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Statute of Limitations Considerations Under the BBA

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In this article, Carney and Dawson explain how the centralized partnership audit regime creates problematic anomalies in the statute of limitations provisions, and they suggest how partnership agreements can be drafted or amended to avoid those procedural pitfalls and ensure that the intended economic results are achieved.

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I. Introduction

The new centralized partnership audit regime (CPAR) governs partnership audits for tax years beginning after December 31, 2017, displacing the rules enacted under the Tax Equity and Fiscal Responsibility Act of 1982. The new rules, passed as part of the Bipartisan Budget Act of 2015, were intended to resolve issues and difficulties that had arisen in partnership audits under TEFRA. The question presented, however, is whether that was accomplished or whether new and more perplexing problems were created. Several important procedural issues are unclear at best and present potential hazards that should be addressed in the drafting of partnership agreements. Existing partnership agreements should also be reviewed to see if they adequately address the problems raised by the CPAR.

The BBA, for the first time, subjects partnerships to liability attributable to audit adjustments in income, deductions, or credits reported by the partnership. This liability is defined in the BBA as an imputed underpayment. The imposition of an imputed underpayment against the partnership under new section 6225 creates procedural and economic effects different from TEFRA. For example, CPAR separates the year under audit (the reviewed year) from the year in which payment of the imputed underpayment becomes due (the adjustment year, as defined in section 6225(d)(2)), which controls the limitations period for assessment of the imputed underpayment. Economic issues among the partners can arise from separating the entity liable for an imputed underpayment (the partnership) from the persons bearing the economic burden of the imputed underpayment (the partners in the adjustment year). Also, if only some of the partners make payments in modification of the partnership's proposed imputed underpayment (under section 6225(c), as described below), are those partners treated differently regarding penalties and interest from the partners who don't participate in the modification procedure?

This article explores these and other procedural and economic effects, including statutes of limitations issues that result from the changes made by the BBA. It focuses specifically on the imposition of an imputed underpayment against the partnership under new section 6225.

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II. The Imputed Underpayment

Section 6225 is the default provision of the CPAR, which determines the imputed underpayment to be a liability[1] of the partnership in the adjustment year, not a tax liability of the partners in the partnership during the reviewed year. Thus, the partners in the adjustment year will bear the economic burden of any imputed underpayment resulting from the partnership adjustments, rather than the partners who enjoyed the benefits of the tax underpayment in the reviewed year (who, of course, may or may not be the same partners). This imputed underpayment will be assessed against the partnership (under section 6232) if it doesn't make an election under section 6226 (discussed below in Section IV) to push out the liability to the partners in the reviewed year.[2] Conversely, the partnership is relieved of liability for the imputed underpayment if it makes a push-out election.

III. 'Adjustments' vs. 'Assessments'

One significant difference between the CPAR and the TEFRA partnership audit rules is the importance of the concept of adjustments for partnership items. TEFRA administrative audit proceedings resulted in a "final partnership administrative adjustment," proposing adjustments to the partnership's items of income, deduction, gain, loss, and credits. Once those adjustments were resolved, the statutory focus then shifted to the assessment of tax against the partners to reflect the changes to partnership items set forth in the FPAA as finally determined. Those assessments could be made within one year after the later of either (1) the close of litigation contesting the FPAA determinations, or (2) the expiration of 150 days after issuance of the FPAA if no suit contesting the proposed changes was filed.[3] This procedure then tracked the rules for the assessment of tax resulting from audit determinations in a regular audit in which a statutory notice of deficiency was issued. The FPAA thus functioned for partnership items in a manner parallel to a statutory notice of deficiency for non-partnership items.

By contrast, the CPAR rules for assessment, and the controlling statutes of limitations, are different. Initially, the CPAR uses the terms "adjustment" and "assessment" in overlapping and confusing ways. For example, section 6221 begins by stating that "*an adjustment* to a partnership related item shall be determined, *and any tax attributable thereto* shall be assessed and collected . . . at the partnership level." (Emphasis added.) Then section 6232 provides that *any imputed underpayment shall be assessed* and collected in the same manner *as if it were a tax* imposed for the adjustment year." (Emphasis added.) Finally, section 6235 provides that "no *adjustment* under this subchapter for any partnership taxable year may be made after the later of. . . . " (Emphasis added.) As discussed more fully later, the statute never specifies how an adjustment is "made," and many of the limitations periods for *adjustments* in section 6235 are similar to the general rules for periods of limitations for the making of *assessments* in section 6501. Below we discuss how to sort through these confusing and overlapping provisions governing the making of "adjustments" and "assessments" under the CPAR.

The CPAR also introduces the "Notice of Proposed Partnership Adjustment" (NOPPA), which, like an FPAA under TEFRA, proposes potential adjustments to the partnership's items of income, gain, loss, deduction, or credit, but which — unlike an FPAA — also proposes an overall partnership-level adjustment and imputed underpayment.[4] The date of the NOPPA commences a 270-day modification period in which the amount of the proposed partnership adjustments and imputed underpayment can be reduced. The statute of limitations on assessment is then determined by the procedural steps triggered by the NOPPA, which results in the issuance of a "Final Partnership Adjustment" (FPA).

[1] It is unclear if this imputed underpayment is actually an income tax under the code, or some other "liability" classification. Section 6232(a) provides that it will be "assessed and collected in the same manner *as if it were a tax*" (emphasis added), thereby suggesting that it is something other than a tax.

[2] Discussed *infra* Section IV.

[3] Former section 6229(a) and (d).

[4] Section 6225(a)(1).

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A. Assessment of the Imputed Underpayment

The statute is somewhat convoluted and confusing on how to arrive at an assessment of the amount of the imputed underpayment against the partnership or, if the imputed underpayment is not timely paid by the partnership, an equivalent assessment of the imputed underpayment pro rata against the partners in the adjustment year.[5] This is important because only an assessment, not an adjustment or imputed underpayment,[6] can be the subject of enforced collection by the IRS.

Section 6225 provides that if the adjustments result in an imputed underpayment, the partnership "shall pay an amount equal to such imputed underpayment in the adjustment year as defined in section 6232." The adjustment year is essentially the year in which an FPA is mailed to the partnership or any litigation regarding the adjustments in the FPA is finalized.[7] The authority to *assess* the tax attributable to an imputed underpayment is found in section 6232, which provides that the imputed underpayment shall be assessed and collected "as if it were a tax imposed for the adjustment year," without the need for a statutory notice of deficiency as is generally required for income taxes.[8] It's unclear why it was necessary to include the statutory mandate "shall pay" in section 6225 and later provide in a separate section[9] that the tax attributable to the imputed underpayment will be assessed "and collected," since any tax that is assessed must be paid either voluntarily or by enforced collection by the IRS. Moreover, the directive "shall pay" — absent an assessment — may be unenforceable (except perhaps as a general claim by the United States for money owed). In any event, the "shall pay" language in section 6225(a)(1) would appear to be superfluous.

The CPAR does not specifically tie a statute of limitations for *assessment* to the partnership reviewed year or have a specific rule for tolling the statute on the reviewed year until the issuance of an FPA. Under TEFRA, the assessment of tax was made for the partnership year under audit, and the statute of limitations was satisfied if the FPAA was sent within three years of the due date (or, if later, the filing) of the partnership return.[10] The assessments under the adjusted partnership items were then made against the partners for the audited year of the partnership, and they were timely if made within a year after the adjustments became final.

Under the CPAR, by contrast, the determination of the statute of limitations is simply moved forward in time, perhaps many years, to the adjustment year. Does that mean that there is no limit on how quickly the IRS must complete an audit? Under the BBA as originally passed by Congress, the answer was yes — there was no limitation. That result followed from the convoluted two-step path of the CPAR, whereby the partnership *adjustments* are first presented to the partnership by the NOPPA that must be sent at least 270 days *before* the FPA. The FPA can be sent 270 days after the completion of the modification procedure or 330 days after the issuance of the NOPPA, whichever is later. Under the original BBA, because there were no time limits on the issuance of the NOPPA *after* the filing of the partnership return, the issuance of the FPA and the corresponding adjustments and imputed underpayment determined by the FPA had no limitation. Consequently, there was effectively no

[5] *See* section 6232(f)(1)(B).

[6] Section 6232(a) provides that an imputed underpayment "shall be *assessed and collected* as if it were a tax" (emphasis added), which suggests, although not a model of clarity, that the imputed underpayment must be assessed before it is collected.

[7] *See* section 6225(d)(2)(A) and (C); section 6225(a)(1); and reg. section 301.6225-1(a)(1) and (2).

[8] Section 6232(a)(1) provides that the assessment of the imputed underpayment is made without regard to the deficiency procedures generally applicable to income taxes under chapter 63, which was the same as for finally determined adjustments to partnership items under TEFRA (*i.e.*, adjustments of partnership items set forth in the FPAA if uncontested, or in the final determination at the conclusion of litigation contesting the FPAA).

[9] Section 6232(a) provides that the "imputed underpayment shall be assessed and collected in the same manner as if it were a tax imposed for the adjustment year." This is strange language: assessing the imputed underpayment "as *if* it were a tax" (emphasis added) instead "as a tax imposed for the adjustment year." This language raises additional questions. If the imputed underpayment is not in fact a tax, how should it be classified for statute of limitations purposes? Is it perhaps a general claim by the United States against the partnership? Also, how is it treated for other provisions of the code that refer to "tax" other than assessment and collection provisions that are specifically mentioned? The BBA doesn't answer those questions. It provides only that the payment by the partnership is nondeductible. Section 6241(4).

[10] Court decisions expanded the statutory extension to include the individual tax years of any partners whose tax years remained open under their individual statutes of limitations, even if the statute for the partnership had expired. *See Rhone-Poulenc Surfactants and Specialties LP v. Commissioner*, 114 T.C. 533 (2000).

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statute of limitations on adjustments (or resulting assessments) against the partnership.

To remedy this problem, the BBA was amended retroactively in the Tax Technical Corrections Act of 2018 to add new subsection (b) to section 6231. It requires that NOPPAs shall not be mailed later than three years after the due date of the partnership return (or, if later, three years after the filing date), and it cross-references section 6235. This effectively limits the time for the issuance of an FPA, because the IRS must issue it within the time determined by the mailing date of the NOPPA. Section 6235 provides that an adjustment must be made no later than 270 days after the completion of the modification process[11] or, if later, 330 days[12] after a NOPPA is issued.[13] It is unstated, and must be inferred, that the *adjustment* is "made" by the sending of the FPA; but that doesn't specify when an *assessment* of the resulting amount must be made.

To complete this serpentine line of analysis, one must look back to section 6225(d)(2), defining the adjustment year as the later of the year in which the FPA is mailed[14] or the year in which any litigation disputing the FPA adjustments becomes final.[15] Presumably, the statute of limitations under section 6501 for that adjustment year will then provide the limitations period on *assessment* of the imputed underpayment under section 6232 "as if it were a tax," in the amount resulting from the *adjustment* that was deemed by inference to have been made under section 6235 by the sending of the FPA.

[11]Section 6235(a)(2).

[12]Presumably, the 330-day limit is derived from the 270-day limitations period for issuing an FPA after the NOPPA is issued (see section 6231(b)(2)), plus 60 days in which to issue the FPA. However, section 6235(a)(2) also provides a later date for use of the modification procedure in section 6225(c) — specifically, 270 days "after the date on which everything required to be submitted to the Secretary pursuant to such section is so submitted." On its face, this would appear to present possible ambiguity regarding the starting date of the 270-day period. This additional provision therefore allows for an extended limitations period, *i.e.*, beyond the 330-day limitation after the issuance of the NOPPA, for the modification process to be completed and an FPA to be issued. It would therefore be advisable to secure a dated agreement with the IRS confirming that all materials have been submitted in order to establish a definite date for the beginning of this limitation period.

[13]Section 6235(a)(3).

[14]Section 6225(d)(2)(C).

[15]Section 6225(d)(2)(B).

In short, the partners in the partnership's adjustment year — which may be years after the reviewed year — will bear the economic burden of the imputed underpayment. Interest, however, will still accrue from the due date of the return for the reviewed year to the due date of the return for the adjustment year.[16] Interest thereafter will accrue under normal rules from the due date of the return for the adjustment year until the assessment is paid.

B. The 'Modification Period'

Section 6225 is designed to require the IRS to calculate the largest possible tax that could arise from adjustments to partnership items resulting from the partnership audit. The details of the rules for calculating the imputed underpayment set forth in the NOPPA at the conclusion of the partnership audit are complex and beyond the scope of this article. In essence, however, the unfavorable adjustments are taken into account, but the netting of favorable adjustments is severely restricted.[17] The resulting (likely overstated) positive adjustment is then multiplied by the maximum applicable tax rate for the reviewed year.[18]

To mitigate the potential harshness of this approach, section 6225(c) provides that the imputed underpayment determined under the normal rules may be modified using either (1) amended returns filed by partners (not necessarily all partners) that reflect their individual tax liabilities for the reviewed year after taking into account the proposed adjustments as determined on audit, or (2) an alternative procedure that achieves the same result without the filing of amended returns. But these modification approaches create their own procedural issues.

First, the regular modification procedures contemplate that some or all partners will take into account the proposed adjustments and calculate the resulting tax (considering each partner's particular tax situation and tax rate). The portion of the proposed adjustment taken into

[16]*See* section 6233(a)(2).

[17]*See* section 6225(b)(3) and (4).

[18]This rate is subject to adjustment in the modification procedure.

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account by a partner is then removed from the total proposed adjustment in the NOPPA.[19] However, if all partners file amended returns so that the entire proposed adjustment is reduced to zero, presumably an FPA will not be issued because there will be no remaining adjustment or imputed underpayment to include in the FPA. In that event, the partnership (and, indirectly, the partners) could not contest the amount of the proposed adjustments and imputed underpayment in the NOPPA. Thus, unless the partners agree with the proposed adjustments, at least one partner should abstain from filing an amended return to preserve some portion of the adjustment to contest in litigation after the issuance of an FPA.

If amended returns are filed, an additional consideration is that, presumably, interest and penalties will cease to accrue against the partnership for the portion of its imputed underpayment that is reduced by the partners' payments. Does only the nonpaying partner continue to be liable for interest and penalties on the unpaid portion, or does the partnership (and thus all partners, pro rata) incur this liability? These are questions that arise as a result of creating a separate liability of the partnership for an asserted underpayment of tax. The partnership agreement should take these issues into account by providing for contribution among the partners.

Second, can the partners who file amended returns obtain refunds of overpayments if all or a portion of the imputed underpayment is not sustained in court? Although the regulations originally barred partners who filed amended returns under the modification procedures from filing a second amended return, the regulations were amended to permit amended returns to seek refunds resulting from litigation favorable to the partnership.[20] Thus, partners filing amended returns under the modification procedures and paying a portion of the imputed underpayment should later file protective amended returns (within two years after filing the first amended returns and paying the tax shown[21]) to protect their rights to refunds under the court's decision.[22] This could become another trap for the unwary resulting from the creation of a liability on the partnership that is separate from the individual tax liabilities of the partners.

Third, the statute of limitations on both adjustment and assessment can be extended substantially under the modification procedures. If the modification period extends to the end of the 270-day period allowed after issuance of the NOPPA,[23] a *separate* 270-day statute of limitations on adjustment begins to run *only after* "everything required to be submitted" for completion of the modification process has been submitted.[24] This results in at least 18 months (two periods of 270 days) for the statute on making an adjustment to run, even without allowed extensions to the modification period. A further likely extension of the statute will occur if the partnership pursues either or both of the conferences with the Appeals Office allowed by the IRS — one before the NOPPA is issued (based on proposed adjustments set forth in a summary report) at the end of the audit, and a second conference to consider the IRS's determinations regarding the amended returns submitted in the modification process.[25]

C. Example and Unanswered Issues

These unique features of the CPAR — the notion of an imputed underpayment payable either by the partnership or the adjustment-year partners (if not paid by the partnership within 10 days after assessment and notice and demand), and the intermediate modification process — create several anomalies under the limitations provisions. First, because the adjustment year is

[19] *See* section 6225(c)(2).

[20] Reg. section 301.6225-2(d)(2)(viii)(C).

[21] *See* section 6511.

[22] Section 6225(c)(2)(D) provides that the regular statutes of limitations on assessment and refunds (sections 6501 and 6511, respectively) do not apply to amended returns filed for purposes of modification. This was necessary, of course, because the tax years of the individual partners may be closed by the time of the modification period. Note, however, this exemption from the statute of limitations on refunds *does not* apply to second amended returns to recover overpayments of the tax paid by partners on behalf of the partnership during the modification period, when the IRS determinations regarding the imputed tax or the modifications are not sustained in court.

[23] Section 6231(b)(2).

[24] Section 6235(a)(2).

[25] These separate trips to the IRS Independent Office of Appeals will require extensions on the statute of limitations for Appeals consideration, under general Appeals requirements. These extensions are *in addition to* other expected extensions to accommodate the modification process itself.

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the year that the imputed underpayment is deemed to be due, the IRS can assess the imputed underpayment at any time while the statute is open for the adjustment year — that is, three years after the due date of the partnership return for the adjustment year. But as shown in the example below, that adjustment year may be long after the basic three-year period starting with the filing of the partnership return for the reviewed year.

Example: *Extended limitations periods for assessment under the BBA compared with TEFRA.* Assume that there is no litigation after the issuance of the FPA. If there have been (1) three years intervening between the reviewed year and the issuance of the NOPPA as allowed by section 6231(b)(1); and (2) an additional period of 18 months between the issuance of the NOPPA and the FPA (the minimum period for the modification process); then the total period for issuance of the FPA setting forth the imputed underpayment against the partnership can be approximately four and a half years (three years plus 18 months) after the reviewed year.[26]

The statute of limitations for partners can be further extended if the partnership doesn't pay the imputed underpayment within 10 days after assessment and notice and demand. The IRS then can assess each person who is a partner as of the close of the adjustment year a pro rata portion of the imputed underpayment.[27] Section 6232(f)(6)(B) imposes a two-year statute of limitations on assessment after the notice and demand for payment of the imputed underpayment is sent to the partnership. It is unclear if this two-year period is in addition to the normal three-year limitation on assessment against the partners for the adjustment year,[28] or if it instead limits the normal period to two years, at least for a partnership imputed underpayment from an earlier reviewed year. Either way, the period of limitations for the adjustment-year partners gets longer, most likely to at least the end of their normal three-year period for the adjustment year. However, if the two-year period is held to be an extension as opposed to a limitation of the normal three-year period, it might give the IRS five years after the due date of the partnership's return for the adjustment year (and up to nine and a half years after the audited year) for an assessment against the partners if the partnership didn't pay. Meanwhile, the adjustment-year partners are paying interest, and possibly penalties, for the period of nonpayment and, presumably, they couldn't even pay the tax until it is assessed against them.

Compare that possible seven-and-a-half-year limitations period for assessment (or potential nine and a half years in the event of nonpayment by the partnership) of the imputed underpayment with the TEFRA rule, under which the assessment under an FPAA must be made within one year after the completion of litigation (or one year plus 150 days after an FPAA is mailed but not litigated).[29] Assuming no litigation or extensions as in the BBA example, this would result in at most only approximately four years and five months between the due date of the partnership return and the statute of limitations on assessment for any underpayment of tax attributable to the partnership items. Thus, the IRS is granted (potentially) approximately three additional years under the BBA compared with TEFRA (that is, seven and a half years versus four years and five months) after the due date (or filing date) of the partnership return in which to make an assessment in accordance with the proposed adjustments to partnership items.[30]

The partnership is also liable for interest and penalties during all intervening years between the due date for the filing of the partnership return for the reviewed year and the due date of the return for the adjustment year, and it is uncertain whether interest may be avoided by a deposit under section 6603.

As a result, the adjustment-year partners may discover that they have an unanticipated tax liability many years after the audit of the partnership's tax year in issue — a year in which

[26] This does not take into account that the partnership is allowed two Appeals proceedings, as explained above. Under TEFRA, there was only one Appeals conference.

[27] Section 6232(f)(1).

[28] Section 6501(a).

[29] *See* former section 6229(d).

[30] Further, if the partnership files an administrative adjustment request under section 6227, the three-year period for sending a NOPPA resets to three years from the filing of that request (and the entire audit process outlined above commences). Section 6235(a)(1)(C).

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they may not even have been partners. This can be particularly upsetting for a corporate taxpayer with an audited financial statement, because the amount may be material and the company may not have provided a contingency reserve. Prospective partners should insist on provisions addressing this contingency, and potential indemnification for it, when they purchase their partnership interests.

IV. Limitations Issues With Push-Out

A push-out election under section 6626 by an audited partnership relieves the partnership from the requirement to pay the imputed underpayment, and it shifts the collection of the tax attributable to partnership adjustments to the reviewed-year partners, similar to TEFRA. Under section 6226(a), a partnership may make a push-out election within 45 days after the FPA is mailed by the IRS.[31] This 45-day period cannot be extended, and once made, the election may be revoked only with the consent of the IRS.[32] Under reg. section 301.6226-2(b)(1), a partnership that makes a push-out election must provide "push-out" statements to its reviewed-year partners (and file those statements with the IRS) no later than 60 days after the date all the partnership adjustments for the reviewed year are finally determined. Partnership adjustments become finally determined upon the later of the expiration of the time to file a petition under section 6234 or, if a petition is filed, the date when the court's decision becomes final.[33]

The push-out election introduces a new concept — the reporting year — and new limitations period complications. Under section 6226(a) and (b), each reviewed-year partner who is furnished a push-out statement takes into account in the reporting year (the year in which the statement was furnished by the partnership) any increase or decrease in tax caused by recalculating the tax imposed for the reviewed year as a result of the partnership adjustments reflected on that statement. Therefore, the date the statement is furnished by the partnership determines the tax year in which a reviewed-year partner (either direct or indirect) will pay tax as a result of taking into account the partnership adjustments. The push-out mechanism of section 6226 for the additional reporting year tax is similar to Schedule K-1, in that the partnership furnishes statements to the partners and the partners are solely responsible for determining and self-reporting any resulting tax due. The IRS will then have its usual three years to audit the reporting year for each partner to ensure that the proper amounts were calculated and reported.[34]

Unlike under TEFRA, the partners are not entitled to participate in the audit process (or later litigation challenging the FPA) or to determine whether the partnership files a push-out election. Thus, the push-out statements may come as a surprise to reviewed-year partners because they would arrive many years after the reviewed year, and the taxpayers may no longer be partners in the partnership. Again, the partnership agreement should be drafted, or redrafted, to deal with this problem. Similarly, because the reporting year is the year that the push-out tax is deemed to be due, the IRS can assess that additional reportable-year tax at any time while the partner's statute of limitations is open for that year — that is, three years after the due date of the reviewed-year partner's return for the reporting year, or six years if a substantial understatement of gross income results.

V. Conclusion

The CPAR enacted under the BBA creates new and varied statute of limitations issues and longer periods of uncertainty for partners of partnerships that don't elect out of the new regime. The issues discussed above should therefore be considered when drafting (or amending) partnership agreements to ensure that the intended economic results are achieved and procedural pitfalls are avoided. ■

[31] *See* IRS Form 8988, "Election for Alternative to Payment of the Imputed Underpayment — IRC Section 6226."

[32] *See* reg. section 301.6226-1(a)-(c).

[33] *See* reg. section 301.6226-2(b)(1)(i) and (ii), and -2(c).

[34] For some reason, section 6226(c)(2)(C) increases the interest rate under section 6621(a)(2) to the "Federal short-term" rate plus 5 percent, rather than the customary 3 percent, on the underpayments assessed against the partners in push-out.

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