public comments received in response to the June 2017 NPRM, the December 2017 NPRM, and the August 2018 NPRM, as well as statements made during the public hearings for the June 2017 NPRM and the August 2018 NPRM, the portions of the August 2018 NPRM described in this preamble are adopted as amended by this Treasury Decision. Comments received in response to the February 2018 NPRM or that otherwise concern basis and tax attribute rules under §301.6225-4 or §301.6226-4 will be addressed in future guidance. For purposes of this preamble, the regulations proposed in the June 2017 NPRM, the November 2017 NPRM, and the December 2017 NPRM are collectively referred to as the "former proposed regulations." The regulations proposed in the August 2018 NPRM are referred to as the "proposed regulations."

Resolution of Statements and Comments Received by the IRS and Provisions Contained in the Final Regulations

The final regulations address important parts of the centralized partnership audit regime but clearly do not address all important provisions and areas where definitive guidance is needed. In general, the final regulations made changes as to the scope of the BBA and set forth detailed and complex rules and examples pertaining to the consistency reporting requirements under Code Sec. 6221. For example, the rule-making does not address appeals proceedings under the BBA or adjustments to basis and tax attributes, which were part of the proposed regulations. As set forth in a lengthy several hundred-page Preamble, the final regulations address rules pertaining to imputed underpayments, modification of an imputed underpayment and rules pertaining to how adjustments not resulting in an imputed underpayment are taken into account. The final regulations make changes or clarifications pertaining to the notice of proceedings and adjustments, interest and penalties with respect to imputed underpayments as well as issues related to judicial review. Also addressed are rules regarding the liability of former partners for any imputed underpayments with respect to the partnership that has terminated or otherwise ceased to exist. The newly issued final regulations apply to partnership tax years beginning after December 31, 2017, and ending after August 12, 2018, as well as partnerships that had elected to apply the centralized partnership audit regime to partnership tax years beginning on or after November 2, 2015, and before January 1, 2018.

Some of the more important set of determinations set forth in the Preamble and reflected in the final regulations just issued are as follows:

1. Scope of the Centralized Partnership Audit Regime. The BCCA amended Code Sec. 6221(a) by replacing the phrase "items of income, gain, deduction loss or credit of a partnership for a partnership taxable year (and any partner's distributive share thereof)" with the term "partnership-related item." The August 2018 NPRM adopted the BCCA amendments to Code Secs. 6221(a) and 6241(b) by moving the majority of the regulation text under former Proposed Reg. §301.6221(a)-1 to the definition of "partnership-related item" under Proposed Reg. §301.6241-6. As revised, Reg. §301.6241-1(a)(6) provides that partnership-related items are only items or amounts reflected, or required to be reflected, on the partnership's return or in its books and records with respect to the partnership. This includes items or amounts relating to any transaction with, liability of, or basis of the partnership. Under Code Sec. 6241(2)(B)(i), a partnership-related item includes a partner's distributive share of amounts or items such partner is to be allocated in accordance with the partnership agreement. It also would include allocations of gain or loss required under Code Secs. 704(c) or 743.

   The final regulations revise the operative language with respect to making adjustments to partnership-related items as to those items that require a legal or factual determinations to be made at the partnership level, including tax and penalties. This would include, quite obviously perhaps, the determination of the applicable statute of limitations with respect to the partnership-related items. The phrase "with respect to the partnership" excludes items or amounts shown, or required to be shown, on a return of a person other than the partnership (or in that person's books and records) that result after application of the Code to a partnership-related item and that take into account the facts and circumstances specific to that person. *See* Code Sec. 6241(2)(B)(i); Reg. §301.6241-1(a)(6)(vi) (examples).

2. Consistency Requirements under Code Sec. 6222. Under the statutory consistency rule, a partner is required to treat each partnership item reflected on Form K-1 issued by the partnership in the same or consistent manner in filing its tax return. The partner's treatment must be consistent with respect to amount, timing and characterization of the item. Guidance on the consistency requirement was issued in the June 2017 NPRM.

   The final regulations clarify and provide in great detail issues and rules regarding the consistency requirement including:

   a. Returns Requiring Consistent Treatment or Inconsistency Statement. The consistency requirement applies to each return of the partner that reflects, or is required to reflect, partnership-related items including both original and amended returns. The final regulations provide that a relevant return for this purpose includes any return, statement, list or schedule as well as any amendment or added disclosure made with respect to such return filed by a partner as to any tax imposed by the Code. Reg. §301.6222-1(a).

   b. Notice of Inconsistent Treatment. A partner is permitted to file a notice of inconsistent treatment, provided such statement is properly made and timely submitted in a statement attached to the "partner's return" with respect to which the partnership-related item is being treated on an inconsistent basis or is identified as potentially being inconsistent with the manner in which the item is reported by the partnership.

   c. NOPA Cut-Off. Once a NOPA has been issued by the IRS to the partnership and partnership representative under Code Sec. 6231, a partner may not notify IRS that the partner is treating an item inconsistently with the partnership return, or, if applicable, with respect to an item reported for a tax year after a notice of administrative proceeding has been mailed. Reg. §301.6222-1(c)(5). The IRS's rationale for the purpose for such rule is clear, *i.e.*, once a NOPA is issued with respect to any tax year of the partnership, any adjustment to a partnership-related item must be determined exclusively within that partnership-level proceeding in accordance with Code Sec. 6221(a).

   d. Partnership Representative May Bind All Partners. Confirms that all partners, including those partners who filed notice of inconsistent treatment, are still bound by the actions of the partnership through its partnership representative in a final determination or petition for readjustment proceeding under the BBA.[20] However, the final regulations acknowledge, despite the clear language of Code Sec. 6223 that granted sole and exclusive authority to the partnership representative to represent the partnership, that it has discretion to allow any person, including a partner who reported inconsistent treatment, to participate in that proceeding.[21]

   e. Consistency Requirement Where No Partnership Return Filed. Where a partnership failed to file an informational tax return, any treatment of a partnership-related item on a partner's return may be removed, and the IRS may determine any underpayment of tax resulting from such adjustment. Reg. §301.6222-1(b)(1)). Under the proposed regulations, a partner's treatment of a partnership-related item attributable to a non-filing partnership was per se inconsistent.

3. Provisions Related to Imputed Underpayment Rules. The newly issued final regulations address, in detail, rules required to be applied in the determination of an imputed underpayment,[22] the modification of an imputed underpayment,[23] and adjustments that do not enter into the determination of an imputed underpayment.[24]

   a. No Netting of Adjustments Across Reviewed Years. Under Code Sec. 6225(b)(1)(A), any imputed underpayment for a reviewed year is determined by appropriately netting all adjustments with respect to such year. No mention is made in the statute of netting across reviewed years. We know that in order to determine an imputed underpayment, each partnership adjustment made by the IRS is allocated into one of four groups:[25] the reallocation group or grouping, the credit grouping, the creditable grouping or the residual grouping. There are then subgroupings made, where appropriate, within each grouping such as the netting of long and short-term capital gains and losses.[26] The final regulations cover in great length the grouping and netting rules. Then, the audit phase enters into the modification rules (which are set forth in Code Sec. 6225(c)) in an effort by the partnership representative, on behalf of both the partnership and individual partners, whether direct or indirect partners, to mitigate the amount of the imputed underpayment to

the partnership or under regulations under Code Sec. 6226 with respect to push-out election payments to be made by each reviewed year partner, taking into account individual partner tax attributes and history. The final regulations confirm that there is no netting of adjustments for one reviewed year with another reviewed year.

b. Imputed Underpayment Determined Under Highest Marginal Rate of Tax. Under Code Sec. 6225(b)(1)(B) and Proposed Reg. §301.6225-1, an imputed underpayment is determined by multiplying the total net partnership adjustment by the highest rate of federal income tax in effect for the reviewed year under Code Secs. 1 or 11 and increasing or decreasing such amount by certain adjustments for credits and creditable expenditures. Comment was received by the IRS that partners having a lower rate of tax be used in computing the imputed underpayment amount, but that idea was rejected in the Preamble. The modification rules in Code Sec. 6225(c) take care of the issue.

c. No Presentation During the Partnership Audit of Partner-Level Tax Attributes. Despite receiving a comment that would allow such information to be presented during the partnership audit, the IRS rejected this proposal on the basis that it would significantly impede the exam and create administrative burdens for the government. Instead, modification is generally the proper point in the audit during which partner tax attributes may be raised by the partnership and considered by the IRS.

d. Clarifications with Respect to the Code Sec. 6225(c) Modification Rules. The modification provisions under Reg. §301.6225-2 are designed to determine an imputed underpayment amount that reflects, as closely as possible, the tax the partners would have paid had they correctly reported the adjusted items, while at the same time maintaining the efficiencies of a streamlined examination and collection process. Otherwise, as the Preamble to the final regulations acknowledges, the centralized partnership audit rules can produce an imputed underpayment amount that exceeds the proper amount of tax that the reviewed year partners, in the aggregate, would have had to pay if the adjustments resulting in an increase in tax for one or more reviewed years were made to the individual returns. Under the final regulations, a partnership may request modification with respect to reviewed year partners (direct partners), including passthrough partners, and indirect partners. For example, the partnership and its partners can utilize the amended return procedure or the alternative procedure to filing amended returns, the "pull in" procedure, which requires partners to take the adjustments into account in light of their individual tax attributes and make payment of any tax and additions to tax owing to reduce the imputed underpayment amount. Those procedures would potentially allow partners to offset passive income with any passive losses, consistent with the procedure recommended by the comment. In the alternative, the partnership may elect to push out the adjustments under Code Sec. 6226, and the partners would be required to take into account the adjustments and any effects on the partners' tax attributes. A partnership may not request modification, however, with respect to a direct or indirect partner that is a wholly-owned entity disregarded as separate from its owner for Federal income tax purposes. As with the final regulations generally, the Preamble and the final regulations cover this area in great depth and respond to each comment submitted with respect to the areas covered in the final regulations, including the determination of the imputed underpayment amount and the modification rules and procedures.

e. Pull-In Mechanics. As set forth in the BCCA in Code Sec. 6225(c)(2)(B) and Reg. §301.6225-2(d)(2)(x), under the alternative procedure the partnership may meet the requirements of amended return modification by submitting on behalf of relevant partners, in accordance with such information required by the IRS in guidance or otherwise prescribed, all information and payment of any tax, penalties, additions to tax, additional amounts, and interest that would be required to be provided if the relevant partner were filing an amended return. The partnership must demonstrate that relevant partners have agreed to take into account tax attributes consistent with taking into account the partnership adjustments allocable to that partner. A comment recommended that the modifying partner using the "push-in" procedure to deal directly with the IRS exam team

during the partnership audit because many partners will not want to provide the details of their financial affairs to the partnership representative or the partnership. The regulations do not provide specific details as to what information will need to be provided to the IRS under the alternative procedure, but the IRS intends to develop such processes. This is a welcome development. The processes the IRS develops may ultimately provide that the partners submit some information directly to the IRS, but the partners will likely be required to provide some information to the partnership representative to request modification. Nothing in the regulations prevents the partnership from working with third parties or selecting a partnership representative that will not share the details of the partners' financial affairs directly with the partnership. The partnership, the partnership representative, and the partners will ultimately be required to meet filing requirements established in forms, instructions, and other guidance. There were 22 comments received concerning Code Sec. 6226.

f. Partner-Level Defenses to Penalties. The BBA provides that penalties on adjustments to partnership-related items are determined at the partnership level. Nevertheless, the guidance under the BBA has acknowledged that partner-level defenses, such as based on reasonable cause under Reg. §1.6664-4, would be entertained at the appropriate time in the audit or assessment process. The IRS and Treasury, as reflected in the Preamble, determined that the partner-level penalty defenses should not be addressed as part of the modification process. Instead, the partnership-level penalty is to be assessed as part of the imputed underpayment, or, if elected by the partnership through its partnership representative, pushed-out to the review-year partners. Alternatively, the penalties can be required to be paid by each partner who submits an amended return together with payment of tax and penalties, *etc.*, or comes forward with a push-in election and payment of tax and penalties, *etc.* Whether a specific partner is then entitled to a refund of penalties paid is to be determined outside of the modification procedures. The final regulations provide that a partner must first pay any penalty due with the amended return (or alternative push-in information) during the modification process and then afterward file a claim for refund of the penalty in order to raise a partner-level defense. In response to a comment, the final regulations per Reg. §301.6225-2(d)(2)(vii) provide that the IRS intends to develop through future guidance alternative procedures for raising partner-level defenses as the IRS "gains more familiarity with the centralized partnership audit regime." Yes, that's what the Preamble states.

g. Partnership Payment of Penalties on Behalf of Partners. A comment was received recommending that the partnership have the option of paying penalties at the partnership level while pushing out the partnership adjustments to its partners. This was recommended, in part, because pushing out penalties would require long and complex explanations why the penalties apply, which may prove to be burdensome to the partnership, the affected partners of course and may result in disputes and possibly litigation among the partners, the partnership representative and the partnership. Code Sec. 6226(c)(1) provides that penalties, additions to tax or additional amounts will be determined under Code Sec. 6221 and the partners of the partnership will, in the event a push-out election is made, be liable for the payment of such additions to tax. Were the partnership to pay any penalties, additions to tax or additional amounts instead of pushing out those amounts to its partners, the payment would be a payment towards the liability of the partners and not the partnership. The Preamble does not provide whether such payment would constitute a distribution under Code Sec. 731(a) or income from the discharge of indebtedness. Presumably, the Service will treat the payment as a deemed distribution. Alternatively, the partnership could document the advance for the payment of penalties, additions to tax, *etc.*, despite the push-out election as a loan with appropriate terms for repayment. Indeed, the Preamble notes that the partnership and its partners may enter into a business arrangement in this context. While the final regulations make no specific provision for partnership-level payment of partner additions to tax as part of reducing the push-out adjustment (and added tax in the adjustment year return of each affected partner), it does not prohibit the partnership from making such payment in general.

h. Payment of Tax and Additions to Tax on Behalf of Foreign Partners Under a Push-Out Election. A comment was also received that suggested the IRS create a process by which the partnership could pay both interest and penalties on behalf of foreign partners so that those foreign partners would not need to obtain a TIN to file a U.S. tax return to report and pay interest and penalties. While there were several aspects to this recommendation, it was not adopted. In short, the IRS stated that push-out statements to foreign partners requires the foreign partners to pay the tax on their U.S. income tax return for the adjustment year.

4. Rules for AARs. Under Code Sec. 6227, a partnership may file an AAR for one or more partnership-related items for any partnership year. Proposed Reg. §301.6227-1(a) sets out applicable rules for filing an AAR. In particular, a partnership may file an AAR as to one or more items of income, gain, loss, deduction, or credit of the partnership and any partner's distributive share thereof for any partnership taxable year as determined under Code Sec. 6221 and the regulations thereunder. Proposed Reg. §301.6227-1(a) requires a partnership to determine whether the adjustments requested in the AAR result in an imputed underpayment in accordance with Proposed Reg. §301.6227-2(a) for the reviewed year, that is, the taxable year to which the adjustments relate (*see* Proposed Reg. §301.6241-1(a)(8)). If adjustments that are requested result in an imputed underpayment, the partnership takes the adjustments into account and requires the partnership to pay the imputed underpayment unless the partnership makes an election. If the partnership makes such election in accordance with Proposed Reg. §301.6227-2(c), the reviewed-year partners take the adjustments into account in accordance with Proposed Reg. §301.6227-3, which provides rules similar to Code Sec. 6226. Under Proposed Reg. §301.6227-1(a), if the adjustments do not result in an imputed underpayment, the reviewed-year partners must still take the adjustments into account under the rules of Proposed Reg. §301.6227-3. Only a partnership may file an AAR, and a partner may not file an AAR unless the partner is doing so in his or her capacity as partnership representative for the partnership. A partnership may not file an AAR after a NOPA is mailed by the IRS.[27] 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 is filed; or (ii) the last day for filing the partnership return for that year determined without regard to extensions.[28]

The final regulations pertaining to an AAR address various items and comments, including:

a. Can Multiple Imputed Underpayments Be Combined in a Single AAR? The IRS received a comment recommending that the final 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. The IRS agreed that a partnership may file multiple AARs to allocate adjustments into separate imputed underpayments—effectively achieving the same result. The IRS also revised the final regulations in order to (i) "accommodate future cases in which an AAR may result in more than one imputed underpayment" and (ii) clarify that, in the case of an election to have the reviewed year partners take into account the adjustments in an AAR, such partners take into account only those adjustments that are associated with the imputed underpayment to which the election relates.[29]

b. Intersection of AAR and Push-Out Elections. Proposed Reg. §301.6227-3(e) is confirmed in the final regulations by adopting the rule that allows passthrough partners to take into account adjustments requested in an AAR by either making a payment or pushing out the adjustments to the next tier of partners.

c. Information Deficient AARs. The final regulations clarify that where the partnership fails to provide information required under Reg. §301.6227-1(c)(2), the IRS may, in its discretion, invalidate an AAR or readjust items that were adjusted in the AAR.[30] Under the final regulations, a passthrough partner must take into account AAR adjustments that, with respect to that passthrough partner, do not result in an imputed underpayment, by furnishing statements to its affected partners—regardless of whether the adjustments that do not result in an imputed underpayment arose pursuant to Reg. §301.6225-1(f)(1)(i) or Reg. §301.6225-1(f)(1)(ii). This rule also applies in situations where the passthrough partner pays an imputed underpayment. Reg. §301.6227-1(e)(2) further clarifies that when a partnership pays an imputed

underpayment and there are adjustments that did not result in that imputed underpayment pursuant to Reg. §301.6225-1(f)(1)(i), only the adjustments that did not result in an imputed underpayment are to be included in the statements to its affected partners.

5. Rules With Respect to the Modification Rules and Foreign Partners and Certain U.S. Partners. The proposed regulations, in Proposed Reg. §301.6226-2, "reserve" on rules applicable to the withholding provisions to foreign partners, including foreign entities, or certain domestic partners. In general, amounts received by a partnership allocable to a foreign partner are potentially subject to withholding under chapter 3 of subtitle A of the Code (chapter 3),[31] and certain amounts allocable to a foreign or domestic partner may be subject to withholding under chapter 4 of subtitle A of the Code (chapter 4).[32] To the extent that amounts are withheld by the partnership or other withholding agent under chapter 3 or 4, and remitted to the IRS, such amounts are creditable by the foreign partner or domestic partner to offset the chapter 1 tax the partner otherwise would owe in the absence of the withholding. The purpose of chapter 3 withholding is to ensure compliance by foreign persons with respect to income subject to tax under chapter 1, by requiring the partnership (or other withholding agent) to withhold and remit the tax that would normally be paid by the foreign person on payments or income allocated to the foreign person. The final regulations provide that partnership-level income generated as part of a push-out statement to a foreign person where the partnership elects under Code Sec. 6226, such income should nevertheless be subject to the withholding regimes in chapters 3 and 4 in the adjustment year to the same extent that such amounts would have been if they had been properly accounted for by the partnership in the reviewed year. Regulations will be forthcoming in this area and further comments were requested. In particular, Treasury and the IRS request comments on: (i) how the partnership should satisfy its reporting obligations under chapters 3 and 4 in the reporting year with respect to income allocable to a foreign partner or domestic partner; (ii) whether the partnership should be required to obtain new documentation from partners, including qualifying for a lower rate under applicable treaty, to obtain a lower withholding rate or whether the partnership should be able to rely on documentation obtained with respect to the reviewed year; and (iii) how the rules under chapters 3 and 4 should apply when a statement described in Proposed Reg. §301.6226-2 includes additional income allocable to a foreign partner that is an intermediary or flow-through entity. The IRS also intends to issue regulations that address instances where a direct partner in the partnership is a foreign entity, such as a trust or corporation, that may not be liable for U.S. federal income tax with respect to one or more adjustments, but an owner of the direct partner is, or could be liable for tax with respect to such amount. For example, if a direct partner in the audited partnership is a controlled foreign corporation, the foreign corporation as a direct partner may not have a U.S. tax liability with respect to a given adjustment; however, the adjustment may impact the tax liability of its U.S. shareholder(s). The tax effects on the U.S. shareholder(s) may arise in the adjustment year, an intervening year, or some subsequent year, depending on the specific facts and circumstances.

The foregoing summary of many of the important issues addressed by Treasury and the IRS in issuing the December 21, 2018 set of BBA final regulations in no way reflects the depth and breadth of coverage of the final regulations and the analysis provided in the Preamble. It indeed is a lengthy and complex read. Perhaps an extensive rules-based system is what the BBA needs, if not required. But the overall predicate or foundation of the BBA that the partnership representative "binds all partners" and indirect partners, which is what the former Commissioner of the IRS implored that Congress enact into law, will, in the view of this author, generate much controversy and yes, litigation, among partners, the partnership and the partnership representative. Why? Because one person or one individual is deciding what the individual partners, either for the reviewed year(s) under audit, or as to even new partners who indirectly are charged with payment of the tax under a Code Sec. 6225 assessment, will pay in additional tax, penalties and ("super-charged") interest. This did not occur under TEFRA. TEFRA allowed notice partners to participate at all stages of the audit through trial and appeal. The assessment was always made to the reviewed-year partners. The statute may work for large funds and funds of funds with hundreds, if not thousands, of partners where taxes are paid at the partnership level for prior year adjustments, in similar fashion to corporate income tax procedures. But this law takes away important procedural and substantive due process rights that are inherent and long-standing in our tax administration system. Someone ought to go back to Congress and get them to listen. What's the key then? Well, electing out.

But it must be done timely and on an annual basis, and all direct partners must be eligible to qualify the partnership representative to make the election out. Many closely held partnerships, particularly family partnerships, which have trusts, including grantor trusts or even defective entities as owners of membership interests, are not eligible. Maybe some tax advisors who see through the morass of rules and, more importantly, unfortunate outcomes under the audit rules and the process itself, may decide to migrate back to corporate status either under Subchapter S, to retain flow-through treatment and shareholder-by-shareholder audits and assessments, or Subchapter C. But even that suggestion fails to remedy the problem, if such entity invests in a business that is a partnership that does not elect out of the BBA or itself invests in a lower-tier partnership that does not elect out.

ENDNOTES

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1 Comments on proposed regulations (REG-118067-17) issued in February 2018 or comments regarding basis and tax attribute rules will be addressed in a forthcoming set of regulations or other guidance.

2 Act Sec. 1101 of Bipartisan Budget Act of 2015 (the "BBA") (P.L. 114-74).

3 Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") (P.L. 11-113).

4 P.L. 97-248 (former subchapter C of chapter 63 of the Code). Section 1101(c) of the BBA replaced the TEFRA partnership procedures and the rules applicable to electing large partnerships with a centralized partnership audit regime that determines adjustments and, in general, determines, assesses, and collects tax at the partnership level. *See, generally*, August, *New Final and Proposed Regulations on the Centralized Partnership Audit Regime*, Corporate Taxation (WG&L) (Jul/Aug 2018); August and Cuff, The New Partnership Audit Rules: Guidance Needed, 44 Corp. Tax'n 3 (Jan/Feb 2017); August, *Drafting Partnership Agreements: The New Partnership Representative and the Outgoing Tax Matters Partner*, 44 Corp. Tax'n 3 (Sep/Oct 2017); August and Cuff, *The TEFRA Partnership Audit Rules Repeal: Partnership and Partner Impacts*, ALI-CLE Video Webcast (July 17, 2016); August, *The Good, the Bad, and Possibly the Ugly in the New Audit Rules: Congress Rescues the IRS from Its Inability to Audit Large Partnerships*, 18 Business Entities 4 (May/June 2016); August, *Entity-Level Audit Rules Continue to Pose Challenges for Partners*, Parts 1 and 2, 16 Business Entities 4 (Nov/Dec 2014), 17 Business Entities 4 (July/Aug 2015). Budget Act section 1101 repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level. On the new audit provisions generally, *see* NYS Bar Ass'n, Tax Section, *Report on the Partnership Audit Rules of the Bipartisan Budget Act of 2015*, Report No. 1347 (May 25, 2016). For a criticism of the TEFRA audit rules, *see* Prescott, *Jumping the Shark: The Case for Repealing the TEFRA Partnership Audit Rules*, 11 Fla. Tax Rev. 503 (2011); Spellmann, *Taxation Without Notice: Due Process and Other Notice Shortcomings with the Partnership Audit Rules*, 52 Tax Law 133, 162 (1998).

5 The IRS must approve all requested modifications and will object to a request for modification made by the partnership representative where the partnership does not timely provide the information the IRS considers necessary. All "necessary payments" must also be made with respect to the modifications either under the new "pull-in" procedure or the amended return modification rule.

6 Code Secs. 6232(b), 6232(c) (readjustment petition in Tax Court).

7 Code Sec. 6234(b)(1) (readjustment petition for obtaining jurisdiction in district court or Court of Federal Claims).

8 T.D. 9780, 81 FR 51795; REG-105005-16, 81 FR 51835.

9 REG-136118-15, 82 FR 27334-01.

10 REG-119337-17, 82 FR 56765.

11 REG-120232-17 and REG-120233-17 (Dec. 2017 NPRM).

12 82 FR 28398.

13 83 FR 4868-01.

14 Bipartisan Consolidated Appropriations Act ("BCCA") (P.L. 115-114).

15 The amendments under the TTCA are effective as if originally included in section 1101 of the BBA, and are retroactive in their effect under the general effective date rules contained in section 1101(g) of the BBA. Another noteworthy reform enacted into law as part of the BCCA bill, new Code Sec. 6232(f) permits the IRS to pursue collections against both a partnership and its partners for the same liability, subject to a ceiling of 100% of the applicable taxes, interest, and penalties. Code Sec. 6232(f) is triggered if any amount of an imputed underpayment is not paid within ten days of the agency demanding payment. The new collection provision may prove to be difficult to apply where there is a multi-tiered partnership structure and one or more lower-tier partnerships fail to make the required payments of tax. While the BCCA puts some additional language in the BBA, most noteworthy presumably will be the "pull-in" and collection provisions.

16 83 FR 39331.

17 Corresponding temporary regulations under Temporary Reg. §301.9100-22T were withdrawn.

18 83 FR 41954.

19 REG-136118-15, August 2018 NPRM.

20 Reg. §301.6222-1 provides that the BBA applies to all partners, including partners that are partnerships which may have elected out of the partnership audit rules under Code Sec. 6221(b).

21 Reg. §301.6222-1(c)(4).

22 Reg. §301.6225-1.

23 Reg. §301.6225-2.

24 Reg. §301.6225-3.

25 Reg. §301.6225-1(c).

26 Regs. §§301.6225-1(b)(2), 301.6225-1(d), 301.6225-1(e).

27 Code Sec. 6227(c).

28 Code Secs. 6227(c)(1), 6227(c)(2).

29 Regs. §§301.6227-2(c), §301.6227-3(a).

30 *See* Reg. §301.6227-2(b)(1) ("valid" election under Reg. §301.6227-2(c) "turns off" the partnership's obligation to pay an imputed underpayment resulting from adjustments requested in an AAR).

31 *See* Code Secs. 1441, 1442, 1445, 1446.

32 *See* Code Secs. 1471 (foreign financial institutions), 1472 (passive non-financial institutions).