Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:HMT:CIN:1:Postf-105258-02
JEBudde

date: JANUARY 30, 2002

to: Debbie Jones, LMSB Exam, Louisville, KY
Attn: Kevin Dougherty

from: Associate Area Counsel, LMSB, Cincinnati, OH

subject: [redacted] **Partnership** [redacted] **and** [redacted] **Statute of Limitations**

You requested our advice concerning the statute of limitations for tax assessments owed by the partners of the [redacted] partnership for flow-through adjustments made at the partnership level. Based on the facts outlined below, we believe the statute of limitations remains open for assessments to the partners for partnership flow-through items.

Background

You are examining the [redacted] and [redacted] partnership tax returns of [redacted]. That partnership has two partners, [redacted] and [redacted]. [redacted] filed the [redacted] and [redacted] Form 1065 partnership tax returns on or about April 15, [redacted], and April 15, [redacted], respectively. The partnership has not extended the statute of limitations for either of these two returns. Absent some unusual circumstance, and we are unaware of any, the statute of limitations for the partnership tax return filed April 15, [redacted], expired on April 15, [redacted]. The statute of limitations for the partnership tax return filed April 15, [redacted], will expire on April 15, [redacted]. I.R.C. § 6501.

You advised us that both partners are domestic corporations and subsidiaries of [redacted], Inc. [redacted] files a consolidated tax return, and [redacted] and [redacted] are members of the [redacted] consolidated group. The partnership, itself, is not part of the [redacted] consolidated group. [redacted] has a December 31 year end. [redacted] [redacted] consolidated Form 1120 was timely filed on or about [redacted], [redacted], pursuant to the usual extensions. Absent some unusual circumstance, the statute of limitations for [redacted] [redacted] tax

return expired on [redacted]. The statute of limitations for [redacted] [redacted] tax return is set to expire on [redacted], [redacted]. I.R.C. § 6501.

The three-year general rule of § 6501 does not control the [redacted] tax returns because prior to [redacted], [redacted] extended the statute of limitations for the [redacted] year to [redacted], [redacted]. That single consent also extended the time for assessments against the parent and all its subsidiaries in the Tricon consolidated group. Rev. Procs. 72-38, 79-22, and 82-6; Treas. Reg. § 1.1502-77(c). You should verify that the two partners were identified on the Form 872 or on a rider to the Form 872 as a subsidiary of [redacted]. Assuming the partners are so identified on that form, the [redacted] partners have extended the statute of limitations for their tax returns to [redacted], [redacted]. Consequently, the assessment period for both partners for both years is still open.

Issue and Conclusion

You ask whether you can assess tax against the partners for partnership flow-through items even though the [redacted] partnership statute has expired.

Yes you can. The partners' statute controls, and you may assess taxes due from the partners for partnership flow-through items.

Analysis

The statute of limitations for assessing tax against partners based on adjustments to partnership items is measured from the date of the partners' returns, not from the date of the partnership's returns. Siben v. Commissioner, 930 F.2d 1034, (2nd Cir. 1991), 91-1 USTC ¶ 50,215; Charlton v. Commissioner, 990 F.2d 1161 (9th Cir 1993) 93-1 USTC ¶ 50,239. When the partners signed a consent agreement, the statute of limitations did not expire for adjustments of pass-through items from the partnership, even though the limitations period expired for the partnership's tax return. The limitation period for assessment applies only to the partners, and we are not required to obtain a consent from the partnership in this case (for a list of cases supporting this proposition and a discussion of the leading cases, you might look at 16 CCH Standard Federal Tax Reporter ¶ 38,963.62).

Although not required to do so in this non-TEFRA context (TEFRA discussed below), we nevertheless do obtain statute

extensions from partnerships when possible to do so. In this case, we recommend that you obtain a statute extension from the [redacted]. partnership for [redacted]. That statute remains open until at least [redacted]. You will want to have any authorized partner (customarily a general partner) of the partnership sign the consent to extend the statute. Because both general partners are corporations, any officer or other designated person authorized to act for the corporation can sign the consent.

Because the statute for [redacted] has already expired, there is no reason to obtain any such consent for [redacted]. Instead, you will need to monitor the statute for the partners for both years since their statute limits the time for the IRS to assess any additional taxes. You should also assure that the correct IDRS codes have been input to reflect the appropriate statute extensions and entity controls. IDRS should also reflect that the partnership is NOT a TEFRA entity, and there is no TMP, for [redacted] and [redacted].

TEFRA

Based upon the information you provided, we do not believe the TEFRA procedures automatically apply to this partnership for either year. For 1996 and prior years, if C corporations were partners in a partnership, the TEFRA rules automatically applied. The law changed in 1997 so that effective for tax years ending after August 5, 1997, C corporations can now be partners in a partnership, and the partnership can qualify as a "small partnership" so that the TEFRA provisions do NOT apply.

The current law provides that the TEFRA provisions are applicable to partnership examinations unless the small partnership exception is met. Section 6231(a)(1)(B)(i) defines a small partnership as a partnership that meets all of the following requirements:

(1) The partnership has ten or fewer partners (husband and wife, or individual and estate, count as one partner).

(2) All partners are natural persons or estates. For years ended after August 5, 1997, non-TEFRA partnerships may have C corporations as partners.

(3) No partners are non-resident aliens.

(4) All partners meet the same share requirement pursuant to Treas. Reg. 301.6231(a)(1)-1(a)(3). This requirement is eliminated for tax years ended after August 5, 1997.

(5) The partnership has not made an election for TEFRA provisions to apply.

This 1997 legislative change has converted many partnerships with a corporate partner from TEFRA to non-TEFRA. The 1997 legislation also provided some relief to the Service, and taxpayers, who are unaware of the change by allowing the IRS to apply TEFRA audit procedures to partnerships meeting the small partnership exception, if based upon the partnership's return for the year, the IRS reasonably determines that the TEFRA procedures should apply. These rules are effective for partnership taxable years ending after August 5, 1997, so they apply to both the [redacted] and [redacted] years for your taxpayers.

TEFRA Election

Apparently, many taxpayers and IRS examiners remain unaware of the new rules and the partnership's change in status. Often, the IRS and the taxpayers want the partnerships to be TEFRA. They still can be. The law allows the partnerships to elect TEFRA status, but they need to do so a full year before the statute expires.

§301.6231(a)(1)-1T. Exception for small partnerships

(a) *In general.* For purposes of the exception for small partnerships under section 6231(a)(1)(B) the rules contained in this section shall apply.

(1) *"10 or fewer."* The "10 or fewer" limitation described in section 6231(a)(1)(B)(i) is applied to the number of natural persons (other than nonresident aliens), C corporations, and estates of deceased partners that were partners at any one time during the partnership taxable year. Thus, for example, a partnership that at no time during the taxable year had more than 10 partners may be treated as a small partnership even if, because of transfers of interests in the partnership, 11 or more natural persons, C corporations, or estates of deceased partners owned interests in the partnership for some portion of the taxable year. For purposes of section 6231(a)(1)(B) and this section, a husband and wife (and their estates) are treated as one person.

(2) *Pass-thru partner.* The exception provided in section 6231(a)(1)(B) does not apply to a partnership for a taxable year if any partner in the partnership during that taxable year is a pass-thru partner. For purposes of this paragraph (a)(2), an estate shall not be treated as a pass-thru partner.

(3) *Determination made annually.* The determination of whether a partnership meets the requirements for the exception for small partnerships under section 6231(a)(1)(B) and this paragraph (a) shall be made with respect to each partnership taxable year. Thus, a partnership that does not qualify as a small partnership in one taxable year may qualify as a small partnership in another taxable year if the requirements for the exception under section 6231(a)(1)(B) and this paragraph (a) are met with respect to that other taxable year.

(b) *Election to have subchapter C of chapter 63 apply*--(1) *In general.* Any partnership that meets the requirements set forth in section 6231(a)(1)(B) of the Code and paragraph (a) of this section (relating to the exception for small partnerships) may elect under paragraph (b)(2) of this section to have the provisions of subchapter C of chapter 63 of the Code apply with respect to that partnership.

> **(2) *Method of election.* A partnership shall make the election described in paragraph (b)(1) of this section by attaching a statement to the partnership return for the first taxable year for which the election is to be effective. The statement shall be identified as an election under section 6231(a)(1)(B)(ii), shall be signed by all persons who were partners of that partnership at any time during the partnership taxable year to which the return relates, and shall be filed at the time (determined with regard to any extension of time for filing) and place prescribed for filing the partnership return. However, for partnership taxable years for which a partnership return is to be filed before 90 days after the date final regulations under this section are published in the Federal Register the partnership may file the statement described in the preceding sentence on or before the date which is one year before the date specified in section 6229(a) for the expiration of the period of limitations with respect to that partnership (determined with regard to extensions of that period under section 6229(b)).**
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> (3) *Years covered by election.* The election shall be effective for the partnership taxable year to which the return relates and all subsequent partnership taxable years unless revoked with the consent of the Commissioner.

The partnership may file a TEFRA election with their partnership return or later so long as the election is filed one year prior to the Section 6229 statute expiration. This period may be extended by a statute extension secured under I.R.C. § 6229(b). Because there is no TMP (the partnership is non-TEFRA), all the partners who were partners in the partnership tax year MUST sign a F872 or F872-A with the following special language:

> **Without otherwise limiting the applicability of this agreement, this agreement also extends the period of limitations for assessing any tax (including additions to tax and interest) attributable to any partnership items (see § 6231(a)(3)), affected items (see § 6231(a)(5)), computational adjustments (see § 6231(a)(6)), and partnership items converted to non-partnership items (see § 6231(b). This agreement extends the period for filing a petition for adjustments under § 6228(b) but only if a timely request for administrative adjustment is filed under § 6227. For partnership items which have converted to non-partnership items, this agreement extends the period for filing a suit for refund or credit under § 6532, but only if a timely claim for refund is filed for such items. In accordance with paragraph (1) above, an assessment attributable to a partnership shall not terminate this agreement for other partnerships or for items not attributable to a partnership. Similarly, an assessment not attributable to a partnership shall not terminate this agreement for items attributable to a partnership.**

and with the additional paragraph if using a F872-A:

> **The issuance of a notice of deficiency will not terminate this agreement under paragraphs (1) and/or (2) for the items described by this paragraph.**

Once the partnership successfully elects TEFRA and designates a TMP, that partnership is handled just like any other TEFRA

partnership. Any further need for statute extensions can be made at the partnership level and signed by the TMP. Once the election is made, it applies to subsequent tax years and cannot be revoked without the Service's consent.

We recently received a "TEFRA Alert" from another exam team which describes the same situation in which you find yourself, i.e., LMSB agents working [redacted] and [redacted] cycles and discover that the taxpayer is no longer a TMP and the partnership is non-TEFRA for [redacted] and [redacted]. Apparently, some exam agents discovered this in time to save the [redacted] statute and obtained the above-described elections to be TEFRA. Most of these elections were for [redacted] not [redacted]. Also, many of the elections are not signed by all the partners that held a partnership interest during that tax year, which makes the election invalid, according to the "Alert".

Where the partnership made a valid election in [redacted], but also wants to retroactively apply the election to [redacted], it may do so as long as it follows the same procedures used to extend the [redacted] statute. The fact they made an election for [redacted] does not preclude them making a valid election for [redacted] as long as they meet all the requirements.

If we have misstated the facts, please let us know immediately. A copy of this memo will be sent to our national office for 10-day post review. Should you have any questions about the foregoing, please call John E. Budde at 513-263-4857.

RICHARD E. TROGOLO
Associate Area Counsel
(Large and Mid-Size Business)

By:_____
JOHN E. BUDDE
Senior Attorney (LMSB)