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INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR JAMES E. CANNON
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FROM: CURTIS G. WILSON
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SUBJECT: Binding Effect of 870-P

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official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND
Date 1 =
Date 2 =
Year 1 =
Year 2 =

ISSUE

Whether, after executing a Form 870-P, a taxpayer may file a request for administrative adjustment.

CONCLUSION

No. A Form 870-P is a final determination as to partnership items, and a claim for adjustment of partnership items may not be made, absent fraud, misrepresentation, or mistake of fact.

FACTS

On Date 1, the Internal Revenue Service (IRS) countersigned two Forms 870-P(AD) relating to year 1 and year 2, which had been submitted by partners of Partnership A. Following the processing of these forms, the partnership filed administrative adjustment requests in which they increased the research credit for years 1 and 2. Nearly a year later, the taxpayer and the Service executed a "memorandum of understanding" stating that it was the mutual understanding of the Associate Chief of Appeals and the taxpayer at the time of executing the Form 870-P(AD) that the taxpayer had the right to file claims for additional research credit.

LAW AND ANALYSIS

Generally, the tax treatment of partnership items is determined at the partnership level. Section 6221. Partnership items include, among other things, each partner's share of credits of the partnership. Treas. Reg. § 301.6231(a)(3)-1(a)(1)(i). Thus, the claim at issue is with regard to a partnership item, and the TEFRA provisions are implicated.

With regard to settlements, the Code generally allows the Service to enter into written closing agreements with taxpayers "in respect of any internal revenue tax for any taxable period." Section 7121. The TEFRA provisions provide for special rules in the case of settlements with regard to partnership items. See section 6224(c); see also Segel v. United States, 97-1 USTC ¶ 50,404 (S.D. Fla. 1997). Specifically, section 6224(c) addresses three specific issues:

- the binding effect on indirect partners of an agreement executed by a flow through partner (section 6224(c)(1));
- the right of partners to request an agreement that is consistent with an agreement that another partner has executed (section 6224(c)(2)); and
- the authority of a tax matters partner (TMP) to execute an agreement binding nonnotice partners (section 6224(c)(3)).

These provisions are exceptions to the general rules of section 7121; however, section 7121 otherwise controls settlement agreements. The Form 870-P(AD) is more than an mere waiver of restrictions on assessment. The form is, and purports on its face to be, a determination of partnership items. The form states that "the tax treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." Moreover, "[t]he standard that section 6224(c) prescribes for setting aside a settlement agreement is the same standard prescribed by section 7121(b) for setting aside a closing agreement." H Graphics/Access Ltd. Partnership v. Commissioner, T.C. Memo. 1992-345. Though the form used for the year at issue does not expressly invoke section 7121, that does not change the nature of the agreement; by its terms, it is a final determination of partnership items. Thus, absent one of the numerated exceptions, a taxpayer who executes such an agreement may not seek a redetermination of any partnership items.

None of the exceptions to the finality of the agreement are supported by the facts of this case. There is no allegation of fraud, malfeasance, or misrepresentation of fact. The taxpayer may argue that the agreement was executed based upon a mutual mistake; however, the mutual mistake that may have existed is not a mistake of fact; but rather, it is a mistake of law and does not fall within any of the exceptions as to finality.

The execution of a settlement agreement with regard to partnership items converts the partner's partnership items to nonpartnership items as of the date the agreement is countersigned for the Commissioner. Section 6231(b)(1)(C). Thus, once a settlement agreement with regard to partnership items has been executed by both parties, the partner ceases to have partnership items for the taxable years

controlled by the agreement. In the instant case, the agreement as to years 1 and 2 was countersigned for the Commissioner on Date 1. Thus, the partner's partnership items ceased to be partnership items as of that date.

On date 2, the partner filed a request for administrative adjustment pursuant to section 6227. Such a request presupposes that the partner has partnership items to adjust. As the partner's partnership items had previously converted to nonpartnership items, the AAR was invalid and cannot be granted.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

As noted above, we believe that the facts set forth above do not clearly support a finding that there has been fraud, malfeasance, or a misrepresentation of fact of a degree that would allow a court to modify or set aside the Form 870-P(AD) here. However, the terms of the "memorandum of understanding," and the circumstances surrounding the execution of the Form 870-P(AD), raise a concern that a court might not regard the facts in the same light. In H Graphics/Access Ltd. Partnership v. Commissioner, T.C. Memo. 1992-345, 63 T.C.M. (CCH) 3149, the Tax Court stated that a misrepresentation is "a false statement of a substantive fact, or any conduct which leads to a belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead." Id. at 3149-5. The Tax Court further stated that to show there has been a misrepresentation sufficient to set aside a closing agreement, it must be shown that "one party intentionally made incorrect or misleading representations regarding the express terms reflected by the proposed closing agreement, and that such terms were relied upon by the other party to its detriment." Id. The Tax Court also stated that misrepresentation requires "a deliberate intent to deceive or mislead similar to that required to prove fraud." Id. [redacted]

In Alexander v. United States, 44 F.3d 328 (5th Cir. 1995), the Fifth Circuit held that a suit for a refund attributable to partnership items was not prohibited by section 7422(h). The court's opinion was based upon the conversion of partnership items to nonpartnership items. The court reasoned that settlement converts partnership items to nonpartnership items, and thus, the prohibition against refunds suits attributable to partnership items is no longer effective. Though Counsel does not agree with this position, the Fifth Circuit's rationale presents an added hazard in this case. It is notable that, in Alexander, the Fifth Circuit continued and held that the settlement agreement did not constitute a waiver of the period of limitations. The court ultimately held that the taxpayer was entitled to the refund.

[redacted]

Please call if you have any further questions.