ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

Office of Chief Counsel
Internal Revenue Service

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memorandum

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CC:DOM:FS:P&SI:RLBuch

date: August 5, 1998

to: Brooklyn District Counsel CC:NER:BRK

from: Assistant Chief Counsel (Field Service) CC:DOM:FS

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subject: Adjustments From Amended Partner Returns

This responds to your request for Significant Advice, dated June 15, 1998, in connection with a question posed by the TEFRA Coordinator of the Brookhaven Service Center.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in CCDM (35)2(13)3:4(d) and (35)2(13)4:(1)(e). This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issue

Whether the acceptance of an amended return and assessment of any additional tax arising therefrom constitutes a settlement agreement, thereby causing a conversion of partnership items to nonpartnership items and triggering the application of I.R.C. § 6229(f).

Conclusion

The acceptance of an amended return filed by a partner in a TEFRA partnership when such return reflects adjustments to partnership items does not constitute a settlement agreement within the meaning I.R.C. § 6231(b)(1)(C) and hence, does not cause a conversion of partnership items to nonpartnership items. Accordingly, I.R.C. § 6229(f) is not applicable to the assessment of any tax reflected on the amended return.

Facts

Currently, when an amended return which sets forth adjustments to partnership items is received at a service center, if the amended return results in an increased tax liability, the tax is assessed. In a current case, a taxpayer was an investor in a tax shelter that is subject to the TEFRA unified audit and litigation procedures. Settlement terms were made available to all partners of the shelter. The taxpayer, rather than entering into a settlement agreement, filed an amended return in a manner that was consistent with the settlement terms. The taxpayer asserts that our processing of the amended return constitutes a settlement.

Discussion

In 1982, Congress enacted the TEFRA 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." Conf. Rep. No. 97-248 (1982). Partners are generally required to report items in a manner consistent with partnership treatment, and the Service may examine the partnership as an entity, rather than conduct separate examination as to each of the partners. Where applicable, the TEFRA provisions either supplant or augment the general administrative provisions. Generally, the TEFRA procedures apply to determinations as to partnership items.[1] I.R.C. § 6221.

Settlement Agreements

The Service's authority to enter in to an agreement is set forth in I.R.C. § 7121, which provides that "[t]he Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period." Section 6224(c) sets forth specific rules regarding who is bound by such agreements in TEFRA cases; specifically, allowing passthrough partners and tax matters partners to bind indirect partners and nonnotice partners, respectively. See, Segal v. United States, 97-1 USTC ¶ 50,404 (S.D. Fla. 1997). Even after the enactment of TEFRA, the question of what constitutes an agreement continues to be controlled by I.R.C. § 7121 and the precedent established thereunder. In that regard, an amended return does not constitute an agreement within the meaning of I.R.C. § 7121. Shumaker v. Commissioner, 648 F.2d 1198, 1200 (9th Cir. 1981). The statute and regulations

[1]A partnership item is an item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations provide that such item is more appropriately determined at the partnership level than at the partner level.

provide the means by which an agreement may be reached, and the procedures set forth therein are exclusive. Botany Worsted Mills v. United States, 278 U.S. 282 (1929).

Limitation on Assessment

Because tax is only assessed against the partners (and not the partnership), the partner's limitation on assessment controls the timeliness of any assessment as to that partner. The limitation on assessment is generally set forth in I.R.C. § 6501 and provides that taxes must generally be assessed within three years from the later of the date of filing the taxpayer's return or the due date for filing the taxpayer's return . I.R.C. § 6501(a). In the case of partnership items, I.R.C. § 6501(n)(2) provides for an "extension of the period in the case of partnership items" and refers to I.R.C. § 6229, which sets forth a minimum assessment period within which the limitation on assessment cannot expire. The minimum assessment period is impacted when a partner enters into an agreement. Upon execution, an agreement converts partnership items to nonpartnership items. I.R.C. § 6231(b)(1)(C). Because the partnership items have converted to nonpartnership items, the period of limitation applicable to partnership items no longer controls. Accordingly, Congress included into the TEFRA provisions I.R.C. § 6229(f), which provides that the period for assessment of tax attributable to partnership items which have become nonpartnership items shall not expire before one year after the date of conversion. This provision does not shorten, but only serves to lengthen, the limitation on assessment. Harris v. Commissioner, 99 T.C. 121 (1992).

Analysis

Applying the above to the facts submitted, the amended return submitted by the taxpayer does not constitute an agreement and therefor does not convert the partner's partnership items to nonpartnership items. Instead of being an agreement, the amended return is akin to a request for administrative adjustment (AAR) filed pursuant to I.R.C § 6227(d). Under this provision, when a partner (not acting in the capacity of the TMP) files an AAR, the Service is granted four statutory alternatives. As relevant to this inquiry, I.R.C. § 6227(d)(2) expressly authorizes the Service to "assess any additional tax that would result from the requested adjustments." Under separate authority, the Service is authorized to convert the partner's partnership items to nonpartnership items. See I.R.C. § 6227(d)(3) and cross-references. By making the assessment, the Service has not caused a conversion event. In fact, for TEFRA purposes, the partner continues to be subject to the TEFRA proceeding until such proceeding is concluded or until the partner's partnership items have converted to nonpartnership items. See e.g., I.R.C. § 6226(d). In the situation described above, it is advisable to solicit an agreement from the taxpayer; however, it is appropriate to assess any additional tax upon receipt of the amended return.

If you have any questions or need assistance, please contact Ronald L. Buch, Jr. at 202-622-7329.

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