DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Reliance on the I.R.C. § 6501 Period For Issuing a Notice of Final Partnership Administrative Adjustment

This Field Service Advice responds to your memorandum dated December 4, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Country 1 =
Country 2 =

A =
B =
C =
D =
E =
F =
G =

H	=
$X	=
J%	=
K%	=
L%	=
M%	=
N%	=
O%	=
P%	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Date 14	=
Date 15	=
Date 16	=
Date 17	=
Date 18	=

ISSUE

Whether the Service may issue a notice of final partnership administrative adjustment relying of the limitation on assessment of the consolidated parent of a partner in a TEFRA partnership relying on the I.R.C. § 6501 limitation on assessment.

CONCLUSION

The Service may issue a notice of final partnership administrative adjustment relying of the limitation on assessment of the consolidated parent of a partner in a TEFRA partnership relying on the I.R.C. § 6501 limitation on assessment.

FACTS

A was formed as a limited partnership on or about Date 1.[1] Upon initial formation, A had two partners: B, a general partner with a J% interest in profits and capital, and C, a limited partner with a K% interest in profits and capital. The purpose of the partnership was to "acquire, own, manage, trade, finance, invest in and hedge mortgage interests. ..."

The interests in A after the formation were as follows:

B	-	J% general partnership interest
C	-	K% limited partnership interest

On Date 2, B and C transferred L% of their partnership interests to D for a $X capital contribution. D is a domestic partnership with two foreign partners - E, a foreign corporation residing in Country 1 that became an J% partner, and F, a nonresident alien individual citizen of Country 2 who became a K% partner.

The interests in A after the transfers were as follows:

B	M% general partnership interest
C	N% limited partnership interest
D	O% general and limited partnership interest

A filed its initial partnership return for the tax year ending Date 3 on Date 4. The subsequent year return was filed with a tax year ending Date 5 on Date 6.

B is a subchapter C corporation owned P% by G. B filed consolidated corporate tax returns for the tax years ending Date 7 and Date 8. In Date 9, B and its subsidiaries were acquired by H. H became the parent for the consolidated group that included B after that date.

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[1] In addition to A, several other partnerships were formed to engage in the same financial transactions as A. For some of these partnerships, the factual situation is nearly identical in terms of the filing of returns and statute of limitations. Our advice is intended to be applied to all such partnerships.

Consolidated corporate tax returns for H, which included B, were filed for the tax years ending Date 3 and Date 10. The H tax return for the tax year ended Date 3 was filed on Date 11. The statute of limitations for this year would have expired Date 12, but was extended to Date 13. The Form 872 that extends the statute of limitations does not contain any language which extends the statute of limitations for any partnership items.

The H tax return for the tax year ended Date 14 was filed on Date 15. The statute of limitations for this year would have expired on Date 16, but was extended to Date 17. The Form 872 which extends the statute of limitations does not contain any language that extends the statute of limitations for any partnership items.

Consents to extend the statute of limitations for A's tax years ending Date 3 and Date 5 were executed prior to their expiration. These consents extended the statute of limitations until Date 18.

LAW AND ANALYSIS

In 1982, Congress enacted the TEFRA[2] unified audit and litigation procedures to simplify and streamline the partnership audit, litigation, and assessment process. The underlying principle of TEFRA is that "the tax treatment of items of partnership income, loss, deductions, and credits will be determined at the partnership level in a unified partnership proceeding rather than separate proceedings with the partners."[3] Accordingly, the Service may examine the partnership as an entity, rather than conduct a separate examination as to each of the partners.

Income Taxes are Assessed Against Partners

Despite the creation of a unified procedure for audit and litigation, the manner of tax reporting and assessment is not affected by TEFRA. The Conference Report to TEFRA expressly notes that “[f]or income tax purposes, partnerships are not taxable entities. Instead, a partnership is a conduit, in which the items of partnership income, deduction, and credit are allocated among the

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[2]Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248.

[3]Conf. Rep. No. 97-248 at 600 (1982), 1982-2 C.B. 462.

partners for inclusion in their respective income tax returns."[4] For example, a partnership files a Form 1065 "U.S. Partnership Return of Income"; however, this form is merely an informational return that sets forth the amounts of partnership items and includes schedules allocating such items among the partners. The enactment of TEFRA merely set forth rules as to the administrative procedures for making adjustments to these items; taxes continue to be assessed against the partners and the partnership continues to be a mere conduit for tax purposes.

Partnership Examinations Before TEFRA

Prior to enactment of TEFRA, there was no framework within which to conduct a unified partnership examination; rather, examinations of partnership items were conducted at the partner level. Accordingly, if many partners in the same partnership were examined, the partnership might be the subject of several examinations as to the same taxable year. Because there were multiple examinations, there would be multiple cases involving the same partnership and it was possible that the examinations might reach different results.

Regarding the statute of limitations, several problems arose in the absence of a unified proceeding. Because a partnership was examined only in conjunction with the examination of a partner's return, the examination of the partnership was frequently concluded several years after the partnership return was filed and at a time when the assessment period of the partner under examination was under voluntary extension. If significant adjustments were identified at the partnership level, the Service would be unable to make adjustments to the tax liability of partners other than the partner under examination, if the statute of limitations governing such other partners had expired.

Partnership Examinations After TEFRA

With the enactment of TEFRA, Congress established a unified audit and litigation proceeding through which determinations as to partnership items[5] are required to be made at the partnership level. Section 6221. Partners generally have the right to receive notice of the proceedings and have the right to participate

[4]Conf. Rep. No. 97-248, at 599 (1982), 1982-2 C.B. 462.

[5]A partnership item is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent that regulations . . . provide that . . . such item is more appropriately determined at the partnership level than at the partner level." Section 6231(a)(3).

in both the audit and litigation of the partnership items. Sections 6223, 6224. Once partnership determinations become final, the Service generally may assess any adjustments to the tax liabilities of the partners without following deficiency procedures. Section 6230. But, despite the changes to the audit and litigation procedures, income taxes continue to be assessed only against the partners and not the partnership.

To alleviate the statute of limitations issues described above, Congress enacted a minimum assessment period during which assessments could be made to the tax liabilities of all partners for tax attributable to partnership items. Specifically, section 6229 provides:

- a minimum period for assessment based upon the filing of the partnership return;
- rules for the extension by agreement of the minimum period for assessment;
- a minimum period for assessment after the conversion of partnership items to nonpartnership items;
- rules for the suspension of the minimum period of assessment; and
- rules that extend the minimum period for assessment in special circumstances (i.e., fraud, substantial omission, no return, or unidentified partner).

Note that section 6229 sets forth minimum periods for assessment; however, because taxes are only assessed against partners (and not the partnership), the general limitation on assessment found in section 6501 continues to control except to the extent it is extended by section 6229.

Limitations On Making Assessments

As noted above, the general limitation on assessment under section 6501 controls the timing of when assessments of tax may be made against a taxpayer, even when that taxpayer is a partner of a partnership. Accordingly, a discussion of limitations on assessment must begin with an analysis of section 6501.

Section 6501 sets forth the general limitation on assessment and provides:

> (a) General Rule.--Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not the return was filed on or after the date prescribed) . . . For the purposes of this chapter, the term “return” means the return required to be filed by the taxpayer (and

> does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).[6]

Under this provision, the time within which an assessment must be made is three years from the later of the due date for filing or the actual date of filing of the return. See section 6501(b)(1). For purposes of section 6501(b)(1), the return at issue is the return of a partner or shareholder and not the return of the flow through entity. The Supreme Court in Bufferd v. Commissioner, 506 U.S. 523 (1993), held "that the limitations period within which the Internal Revenue Service must assess the income tax liability of an S corporation shareholder runs from the date on which the shareholder's return is filed." Id., 506 U.S. at 533. As the Court noted, "tax returns that 'lack the data necessary for the computation and assessment of deficiencies' generally should not be regarded as triggering the period of assessment." Id., 506 U.S. at 528, quoting Automobile Club of Mich. v. Commissioner, 353 U.S. 180, 188 (1957). Accordingly, the return of the flow-through entity does not trigger the running of the statute of limitations as to a member (i.e., partner/shareholder).

Although the TEFRA unified audit and litigation procedures for partnerships include a specific provision setting forth a minimum assessment period for adjustments attributable to partnership items, the enactment of TEFRA did not alter prior law. The triggering event for the assessment of tax against a taxpayer continues to be the filing of the taxpayer's return and not the information return of the flow through entity from which the taxpayer received items of gain, loss, deduction or credit.

With the enactment of TEFRA, specific provisions affecting the limitation on assessment were enacted that are unique to TEFRA partnerships. First, the general limitation on assessment was amended by adding section 6501(n)(2),[7] which expressly provides: "For an extension of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229." Following this cross-

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[6]The last sentence of this provision was added by section 1284 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34 and "clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit." Conf. Rep. No. 105-220 at 702-703 (1997). Though the Act sets forth a prospective effective date, this provision does not substantively alter the law. See Bufferd v. Commissioner, 506 U.S. 523 (1993).

[7]This provision has been renumbered numerous times since its enactment as part of Pub. L. No. 97-248; however, the language of the provision has remained unchanged.

reference leads to the minimum assessment period for adjustments attributable to partnership items.

Section 6229(a) sets forth a minimum period for assessing tax attributable to partnership items, and provides:

> (a) General Rule.--Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of--
>
> > (1) the date on which the partnership return for such taxable year was filed, or
> >
> > (2) the last day for filing such return for such year (determined without regard to extensions).

Simply stated, adjustments attributable to partnership items <u>may</u> be assessed within three years of the later of the date of filing or due date of the partnership return. In essence, section 6229 holds open the section 6501 limitation period as to all partners for a fixed period of time, thereby providing a minimum period within which to assess adjustments attributable to partnership items against all partners.

The Present Case

Applying the above analysis to the facts presented, the statute of limitations on assessment remained open for adjustments to the tax liability of H with regard to its return filed for the tax year ended Date 15 until Date 16, without regard to the source of the adjustments. This would include adjustments to partnership tax year ended Date 5. All other tax years are closed due to the expiration of the I.R.C. § 6501 period, even with regard to the extension provided by I.R.C. § 6229. Accordingly, a notice of final partnership administrative adjustment (FPAA) was properly issued before Date 16. It is our understanding that the FPAA reallocated income from D to B and C; however, as the consolidated parent of both partners, the operative limitation period is based upon the date of the filing of the consolidated parent's return. <u>See generally</u>, Treas. Reg. § 1.1502-77. Thus, an FPAA was properly issued on or before Date 16.

<u>CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:</u>

We agree with the conclusion reached in your incoming memorandum that the Service may not rely on extension of the I.R.C. § 6501 period executed under I.R.C.

§ 6501(c)(4) without any special language indicating that the consent is also intended to apply to partnership items. See I.R.C. § 6229(b)(3). Accordingly, the FPAA that was issued properly did not assert adjustments to years other than those for which the statute is open without regard to extensions.

If you have any further questions, please call (202) 622-7950.

By: ______________________________
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