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NEW RULES FOR AUDITS OF PARTNERSHIP RETURNS

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Effective for audits of partnership returns beginning after 2017, the IRS will use a centralized audit system that requires partnership adjustments to be determined at the partnership level and any tax attributable to the adjustments to be assessed and collected at the partnership level. These new rules allow for a small-partnership opt-out and an elective alternative to "push out" the audit adjustments made and tax paid to the partners. The audit process will be streamlined by limiting the right to notices and participation in the audit to one "partnership representative." This article presents the new rules and existing guidance that consists of a report by the Joint Committee on Taxation and temporary regulations on an early opt-in to the rules prior to their effective date.

INTRODUCTION

In 2015, as part of the Bipartisan Budget Act of 2015 (BBA), Congress repealed the unified partnership audit rules and the audit rules for electing large partnerships (ELPs) and replaced them with a new audit regime (the BBA audit rules).[1] The BBA audit rules generally are effective

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[1] Pub. L. No. 114-74, § 1101, 129 Stat. 584 (2015). Corrections were made to the BBA audit rules by the Protecting Americans from Tax Hikes Act, Pub. L. No. 114-113, Div. Q, § 411, 129 Stat. 2241 (2015).

See Jerald David 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*, BUS. ENTITIES (May/June 2016); Christian Brause, New Partnership Audit Rules: Concepts and *Issues*, 151 TAX NOTES 621 (May 2, 2016), 151 TAX NOTES 773 (May 9, 2016); Carol Kulish Harvey et al., *New Partnership Audit Rules–What We Know So Far*, 152 829 TAX NOTES (Aug. 8, 2016), 152 991 TAX NOTES (Aug. 15, 2016); Donald B. Susswein & Ryan P. McCormick, *Understanding the New Partnership Audit Rules*, 149 TAX NOTES 1171 (Nov. 30, 2015); Michael G. Wasserman, *A Fix Too Fast: Anomalies in the New Legislation on Partnership Tax Audits*, 124 J. TAX'N 118 (Mar. 2016).

for audits of partnership returns for tax years beginning after 2017.[2] Although the unified partnership audit rules were enacted to address difficulties with partnership audits, particularly tax shelters,[3] they proved difficult to implement. In a 1990 report to Congress, the IRS and the Treasury concluded that large partnership audits were an inefficient and time-intensive use of limited resources.[4] Congress's efforts to solve these problems led to the enactment of the audit rules for ELPs.[5] Despite the ELP audit rules and the rapid increase in the number of large partnerships,[6] only 91 partnerships filed returns as ELPs (Form 1065-B) in 2013.

A 2014 audit by the U.S. Government Accountability Office found that the IRS audits few large partnerships and most audits resulted in no change to the partnerships' returns.[7] The audit report specifically referenced the challenges of partnership audits under statutory time frames and the complex procedures for multi-tier partnerships. Of particular note were the time-consuming tasks of identifying the Tax Matters Partner (TMP) and passing through audit adjustments to partners. Congress repealed the unified audit and ELP audit rules and enacted the BBA audit rules to alleviate these problems.[8]

The BBA audit rules address the deficiencies of the unified audit

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[2] Pub. L. No. 114-74, § 1101(g)(1), 129 Stat. 584 (2015).

[3] STAFF OF J. COMM. ON TAX'N, 97TH CONG., 2D SESS., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 at 268 (Comm. Print 1982).

[4] U.S. DEP'T OF THE TREASURY, WIDELY HELD PARTNERSHIPS: COMPLIANCE AND ADMINISTRATION ISSUES—A REPORT TO CONGRESS (1990).

[5] I.R.C. §§ 6240-6255 (before repeal in 2015), enacted by Pub. L. No. 105-34, 111 Stat. 788 (1997).

[6] From 2002 to 2011, the number of large partnerships (partnerships with $100 million or more in assets and 100 or more direct or indirect partners) more than tripled to nearly 11,000. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-14-732, LARGE PARTNERSHIPS: WITH GROWING NUMBER OF PARTNERSHIPS, IRS NEEDS TO IMPROVE AUDIT EFFICIENCY, at 13 (2014). Almost two-thirds of the large partnerships had 1,000 or more partners and hundreds had more than 100,000 partners. *Id.* at 15.

[7] *Id.* Only 0.8 percent of large partnerships were audited in 2012 compared with 27.1 percent of large corporations.

[8] A motivating factor for enacting the BBA audit rules was the revenue projection of $9.3 billion for the period 2016 to 2025. STAFF OF J. COMM. ON TAX'N, 114TH CONG., 1ST SESS., ESTIMATED REVENUE EFFECTS OF THE TAX PROVISIONS CONTAINED IN H.R. 1314, THE "BIPARTISAN BUDGET ACT OF 2015," (Comm. Print 2015). *See* discussion of difficulties with the unified audit rules in Jerald David August, *Entity-Level Audit Rules Continue to Pose Challenges for Partners*, 16 BUS. ENTITIES 4 (Nov./Dec. 2014), 17 BUS. ENTITIES 4 (July/Aug. 2015); Peter A. Prescott, *Jumping the Shark: The Case for Repealing the TEFRA Partnership Audit Rules*, 11 FLA. TAX REV. 503 (2011); Donald B. Susswein & Ryan P. McCormick, *Fixing the Partnership Audit Process*, 149 TAX NOTES 123 (Oct. 5, 2015); Corina Trainer & Tony Russo, Working Within a Changing TEFRA Partnership Landscape, 148 TAX NOTES 79 (July 6, 2015). *See also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REF. NO. 2014-30-083, IMPROVEMENTS ARE NEEDED TO ENSURE THAT PROCEDURES ARE FOLLOWED DURING PARTNERSHIP AUDITS SUBJECT TO THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 (Sept. 26, 2014).

The IRS requested comments regarding implementation of the BBA audit rules in I.R.S. Notice 2016-23, 2016-13 IRB 490.

rules through a centralized audit system that requires partnership adjustments to be determined at the partnership level and any tax attributable to the adjustments to be assessed and collected at the partnership level. The BBA audit rules allow for a small-partnership opt-out and an elective alternative to "push out" the audit adjustments made and tax paid to the partners. The audit process is streamlined by limiting the right to notices and participation in the audit to one "partnership representative" who has the "sole authority" to act for the partnership in an audit.

The basic steps in a BBA audit are as follows:

1. The IRS commences the audit by sending a notice of the administrative proceeding to the partnership and the partnership representative.
2. Only the partnership representative participates in the audit.
3. The IRS concludes the audit by sending to the partnership and the partnership representative a notice of proposed partnership adjustment (NPPA) that contains the tentative "imputed adjustment."
4. The partnership has 270 days from the mailing of the NPPA to request a modification in the amount of the "imputed underpayment."
5. The IRS mails a notice of final partnership adjustment (NFPA) no earlier than 270 days after the mailing of the NPPA.
6. The partnership can, within 45 days after the date of the NPPA, elect to "push out" the audit adjustments and resulting tax payments to the partners.
7. The partnership can challenge a NPPA by petitioning the Tax Court, a federal district court, or the Court of Federal Claims within 90 days of mailing of the NPPA.
8. The IRS can assess and collect the imputed underpayment after 90 days following the mailing of the NPPA, or if a petition is filed, the date the decision of the court becomes final.

PARTNERSHIPS SUBJECT TO THE BBA AUDIT RULES

The BBA audit rules apply to all partnerships and entities taxed as partnerships.[9] A "partnership" for these purposes is "any partnership required to file a return under section 6031(a)."[10] The BBA audit rules apply to an entity that filed a partnership return for a taxable year even if it is determined that the entity is not a partnership (or not an entity) in that year "to the extent provided in regulations."[11]

Partnerships may elect out of the BBA audit rules (opt-out election) if the partnership has no more than 100 partners,[12] and all of the partners

[9] I.R.C. § 6221(a).
[10] I.R.C. § 6241(1).
[11] I.R.C. § 6241(8).
[12] I.R.C. § 6221(b)(1). The 100-partner limit is determined based on the number of Schedules K-1 the partnership furnishes under § 6031(b). The exception for small partnerships of 10 or fewer partners under prior law is not contained in the BBA audit

are individuals, C corporations,[13] a foreign entity that would be treated as a C corporation if domestic, S corporations, or estates of deceased partners.[14] Shareholders of an S corporation partner are counted as partners for purposes of the 100-partner limit.[15] Unless allowed by regulations or other guidance, partnerships with partnerships, trusts, or disregarded entities as partners cannot opt out of the BBA audit rules.[16] The opt-out election is made annually with a timely filed partnership return that discloses the name and TIN of each partner (and shareholder of an S corporation that is a partner).[17] The partnership must notify each partner of such an election.[18]

If the partnership elects out of the BBA audit rules, it will not be subject to the repealed unified partnership audit rules. Instead, partnership returns will be audited only incident to audits of the returns of partners, with the audit of each partner's return an independent proceeding, both administrative and judicial.[19]

Although the new rules are effective for partnership returns filed in tax years beginning in 2018, a partnership may elect to apply the rules to a return for an "eligible taxable year" beginning after November 2, 2015, and before January 1, 2018.[20] Temporary regulations set forth the procedures for making the election.[21] A partnership that elects to apply the BBA audit

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rules. *See* Neil E. Harl, Gross Misunderstandings of the Small Partnership Concept, 152 TAX NOTES 1015 (Aug. 15, 2016).

[13] A C corporation includes a regulated investment company or real estate investment trust. STAFF OF J. COMM. ON TAX'N, 114TH CONG., 2D SESS., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 2015 at 58 (Comm. Print 2016) [hereinafter BLUEBOOK].

[14] I.R.C. § 6221(b).

[15] I.R.C. § 6221(b)(2)(A).

[16] *See* I.R.C. § 6221(b)(2)(C), giving authority to the IRS to prescribe rules similar to the S corporation rules for other types of partners. Guidance (not issued as of August 2016) would take into account each interest (direct and indirect) in the partnership, regardless of whether a statement comparable to a Schedule K-1 is required to be furnished. BLUEBOOK, *supra* note 13, at 59-60. Such guidance could allow a partnership that has a partner that is a single-member disregarded limited liability company owned by a corporation to make the election if it provides identifying information of the disregarded entity and its corporate owner, "and each of them is taken into account as if each were a statement recipient in determining whether the 100-or-fewer statements criterion is met." *Id.* at 60. The guidance could also provide similar rules for partnerships that have partners that are partnerships (if "consistent with prompt and efficient collection of tax"), trusts, or grantor trusts.

[17] I.R.C. §§ 6221(b)(1)(D), 6221(b)(2)(A). The Secretary may allow "alternative identification of any foreign partners." I.R.C. § 6221(b)(2)(B).

[18] I.R.C. § 6221(b)(1)(E).

[19] BLUEBOOK, *supra* note 13, at 58.

[20] Pub. L. No. 114-74, § 1101(g)(4), 129 Stat. 584 (2015); Temp. Reg. § 301.9100-22T(d), (e). In order to avoid proceedings under both the unified partnership audit rules and the BBA audit rules, an "eligible taxable year" does not include a year for which the partnership has "taken the affirmative step to apply the [unified partnership audit rules] with respect to the partnership return for that taxable year" by filing an AAR under I.R.C. § 6227(c) (prior to amendment in 2015). An "eligible taxable year" also does not include a year for which a partnership not subject to the unified partnership audit rules has filed an amended return for that year. Temp. Reg. § 301.9100-22T(d)(2); TD 9780, 81 Fed. Reg. 51,795, 51,796 (Aug, 5, 2016).

[21] TD 9780, 81 Fed. Reg. 51,795 (Aug. 5, 2016). The text of proposed regulations issued at

rules before 2018 cannot subsequently elect out of the rules under the small partnership opt-out election of § 6221(b).[22] Once the election is made, it can be revoked only with the IRS's consent. For an election to be "valid," it must be made in accordance with the regulations and must not "frustrate[] the purposes of" the BBA audit rules.[23]

The partnership has 30 days from the date of the notice of selection for examination of a partnership return to elect to apply the BBA audit rules.[24] An election to apply the BBA audit rules prior to their effective date must be made in writing and signed by the TMP or an individual authorized to sign the partnership tax return for the year under examination.[25] After the IRS receives the election, it will mail a notice of administrative proceeding not earlier than 30 days after receipt of the election.[26] If a partnership has not received a notice of selection for examination, it may nevertheless make an election for an eligible taxable year if the partnership intends to file an administrative adjustment request (AAR).[27]

REQUIREMENT OF PARTNERSHIP CONSISTENCY

Generally, a partner must report on her tax return an "item" of income, gain, loss, deduction, or credit "attributable to a partnership" consistently with the treatment of the item on the partnership return.[28] A partner may report an item inconsistently with the item's treatment on the partnership return if the partner files a notice with the IRS that identifies the inconsistency.[29] If a partner's return, although inconsistent with the information on the partnership's return, is consistent with the information the partnership gave the partner (e.g., on Schedule K-1), the partner can elect to be treated as having given notice identifying the inconsistency.[30] If a partner has an underpayment of tax for failure to comply with the

the same time adopt the same text as the temporary regulations. *See* REG-105005-16, 81 Fed. Reg. 51,835 (Aug. 5, 2016).

[22] Temp. Reg. § 301.9100-22T(a).

[23] Temp. Reg. § 301.9100-22T(a). The purposes of the BBA audit rules include "the collection of any imputed underpayment." TD 9780, 81 Fed. Reg. 51,795, 51,796 (Aug. 5, 2016).

[24] Temp. Reg. § 301.9100-22T(b)(1). No extensions to file an election may be requested. Temp. Reg. § 301.9100-22T(a).

[25] Temp. Reg. § 301.9100-22T(b)(2). *See* Temp. Reg. § 301.9100-22T(b)(2)(ii) for information required to be contained in the election, which includes "information required to properly designate the partnership representative."

[26] Temp. Reg. § 301.9100-22T(b)(2)(iii).

[27] Temp. Reg. § 301.9100-22T(c). No election may be made for this purpose, however, before January 1, 2018. If such an election is filed before January 1, 2018, it will be deemed to be an AAR filed under § 6227(c) (prior to amendment in 2015) or an amended partnership return, as applicable.

[28] I.R.C. § 6222(a).

[29] I.R.C. § 6222(c)(1). A partner can also provide notice to the IRS of the partner's position if the partnership has not filed a return.

[30] I.R.C. § 6222(c)(2).

consistency requirement, the IRS can assess and collect the tax in the same manner as for a mathematical or clerical error on the partner's return.[31] The IRS can impose an accuracy-related penalty under § 6662 for a partner's failure to comply with the consistency requirement.[32] A final decision in a proceeding regarding an inconsistent position is not binding on the partnership if the partnership is not a party to the proceeding.[33]

PARTNERSHIP REPRESENTATIVE

The partnership "shall" designate a representative with a "substantial presence in the United States" to have "the sole authority" to act for the partnership in an audit.[34] The partnership representative does not have to be a partner as was required for TMPs under the unified partnership audit rules. If a designation is "not in effect," the IRS "may" select "any person" to be the partnership representative.

NOTICE AND PARTICIPATION RIGHTS

The IRS must provide the partnership and the partnership representative with notice when it initiates or resolves a partnership audit.[35] Unlike the unified partnership audit rules, no other partners have the right to notices regarding the audit. Notices are sufficient if mailed to the last known address of the partnership representative or partnership.

Partners, other than the partnership representative, may not "participate in or contest results of an examination of a partnership,"[36] which is a change from the unified partnership audit rules that allowed all partners to participate in an audit. Even though partners do not receive audit notices or participate in the audit, all partners, both direct and indirect and prior and current, are bound by an audit settlement, an uncontested NFPA, or the final decision in a related judicial proceeding.[37]

PARTNERSHIP-LEVEL ADJUSTMENTS

At the conclusion of a partnership audit, the IRS mails a notice of proposed partnership adjustment (NPPA) to the partnership and the partnership representative.[38] "A [NPPA] informs the partnership of any

[31] I.R.C. § 6222(b). Abatement of the assessment under § 6213(b)(2), however, is not applicable. A partnership that is a partner in another partnership is similarly treated with respect to its interest in the other partnership. I.R.C. § 6232(d)(1)(B).
[32] I.R.C. § 6222(e).
[33] I.R.C. § 6222(d).
[34] I.R.C. § 6223(a).
[35] I.R.C. § 6231(a). The IRS issues notices for initiation of a partnership audit, notices of proposed partnership adjustments, and notices of final partnership adjustments.
[36] BLUEBOOK, *supra* note 13, at 61-62.
[37] I.R.C. § 6223(b). *See also* BLUEBOOK, *supra* note 13, at 62.
[38] I.R.C. § 6231(a)(2). A "partnership adjustment" is defined as "any adjustment in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any

adjustments tentatively determined by the Secretary and the amount of any imputed underpayment resulting from such adjustments."[39] In general, any audit adjustment to an "item" of partnership income, gain, loss, deduction, or credits, and any resulting change to a partner's distributive share, is determined at the partnership level, and any tax attributable to an adjustment is assessed and collected at the partnership level.[40] Interest, penalties, additions to tax, and additional amounts related to the adjustment are also determined and paid at the partnership level.[41]

The partnership is required to pay any "imputed underpayment" resulting from an IRS adjustment for the "reviewed year" in the "adjustment year."[42] The imputed underpayment is in effect an entity-level tax and is computed by multiplying the net amount of all adjustments by the maximum income tax rate for individuals or corporations, as applicable, for the reviewed year.[43] This amount is increased or decreased, "as the case may be," by any adjustments to items of credit. Income is increased or decreased, respectively, by any net decrease or increase in loss.

Adjustments in distributive shares of partners are not netted. Instead, in computing the imputed underpayment, any decrease in an item of income or gain and any increase in an item of deduction, loss, or credit, are disregarded.[44] Thus, if *A* and *B* are equal partners in the AB Partnership, and $100 of income is reallocated in an audit from A to B, the $100 of income increase to *B* is included in computing the imputed underpayment but not the $100 decrease to *A.*

If the adjustment does "not result in an imputed underpayment," the partnership takes the adjustment into account in the adjustment year as a decrease in non-separately stated income or an increase in non-separately stated loss, as appropriate, under § 702(a)(8),[45] or as a separately stated item if a credit.[46] Adjustments could result in no imputed underpayment if,

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partner's distributive share thereof." I.R.C. § 6241(2).
For an adjustment due to a mathematical or clerical error on the partnership return, rules similar to § 6213(b) apply. I.R.C. § 6232(d)(1)(A).

[39] BLUEBOOK, *supra* note 13, at 72.

[40] I.R.C. §§ 6221(a), 6232(a). Under the BBA audit rules, there are no "partnership items" or "affected items" as under the unified partnership audit rules.

[41] I.R.C. § 6233(a).

[42] I.R.C. § 6225(a)(1). The "reviewed year" is "the partnership taxable year to which the item being adjusted relates." I.R.C. § 6225(d)(1). The "adjustment year" is the partnership taxable year in which: (1) a decision of a court in a § 6234 proceeding becomes final, (2) an AAR under § 6227 is made, or (3) if there is no judicial proceeding or AAR, a NFPA is mailed under § 6231. I.R.C. § 6225(d)(2).

[43] I.R.C. § 6225(b)(1). In netting the amounts, "applicable limitations, restrictions, and special rules under present law" must be taken into account. BLUEBOOK, *supra* note 13, at 63. *See* examples of computation of imputed underpayment in General Explanation of Tax Legislation Enacted in 2015. *Id.* at 63-64.

[44] I.R.C. § 6225(b)(2).

[45] I.R.C. § 6225(a)(2)(A). "It may also be appropriate to treat the amount of an adjustment as a reduction (or increase) in a separately stated amount of income, gain, loss, or deduction." BLUEBOOK, *supra* note 13, at 63.

[46] I.R.C. § 6225(a)(2)(B).

for example, the adjustment is a change in character only and not in amount, or the net adjustment is negative.

The Treasury Secretary "shall" establish procedures that allow the amount of the imputed underpayment to be modified.[47] Such procedures will provide for computing the imputed underpayment by taking into account a partner's actual tax rate that is lower than the highest rate (including the portion allocable to tax-exempt partners)[48] and amended return filings and payments by reviewed-year partners.[49] The Secretary may issue regulations or guidance for additional procedures for modifications "on the basis of such other factors as the Secretary determines are necessary or appropriate to carry out the purposes of [the modification provisions]."[50] Under procedures to be established by the IRS, the partnership can request a modification during the 270-day period beginning on the date of mailing of the NPPA; all required documentation must be submitted during this period.[51] No modification will be made without the IRS's approval.[52]

A modification can be requested if any part of the imputed underpayment is allocable to a partner subject to a tax rate less than the maximum.[53] A partner may be subject to a lower rate, for example, if it is a tax-exempt entity or the partner is an individual subject to the capital gain rate on capital gains or qualified dividend income.[54] The portion of the imputed underpayment to which a lower rate applies is generally determined based on the partners' distributive shares of items related to the imputed underpayment.[55]

The partnership can also request a modification if a partner files an

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[47] I.R.C. § 6225(c). The partnership can implement the modification procedures after the initiation of the audit and before the NPPA is mailed. BLUEBOOK, *supra* note 13, at 65. Until regulations or guidance are issued, "it is anticipated that the partnerships will furnish ... the necessary documentation, data, and calculations to determine the amount of the reduction of the imputed underpayment with a reasonably high degree of accuracy." *Id.* at 68.

[48] I.R.C. §§ 6225(c)(3), 6225(c)(4).

[49] I.R.C. § 6225(c)(2).

[50] I.R.C. § 6225(c)(6). The purpose of the modification provisions is "to determine the amount of tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid while at the same time to implement the most efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners." BLUEBOOK, *supra* note 13, at 65-66.

[51] I.R.C. § 6225(c)(7). The IRS can extend the 270-day period.

[52] I.R.C. § 6225(c)(8). *See* § 6225(c)(5) for determination of the imputed underpayment in the case of certain passive losses of publicly traded partnerships.

[53] I.R.C. §§ 6225(c)(3), 6225(c)(4).

[54] I.R.C. §§ 6225(c)(3), 6225(c)(4)(A). An S corporation for these purposes is treated as an individual. A tax-exempt entity is as defined in § 168(h)(2).

[55] I.R.C. § 6225(c)(4)(B). If the imputed adjustment is attributable to more than one item and any partner's treatment of the items is not the same for all of the items, the portion of the imputed payment to which a lower rate applies for a partner is determined by the distributive share of gain or loss a partner would have if the partnership sold all of its assets for their fair market values at the close of the reviewed year.

amended return that takes into account the partner's share of adjustments in the partner's taxable year that includes the end of the reviewed year and pays any tax due with the return.[56] For example, assume that the IRS determines in an audit of Partnership XYZ that the partnership erroneously deducted $500 of operating expenses instead of the correct amount of $200. Partner *X*, an equal partner with *Y* and *Z*, files an amended return to increase his taxable income by his share of the excess deduction of $100 and pays the tax on this amount. The imputed underpayment thus would be reduced to $200, and absent any modification requests by the partnership, the imputed underpayment will be $79.20 ($200 net adjustment multiplied by 39.6 percent, the highest individual income tax rate in the reviewed year). If distributive shares are reallocated, a partnership cannot request a modification unless all affected partners file amended returns.[57]

It may not be practical for a partnership to pay a partnership-level tax when the partners or their interests are not the same in the reviewed year as in the adjustment year. For example, assume ABC Partnership is owned by equal partners *A*, *B*, and *C* in 2018 and only by *A* and *B* in 2021. If, in 2021, ABC partnership is audited for tax year 2018, *A* and *B* will have the burden for taxes due on any imputed underpayments even though C was also a partner in the reviewed year. Also, the partnership may not be in a position financially to pay an entity-level tax. Instead of the partnership-level tax, the partnership can elect to provide its reviewed-year partners with adjusted Schedules K-1 that reflect audit adjustments.

At the end of the 270-day modification period, the IRS mails a notice of final partnership adjustment (NFPA) to the partnership that includes the imputed underpayment amount.[58] If the partnership does not initiate judicial action within 90 days of the mailing of the NFPA, the IRS can assess and collect the imputed underpayment as if it were a federal income tax for the adjustment year.[59] If the partnership files a petition for readjustment with a court, the IRS cannot, absent a written waiver by the partnership, assess or take collection action until the decision of the court has become final.[60]

Interest is computed on a partnership adjustment for the period beginning on the day after the return due date[61] for the reviewed year and

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[56] I.R.C. § 6225(c)(2). If an adjustment reallocates distributive share among partners, the partnership can reduce the imputed underpayment for partners' amended return filings only if all affected partners file amended returns.

[57] I.R.C. § 6225(c)(2)(B).

[58] I.R.C. § 6231(a)(3). The IRS can rescind a notice of partnership adjustment with the consent of the partnership, in which case it is not treated as a notice of partnership adjustment. I.R.C. § 6231(c).

[59] I.R.C. §§ 6221(a), 6232(a), 6232(b). The amount of the assessment in such a case cannot exceed the imputed underpayment set forth in the NFPA. I.R.C. § 6232(e).

[60] I.R.C. §§ 6232(b), 6232(d)(2). IRS action that violates this rule can be enjoined. I.R.C. § 6232(c). The Tax Court has no jurisdiction to enjoin IRS action except with respect to adjustments that are the subject of a timely filed petition.

[61] "Return due date" means the due date (without extension) for filing a partnership return for a taxable year. I.R.C. § 6241(3).

continuing until the return due date for the adjustment year (or the date the imputed underpayment is paid, if earlier).[62] The interest rate is the underpayment rate.[63] Penalties, additions to tax, and additional amounts are computed at the partnership level as if the partnership were an individual and the imputed underpayment were an actual underpayment for the reviewed year.[64] If the partnership fails to pay an imputed underpayment when due, the partnership is liable for interest, penalties, additions to tax, and additional amounts.[65] The partnership cannot take a deduction for any imputed underpayment or related payment.[66]

If a partnership "ceases to exist" before a partnership adjustment "takes effect," the former partners of the partnership are required to take the adjustment "into account" under regulations to be issued.[67]

ALTERNATIVE PARTNER-LEVEL ADJUSTMENTS

Instead of a partnership-level tax resulting from an IRS audit, the partnership can elect to "push out" the audit adjustments to its partners (push-out election).[68] The partnership has 45 days after the date of the NFPA to make this election. Once made, the IRS must consent to a revocation of the election.[69] The partnership can make the election even if it files a petition for judicial review of the NFPA.[70]

The push-out election removes the burden the IRS had under the unified partnership audit rules of allocating adjustments to partners, assessing tax against each partner, addressing disputes with partners, and collecting the tax from each partner. If the partnership makes the election, the partnership determines each partner's allocable share of the audit

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[62] I.R.C. § 6233(a)(2). "Proper adjustments" in the amount of interest must be made for partnership tax years after the reviewed year and before the adjustment year "by reason of such partnership adjustment."
[63] I.R.C. § 6626(b)(2). *See* § 6621(a)(2) for the underpayment rate.
[64] I.R.C. § 6233(a)(3).
[65] I.R.C. § 6233(b). Interest is determined by treating the imputed underpayment as an underpayment of tax in the adjustment year. Penalties, additions to tax, and additional amounts are the same as would apply to a failure to file under § 6651(a)(2) and by treating the imputed underpayment as an underpayment of tax for purposes of the accuracy-related and fraud penalties.
[66] I.R.C. § 6241(4). If partners and the partnership have entered into an indemnification agreement with respect to who bears the burden of tax liability, payments under such an agreement are not deductible. BLUEBOOK, *supra* note 13, at 79.
[67] I.R.C. § 6241(7). For these purposes, a partnership does not cease to exist due to a technical partnership termination under § 708(b)(1)(B), but it does cease to exist if it terminates under § 708(b)(1)(A). A partnership may be treated as ceasing to exist in other circumstances, such as in the case of "a partnership that has no significant income, revenue, assets, or activities at the time the partnership adjustment takes effect." BLUEBOOK, *supra* note 13, at 80.
[68] I.R.C. § 6226(a). *See* Donald B. Susswein & Ryan P. McCormick, *Getting the Partnership Audit Rules Up and Running*, 151 TAX NOTES 495 (Apr. 25, 2016).
[69] I.R.C. § 6226(a). As part of a settlement, "it is contemplated that the Secretary may permit revocation." BLUEBOOK, *supra* note 13, at 69.
[70] I.R.C. § 6226(d); BLUEBOOK, *supra* note 13, at 69.

adjustment and each partner pays any additional tax on the adjustment allocated to the partner. The partnership must provide to the reviewed-year partners and the IRS a statement of each partner's share of the adjustments contained in the NFPA, normally an adjusted Schedule K-1, "at such time and in such manner as the Secretary may provide."[71] A partner "takes such adjustment into account" by computing the partner's additional tax as if the adjustment occurred in the partner's taxable year that includes the end of the reviewed year.[72] Tax attributes are adjusted in accordance with the NFPA, and any additional tax for a partner includes increases in tax resulting from the adjustments to the tax attributes for years after the partner's year that includes the reviewed year and before the year in which the partnership furnished the partner's statement of adjustments.[73] Partners pay the additional tax in the year in which the partnership issues the adjusted Schedules K-1 to the partners, thus avoiding the partners having to file amended returns for the reviewed year.[74]

Penalties, additions to tax, or additional tax are determined at the partnership level but are imposed on a partner for the partner's share.[75] Interest, on the other hand, is determined at the partner level, computed from the due date of the return "to which the increase is attributable," at the underpayment rate under § 6621(a)(2), plus 2 percent.[76]

If a partnership makes the push-out election and has a partnership as a partner, the recipient partnership takes into account its allocated adjustment amount and pays tax attributable to the adjustments "as if it were an individual."[77] Recipient partnerships can file AARs "with respect to their distributive shares of an adjustment."

JUDICIAL REVIEW OF PARTNERSHIP ADJUSTMENTS

Within 90 days after the date of the IRS mailing of a NFPA, a partnership can petition for a readjustment in the Tax Court, a federal district court, or the Court of Federal Claims.[78] For the district court alternative, the petition is filed in the judicial district in which the

[71] I.R.C. § 6226(a)(2). Until there is guidance, the statements are to be furnished "within a reasonable period" after the last date for making the election. BLUEBOOK, *supra* note 13, at 69.
[72] I.R.C. §§ 6226(a), 6226(b)(2)(A). The BBA audit rules do not address the consequences of a partner not taking an adjustment into account, including how tax attributable to the adjustment is assessed and collected. *See* Notice 2016-23, § III.01(6)(f), 2016-23 IRB 490.
[73] I.R.C. §§ 6226(b)(2)(B), 6226(b)(3). No provision is made for decreasing the partner's tax if the tax would be less due to adjustments to tax attributes.
[74] I.R.C. § 6226(b)(1).
[75] I.R.C. § 6226(c)(1).
[76] I.R.C. § 6226(c)(2).
[77] BLUEBOOK, *supra* note 13, at 70-71.
[78] I.R.C. § 6234(a). A petition for readjustment can be made in the case of a push-out election. I.R.C. § 6226(d). For applicable Tax Court Procedures, *see* Prop. Tax Ct. Rules 255.1-255.6.

partnership maintains its principal place of business.[79] If the petition is filed in the Court of Federal Claims or district court, the partnership must deposit with the IRS the amount of the imputed underpayment computed as of the date of filing of the petition.[80] A petitioner is given an opportunity to make up a deposit shortfall rather than having the petition dismissed if the partnership made "a good faith attempt to satisfy" the deposit requirement and any shortfall is "timely corrected."[81] The court has jurisdiction to determine "all items of income, gain, loss, deduction, or credit of the partnership for the partnership taxable year to which the [NFPA] 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."[82] A decision of the court is reviewable.[83] A dismissal by the court generally is considered to be a decision that the NFPA is correct.[84]

If a partnership files a petition, the IRS cannot mail another NFPA, except in the case of "fraud, malfeasance, or misrepresentation of a material fact."[85] If the partnership does not begin a proceeding, the partnership cannot be liable for more than the amount in the NFPA.[86] For a partnership that is in Title 11 bankruptcy, the 90-day filing period is suspended during the period that the partnership is "prohibited by reason of such case" from filing a petition, and for 60 days thereafter.[87]

Administrative Adjustment Request

A partnership can file an AAR if additional tax is due or an overpayment was made.[88] Any adjustment is taken into account either by the partnership (under rules generally similar to § 6225)[89] or the partnership and the partners (under rules generally similar to § 6226), in the partnership year in which the AAR is made.[90] If a requested adjustment does not result in an imputed underpayment, procedures similar to those for partnership adjustments apply and the partnership does not receive a

[79] A partnership with a principal place of business located outside the United States is deemed to have its principal place of business in the District of Columbia. I.R.C. § 6241(5).
[80] I.R.C. § 6234(b). The deposit is not treated as a payment of tax other than for purposes of calculating interest.
[81] I.R.C. § 6234(b)(1).
[82] I.R.C. § 6234(c).
[83] I.R.C. § 6234(d).
[84] I.R.C. § 6234(e).
[85] I.R.C. § 6231(b).
[86] I.R.C. § 6232(e).
[87] I.R.C. § 6241(6)(B).
[88] I.R.C. § 6227(a).
[89] I.R.C. § 6227(b)(1). In an AAR, the partnership can request modification of the imputed underpayment amount due to the partnership having tax-exempt partners or lower tax rates applying to particular income or partners but not for amended return filings by partners under § 6225(c)(2) or other factors under § 6225(c)(6).
[90] I.R.C. § 6227(b). The increased 2 percent interest rate that applies for § 6226 adjustments does not apply to an AAR.

refund.[91]

To be timely, the partnership must file the AAR (1) within three years after the later of the due date (without extensions) or actual filing date (whichever is later) of the partnership return and (2) before the IRS mails a notice of an administrative proceeding for that taxable year.[92] If the adjustment is to be taken into account at the partnership level, the imputed payment is assessed and payment therefor is made when the AAR is filed.[93]

STATUTE OF LIMITATIONS

Generally, under § 6235(a), no partnership adjustment may be made after the date that is three years after the latest of (1) the filing date of the partnership return, (2) the return due date, or (3) the date of filing an AAR.[94] In two circumstances the statute of limitations is effectively extended. First, if the partnership requests modification of an imputed underpayment under § 6225(c), the statute of limitations ends no earlier than the date that is 270 days (plus any IRS-approved extension) after the date on which the partnership has completed its submission to the IRS for the modification.[95] Since the partnership has 270 days to submit the modification request, the statute of limitations can thus be extended for 540 days following the NPPA. Second, if no modification to the imputed underpayment is requested or the modification request is not completed within the required period, the statute of limitations will not end sooner than 330 days (plus any IRS-approved extension) after the date of the NPPA.[96] In effect, the IRS must wait 270 days following an NPPA to see if the partnership files a modification request. If none is filed, the IRS can issue a NFPA within 60 days after the waiting period ends.

Prior to the expiration of the limitations period, the IRS and the partnership can agree to an extension.[97] If the partnership does not file a return or the return is false or fraudulent, the IRS can make an adjustment at any time.[98] In the case of a substantial omission of gross income, the three-year period described above is increased to six years.[99] A return prepared by the IRS under § 6020(b) is not a return for purposes of the statute of limitations for the BBA audit rules.[100] The IRS's mailing of a

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[91] BLUEBOOK, *supra* note 13, at 71.
[92] I.R.C. § 6227(c).
[93] I.R.C. § 6232(a). If an AAR results in an imputed underpayment greater than that reported and paid when the AAR was filed, the additional amount "may be assessed in the same manner and subject to same restrictions as any other imputed underpayment." BLUEBOOK, *supra* note 13, at 73.
[94] For examples of the interaction of notice requirements and the statute of limitations, *see* BLUEBOOK, *supra* note 13, at 76-78.
[95] I.R.C. § 6235(a)(2).
[96] I.R.C. § 6235(a)(3).
[97] I.R.C. § 6235(b).
[98] I.R.C. §§ 6235(c)(2), 6235(c)(3).
[99] I.R.C. § 6235(c)(2).
[100] I.R.C. § 6235(c)(4).

NFPA suspends the limitations period for the 90 days the partners are allowed to file a petition for judicial review and for one year thereafter.[101] If a petition is filed, the suspension periods runs until one year after the court's decision becomes final. If a partnership makes a push-out election, a partner cannot contest the statute of limitations, since adjustments are determined at the partnership level.[102]

For a partnership that is in Title 11 bankruptcy proceedings, the statute of limitations for making a partnership adjustment, or an assessment or collection of an imputed underpayment, is suspended during the period the IRS is prohibited by the bankruptcy case from making the adjustment, assessment, or collection.[103] The period of suspension is increased by an additional 60 days for adjustment or assessment, and an additional six months for collection. The 90-day period for filing a petition under § 6234 is also suspended for such period, plus 60 days.

CONCLUSION

The BBA audit rules represent a significant change from the unified partnership audit rules. With potential tax liability at the partnership level, partnerships need to start planning now for the impact of these rules upon the partnership, particularly regarding changes in ownership interests among partners and sales or other dispositions of partnership interests. With limited guidance to date provided in Temporary Regulations on early opt-in to the rules and the Bluebook, planning and amendment of existing documentation is necessarily restricted until further guidance is provided.

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[101] I.R.C. § 6235(d).

[102] BLUEBOOK, *supra* note 13, at 76.

[103] I.R.C. § 6241(6)(A). The IRS can nevertheless file proof of claim or requests for payment under rules similar to § 6513(f)(2).