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by Gregory T. Armstrong, Ossie Borosh, and Andrew R. Roberson

Gregory T. Armstrong

Ossie Borosh

Andrew R. Roberson

Gregory T. Armstrong is a director in the practice, procedure, and administration group of KPMG LLP's Washington National Tax practice; Ossie Borosh is a principal in the Washington National Tax passthroughs group; and Andrew R. Roberson is a principal in the tax controversy and dispute resolution group of the Washington National Tax practice.

In this installment of Practically Speaking: Tax Controversy, the authors examine important statute of limitations issues raised by the partnership rules in the Bipartisan Budget Act of 2015, including dealing with errors or omissions discovered by the IRS or taxpayers more than three years after a partnership return has been filed, and how those items may affect future, open tax years.

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In 2015 Congress enacted new partnership audit rules in the Bipartisan Budget Act that apply to all partnerships that file a Form 1065, "U.S. Return of Partnership Income," and that cannot, or do not, elect out of the BBA.[1] Under section 6235, generally, no adjustment may be made under the BBA for a partnership tax year more than three years after the filing of the original return for that year. Similarly, under section 6227, a partnership generally only has three years from the filing of the original return to file a request for an administrative adjustment (AAR) of a partnership-related item for that tax year.

What if more than three years have passed since the filing of the partnership return, and the IRS or the partnership (or one of its partners) discovers an error or omission on that return? Is the IRS forever barred from adjusting partnership-related items for that partnership tax year? Are the partnership and its partners similarly precluded from adjusting any items for that year? What happens if an item from that year (now closed to IRS adjustment or an AAR) affects a current-year item such as basis in partnership property, a partner's basis in its partnership interest, or a loss or credit carryforward reported at the partner level?

This article explores those questions and analyzes the IRS's authority to adjust a partnership-related item for a tax year for which the period under section 6235 has expired.[2] It begins with a general discussion of the statutory periods of limitations for assessing and refunding taxes and how courts and the IRS have applied those general principles when errors were

[1] *See* sections 6221 through 6241. The election out of the BBA regime falls under section 6221(b).

[2] This article touches on, but does not directly address, the ability of a partnership and its partners to request an adjustment to a partnership-related item for a year for which the period under section 6227 has expired. We intend to examine that question in a future article.

discovered after those periods had expired. This article also looks at how courts have applied those general principles in the context of assessments made under the rules of the 1982 Tax Equity and Fiscal Responsibility Act. It then describes the procedures under the BBA for making adjustments to partnership-related items and probes whether the pre-BBA general principles as developed by courts and the IRS apply for adjustments made by the IRS under the BBA procedures. Lastly, this article reviews the BBA special enforcement regulations under section 6241 and discusses the relevance of those rules to these issues. In sum, after considering the existing case law and guidance and the authority granted to the IRS under the BBA special enforcement regulations, the section 6235 period appears to preclude actions for closed-year items that generally would have been permitted under pre-BBA case law.

I. Limitation Periods Under the Code

The Internal Revenue Code includes various limitations periods — that is, prescribed periods of time within which the government or the taxpayer must take a certain action for that action to be considered valid. Two prominent limitations periods that regularly affect the IRS and taxpayers alike are sections 6501 and 6511. Under section 6501, the IRS generally has three years from the date a return is filed for a given tax year to assess any tax imposed under the code for that tax year (the assessment period).[3] An assessment made after the assessment period has expired constitutes an overpayment.[4] When a taxpayer overpays tax, section 6511 generally provides the taxpayer a period of three years from the original return filing date or two years from the time the tax was paid, whichever expires later, to make a claim for refund of that overpayment (the refund period).[5] Generally, if a claim is not filed within the section 6511 period, the taxpayer is barred from recovering that overpayment.

Sections 6235 and 6227 are two limitations periods specific to BBA partnerships. Under the BBA, the IRS or the partnership may adjust a partnership-related item, and if that adjustment results in a so-called imputed underpayment, the default rule is that the partnership must pay that imputed underpayment unless the partnership elects to push out the adjustments to its partners.[6] Section 6235 imposes a time limitation on adjusting partnership-related items and provides, in general, that no *adjustment* under the BBA provisions for any partnership tax year may be made after three years have passed from the filing date of the partnership return.[7] Similarly, section 6227 generally provides that a partnership may file a request for an administrative *adjustment* of a partnership-related item within three years of the filing of the original partnership return.[8]

Sections 6235 and 6227 both use the term "adjustment" in expressing their limiting language. A plain reading of both statutory provisions suggests a limitations period in which the IRS or the partnership has a certain amount of time to make an adjustment to a partnership-related item. Is there a meaning to be inferred from the statutory language limiting the time to make an "adjustment," as opposed to a time limitation on making an assessment (like under section 6501) or claiming a refund (like under section 6511)?[9] Does the expiration of the "adjustment" period under section 6235 or the AAR period under section 6227 bar the IRS and the partnership and its partners from ever adjusting an item for that year?

[3] Section 6501(a). The act of assessing a tax is the recording of the taxpayer's liability for that tax in IRS records. Section 6203. For example, when a taxpayer reports a tax liability on a tax return, the IRS may assess that amount of tax in its system as the liability of that taxpayer. Section 6201(a)(1).

[4] Section 6401(a).

[5] Section 6511(a).

[6] *See* sections 6221(a), 6225(a), and 6232(a), discussed *infra*.

[7] Section 6235(a). If the IRS issues a notice of proposed partnership adjustment, additional time is provided for the IRS to make the final partnership adjustment. *See* section 6235(a)(2) and (3). This article focuses on the period for the IRS to propose its adjustments in a notice of proposed partnership adjustment. The time for issuing that notice is tied to the period under section 6235(a). *See* section 6231(b)(1). Certain exceptions exist to the general three-year period under section 6235(b) (extensions) and section 6235(c) (fraud, omission from gross income, etc.). Those exceptions are not addressed in this article.

[8] Section 6227(c). The regulations under section 905(c) provide an exception to this rule in the case of a foreign tax redetermination. *See* reg. section 1.905-4(b)(2)(ii). This article does not address that exception.

[9] As discussed *infra*, section 6232 provides that an imputed underpayment is assessed as if it were a tax for the adjustment year, but the statute does not expressly limit the time within which the IRS may assess the imputed underpayment. *See also* Robert T. Carney and James P. Dawson, "Statute of Limitations Considerations Under the BBA," *Tax Notes Federal*, Apr. 17, 2023, p. 411.

II. Treatment of Closed-Year Items

It may help to start with a discussion of similar questions that arise in the context of the assessment and refund periods. That is, what happens if an error in taxable income is identified for a prior year but both the assessment period and refund period for that year have expired (a closed year)? Are both the taxpayer and the IRS time-barred from correcting the error in the closed year? In general, if correcting the error in the closed year would result in an increase or decrease in tax for that year, and both the assessment period and the refund period are closed, the IRS would be barred from assessing that tax for that year and the taxpayer would be unable to file a timely claim for refund of the overpayment for that year.

But what, though, if correction of the item in the closed year would not result in an increase in tax or a refund for the closed year? Or similarly, what if the correction would result in a change in tax in a closed year, but the IRS or the taxpayer is willing to forgo collecting or claiming the correct amount of tax for the closed year yet seeks to recompute closed-year items for the purpose of determining an open-year liability? In some cases, courts have permitted taxpayers and the IRS to correct a closed-year error not for purposes of assessing or refunding tax in the closed year but to determine tax in an open year or to determine an open-year item or attribute.[10] For example, a taxpayer or the IRS may adjust a net operating loss carryforward in an open year to account for a missed item of income or deduction in an earlier year, even if that earlier year is closed for assessment and refund purposes.[11] Similarly, a taxpayer or the IRS may adjust a credit carryforward to reflect a credit not claimed in an earlier year or incorrectly claimed on that year's return, even when the assessment and refund periods for that year have expired.[12]

The theory behind these types of closed-year "adjustments" is that the periods under sections 6501 and 6511 bar *assessments* and *refunds* for those closed years but do not bar recalculations of taxable income for those years.[13] In *Phoenix Coal*, the Second Circuit held that the assessment period is specific to the return for the year for which tax is being assessed. The court concluded that so long as the year for which the IRS is assessing tax is open, the year for which taxable income is being recalculated can be closed. In reaching this conclusion, the Second Circuit pointed to the predecessor to section 6214(b), a provision of the code that permits the Tax Court to consider facts concerning other tax years to redetermine the correct amount of tax for the tax year before the court, even if the Tax Court is barred from determining whether the taxpayer overpaid or underpaid tax for that closed year.[14] Courts have extended this principle to cases before the district courts and the Court of Federal Claims, reasoning that courts have the "right to examine tax matters in other years when such examination is necessary to determine the tax liability for a year at issue."[15]

III. Closed Years and TEFRA

The case law and IRS guidance discussed above largely developed outside the partnership context.[16] Nevertheless, courts, the IRS, and

[10] The term "open year" refers to a year for which the assessment period and the refund period have not expired. *See Phoenix Coal Co. Inc. v. Commissioner*, 231 F.2d 420 (2d Cir. 1956); *Springfield Street Railway Co. v. United States*, 312 F.2d 754 (Ct. Cl. 1963); *Mecom v. Commissioner*, 101 T.C. 374 (1993), *aff'd*, 40 F.3d 385 (5th Cir. 1994); *Hill v. Commissioner*, 95 T.C. 437 (1990); Rev. Rul. 81-88, 1981-1 C.B. 585; and Rev. Rul. 56-285, 1956-1 C.B. 134.

[11] Rev. Rul. 81-88, situation 2. For a thorough analysis of Rev. Rul. 81-88 and the issues addressed in this section, see James R. Gadwood, "Net Operating Losses and Mistakes in Closed Tax Years," 58 *NYU L. Rev.* 267 (2014-2015).

[12] Rev. Rul. 82-49, 1982-1 C.B. 5. *See also* 2001 IRS CCA LEXIS 358 (extending application of Rev. Rul. 82-49 to research credit); and *Mennuto v. Commissioner*, 56 T.C. 910 (1971).

[13] *Barenholtz v. United States*, 784 F.2d 375 (Fed. Cir. 1986) ("Section 6501(a) bars assessments, not calculations.").

[14] *Phoenix Coal*, 231 F.2d at 421 (citing section 272(g) of the 1939 IRC, the predecessor to section 6214(b)). Although the Tax Court may consider facts from other years, it does not have jurisdiction to determine whether that prior-year tax was overpaid or underpaid. *See* section 6214(b).

[15] *See Springfield Street Railway*, 312 F.2d at 757-758 (quoting *Magee v. United States*, 37 F.2d 763 (Ct. Cl. 1930), *aff'd*, 282 U.S. 432 (1931) ("The court has power to adjudicate and determine all facts necessary to the establishment of the validity of the claim.")).

[16] In LTR 201548006, the IRS applied the principles of Rev. Rul. 82-49 and permitted the recalculation of credits claimed on earlier-filed partnership and S corporation returns. The private letter ruling does not make clear whether the partnership was subject to the TEFRA rules and does not include a substantive analysis of those rules. As discussed in this section, the application of the TEFRA rules complicates the application of the case law and general principles discussed earlier. It is also unclear how much relevance LTR 201548006 still holds after the passage of the BBA provisions.

taxpayers have grappled with similar closed-year issues affecting partnership items and partner tax attributes in the context of the TEFRA rules.

Under the TEFRA rules, the tax treatment of any partnership item is determined at the partnership level through an exam of the partnership return; however, any tax attributable to that partnership item (and any affected item) is assessed against and collected from the partners.[17] Under TEFRA, there are effectively two assessment periods: (1) the period under former section 6229 that generally expires three years after the filing of the partnership return; and (2) the period under section 6501 that generally expires three years after the filing of the partner's own tax return. Courts have held that so long as either the section 6229 period or the section 6501 period is open, the IRS can assess tax attributable to a partnership item.[18]

Before it can assess tax attributable to a TEFRA partnership item, however, the IRS generally must issue a notice of final partnership administrative adjustment to each notice partner.[19] The code and regulations do not impose a time limit, per se, within which the IRS must issue an FPAA. Case law has held that the test for determining an FPAA's timeliness is asking whether, on the date the FPAA is issued, time remains for the IRS to assess any tax resulting from the FPAA adjustments. Using that barometer, the Tax Court has permitted the IRS to issue an FPAA for a closed year because the tax the IRS was seeking to collect related to an open year.[20] In a later case, the Court of Federal Claims extended this logic a step further and allowed the IRS to redetermine a partnership item in a closed year without requiring the agency to issue an FPAA for that year, so long as there was an open-year partnership proceeding and the assessment period for the tax attributable to the partnership item at issue was also open.[21]

The common theme of these holdings is that although the assessment period limits the time within which the government may assess tax for a particular year, it does not limit the time within which the IRS may determine or adjust a TEFRA partnership item for a particular year.[22] These holdings are therefore consistent with the case law and general principles developed outside the partnership context.[23] In sum, under both those general principles and under the TEFRA-specific case law, courts have permitted the IRS to recompute closed-year items for purposes of determining and assessing tax for an open year.

IV. BBA Imputed Underpayment

The BBA rules replaced the TEFRA rules and introduced a new regime for adjusting partnership-related items and assessing tax attributable to those adjustments. The general structure of the BBA regime is that all adjustments to partnership-related items must be determined at the partnership level, but, unlike TEFRA, any tax attributable to those adjustments is assessed at the partnership level in the form of an imputed underpayment.[24] The partnership must pay that imputed underpayment unless it elects for its partners to take into account the adjustments.[25]

As discussed above, typically the IRS assesses tax for the year it is redetermining taxable income,

[17] *See* sections 6221 and 6230(a). The TEFRA rules were repealed by the BBA and replaced with the BBA provisions for tax years beginning after December 31, 2017.

[18] *See, e.g.*, *Rhone-Poulenc Surfactants & Specialties L.P. v. Commissioner*, 114 T.C. 533 (2000), *appeal dismissed and remanded*, 249 F.3d 175 (3d Cir. 2001).

[19] Former section 6225. A notice partner is a partner entitled to notice. Former section 6231(a)(8).

[20] *See Kligfeld Holdings v. Commissioner*, 128 T.C. 192 (2007) (holding that the IRS could issue an FPAA for 1999, even though the 1999 assessment period had expired, to assess tax for 2000).

[21] *J&J Fernandez Ventures L.P. v. United States*, 84 Fed. Cl. 369 (2007). The Tax Court reached the same conclusion under similar facts. *See Wilmington Partners L.P. v. Commissioner*, T.C. Memo. 2009-193 (following *J&J Fernandez Ventures* and holding that "nothing in TEFRA or its legislative history precludes [the court] in TEFRA proceedings from considering events in a nondocketed (or closed) year to make proper adjustments in a docketed year"). In *Wilmington Partners*, the Tax Court indicated that the IRS could seek to adjust the initial basis of a promissory note contributed to the partnership in 1993 — even though the IRS audited and issued a letter to the partnership stating that it was making no adjustment for 1993 and would not issue an FPAA for that year — by issuing an FPAA for two short tax years for 1999 determining that the initial basis was incorrectly reported for the 1999 years.

[22] *J&J Fernandez Ventures*, 84 Fed. Cl. at 374 (characterizing the assessment period as not prohibiting the IRS's "use of information from closed years").

[23] In deciding that the IRS may redetermine closed-year TEFRA partnership items for purposes of adjusting open-year partnership items, the Court of Federal Claims noted that "it is accepted practice in the non-partnership context to determine or adjust tax items more than three years old (and therefore closed for purposes of assessment) in order to assess taxes in a more recent year." *Id.*

[24] Sections 6221(a) and 6225.

[25] Section 6226(a).

and the assessment period starts to run upon the filing of the tax return for that year. Under the BBA, however, in lieu of assessing a tax for the reviewed year (that is, the year subject to the partnership adjustment), the IRS assesses the imputed underpayment "as if it were" a tax for the adjustment year.[26] The adjustment year is the partnership tax year in which the IRS mails the notice of final partnership adjustment (the BBA equivalent of a TEFRA FPAA), or, if the partnership petitions a court to review the IRS adjustments, the year in which the court's decision becomes final.[27]

By tying the assessment to the adjustment year, the BBA structure shifts forward in time the assessment of tax attributable to the adjustments made at the partnership level. The adjustment year will always be a year after the reviewed year and can arise multiple years beyond the date of the filing of the reviewed-year partnership return. The BBA rules do not provide an explicit time period for assessment of the imputed underpayment. However, if the imputed underpayment is assessed as if it were a tax imposed for the adjustment year, one may view the limitations period for that assessment as the limitations period pertaining to the adjustment year.[28] Under section 6501, the IRS then would have a three-year window from the filing of the adjustment-year return within which it can assess the imputed underpayment.[29]

If the assessment period for the adjustment year is open when the IRS seeks to assess the imputed underpayment, does that alone make the assessment valid? Or does the validity of the assessment depend on whether the IRS timely made the *adjustments* that resulted in that imputed underpayment? Does the period under section 6235 restrict *adjustments* in earlier tax years even if the period for the IRS to assess an imputed underpayment may not have even started?

V. BBA Adjustment Periods

The discussion thus far has mainly focused on the timeliness of the IRS's assessment of tax. Case law and IRS guidance have established that as a general matter, the IRS may recalculate or redetermine prior-year items for the purpose of assessing open-year taxes. As discussed above, however, under the BBA, section 6235 sets forth a time period within which an *adjustment* to a partnership-related item may be made, and section 6227(c) limits the time within which a partnership may file a request for an administrative *adjustment* to a partnership-related item.[30] Given that the BBA statutory provisions limit the time to make *adjustments*, it is necessary to reorient the discussion and to focus on the timeliness of the adjustment rather than the timeliness of assessment of tax.[31]

What does it mean for the IRS or the partnership to make an "adjustment" to a partnership-related item? Section 6241 defines a partnership adjustment in a straightforward manner to mean "any adjustment to a partnership-related item."[32] Section 6241 does not define what actions fall within the scope of the term "adjustment," however. The plain meaning of the word "adjust" is to bring something to a more satisfactory state or, in other words, to rectify or correct an error. Presumably, an adjustment could include a recalculation in the amount of an item; a change to an item's character; or a determination that the partnership originally treated an item incorrectly — for example, by treating an expense as capitalizable rather than deductible.

[26] Section 6232(a).

[27] *See* section 6225(d). For an AAR, the adjustment year is the year in which the AAR is filed. The partnership may waive its right to a notice of final partnership adjustment, in which case the adjustment year is the year in which the waiver is executed. *See* reg. section 301.6241-1(a)(1).

[28] *See* Carney and Dawson, *supra* note 9 (making similar observations and reaching the same conclusion). The article provides examples of situations in which the imputed underpayment assessment can occur many years after the reviewed year.

[29] *See id*. In lieu of paying an imputed underpayment, the partnership may elect under section 6226 to have its partners take into account the IRS adjustments. If a valid section 6226 election is made, the partners must compute and pay any chapter 1 tax attributable to the adjustments and report that tax on their next-filed income tax return. Similar to the assessment of the imputed underpayment, this reporting mechanism also shifts the assessment of tax at the partner level to a future year's return.

[30] Sections 6235 and 6227. The regulations under sections 6235 and 6227 generally parrot the statutory language, providing in general that both the IRS and the partnership are limited to making adjustments to partnership-related items within the three-year period commencing with the filing of the partnership return. Reg. sections 301.6235-1(a) and 301.6227-1(b).

[31] Part 2 of this article will address the timeliness of a partnership's or partner's request for an adjustment to a partnership-related item.

[32] Section 6241(2)(A).

The "adjustment" language in section 6235 may derive from the language in former section 6248, which was among the electing large partnership provisions repealed as part of the BBA amendments.[33] Few partnerships chose to elect into the electing large partnership provisions, and little case law exists on their application.[34] However, in *Kligfeld Holdings* (permitting the IRS to issue a TEFRA FPAA for a closed year), the Tax Court in dicta described section 6248 as an example of Congress knowing "how to limit the Commissioner's time to *adjust* partnership items and not just his time to *assess* tax" (emphasis added).[35] The implication of the Tax Court's observation was that the period under section 6248 would have foreclosed *adjustments* to items in closed years and not just *assessments* of tax for closed years.

Does it follow, then, that the periods under sections 6235 and 6227 similarly would bar adjustments for closed years?

VI. Special Enforcement Regulations

Some insights may be gleaned from recently issued final regulations under the BBA's special enforcement provisions. As discussed below, the special enforcement regulations permit the IRS to adjust (and apparently to determine) BBA partnership-related items for partnership tax years for which the section 6235 period has expired. The very existence of those regulations suggests that, but for the IRS invoking its special enforcement authority, the expiration of the section 6235 period would mean the IRS is barred from making adjustments for a closed year.

In November 2020 the IRS published final regulations under section 6241(11) that authorize it to turn off the BBA provisions for any partnership-related item involving a "special enforcement matter."[36] One such rule, reg. section 301.6241-7(f), provides that the IRS "may *adjust* any partnership-related item that relates to any item or amount for which the partner's [assessment period] has not expired," even if the limitations period under section 6235 has expired (emphasis added).[37] The IRS explained that this rule is intended to address situations in which it may not be evident that an adjustment to an item on a partner's return requires an adjustment to a partnership-related item until after the section 6235 period has expired.[38] That statement appears to reflect a concern by the IRS that section 6235 bars adjustments to prior-year partnership-related items once the section 6235 period expires for that prior year. Absent that concern, it is unclear why the IRS would believe it needs a special enforcement provision to turn off section 6235.[39]

Another regulation issued under the IRS's special enforcement authority — the rule under reg. section 301.6241-7(b) — appears to reflect a concern that section 6235 not only limits the time to make adjustments but also may limit the time to make determinations regarding partnership-

[33] *See* BBA section 1101 (repealing the electing large partnership provisions under sections 6240 through 6255). Former section 6248 provided that "no adjustment . . . to any partnership item for any partnership taxable year . . . may be made" after three years have passed since the filing of the partnership return.

[34] For example, in tax year 2011 only 105 partnerships filed a Form 1065-B, "U.S. Return of Income for Electing Large Partnerships." *See* IRS Statistics of Income division, "Partnership Returns, 2011" (Fall 2013).

[35] *Kligfeld Holdings*, 128 T.C. at 192, 205; *see also Burks v. United States*, 108 AFTR 2d 2011-6665 (N.D. Tex. 2008). Unfortunately for the taxpayers in *Kligfeld*, former section 6248 did not apply to their partnership because it was not an electing large partnership. *See* former section 6240(a). The Tax Court in *Kligfeld* ultimately held that the IRS's FPAA was timely because the taxpayers' assessment period was open when the FPAA was issued.

[36] Section 6241(11)(B) sets forth an enumerated list of matters that fall within the term "special enforcement matter," including termination and jeopardy assessments, criminal investigations, indirect methods of proof of income, foreign partners or partnerships, failures to comply with the requirements of section 6226(b)(4)(A)(ii), and other matters that the Treasury secretary determines by regulation present special enforcement considerations.

[37] One of two criteria must be met to trigger reg. section 301.6241-7(f). Either the partner must be related to the partnership under section 267(b) or 707(b), or the partner must have agreed, in writing, to extend the partner's assessment period — specifically, the time to adjust and assess any tax attributable to partnership-related items for the tax year. *See* reg. section 301.6241-7(f)(1) and (2).

[38] Preamble to REG-123652-18, 85 F.R. 74940, 74949 (Nov. 24, 2020). For a critique of the IRS's rulemaking process in promulgating reg. section 301.6241-7(f), see Lee Meyercord and Dawson, "The Next Wave of Partnership Litigation — APA Challenges to BBA Regulations," *Taxes* (Oct. 2023).

[39] Commentators on the proposed regulations observed that reg. section 301.6241-7(f) "appears to be inconsistent with Congress's clear directive in the centralized partnership audit regime to adjust partnership-related items, and to determine the period of limitations for partnership adjustments, exclusively at the partnership level." The preamble to the final regulations responded to this comment by concluding that if the IRS uses its special enforcement authority to turn off the BBA provisions for a partnership-related item, "the item or amount is not adjusted or determined at the partnership level [under the BBA] and the period of limitations on making adjustments at the partnership level [under section 6235] does not apply to that adjustment or determination." Preamble to T.D. 9969, 87 F.R. 75473, 75485 (Dec. 9, 2022).

related items.[40] The rule under reg. section 301.6241-7(b) generally gives the IRS the authority to make a "determination regarding a partnership-related item . . . as part of, or underlying, an adjustment to an item that is not a partnership-related item" during an exam of a partner's return.[41] The preamble explains that the special enforcement rule under reg. section 301.6241-7(b) applies when the IRS "needs to determine a partnership-related item to effectuate [an] overall adjustment to [an] item that is not a partnership-related item" in the context of examining and adjusting a partner's return.[42] The preamble goes to great lengths to make clear (in the IRS's view) that when the IRS makes a determination for a partnership-related item under reg. section 301.6241-7(b), "no *adjustment* to a partnership-related item on the partnership's return or in the partnership's books and records is made" and "nothing on the partnership's return is *changed*" (emphasis added).[43]

It is unclear, however, what differentiates an adjustment from a mere determination. Although the rule under reg. section 301.6241-7(b) does not explicitly reference the adjustment period under section 6235, nothing in the regulation limits its scope to determinations that would be considered timely under section 6235. Moreover, the preamble states that if the IRS invokes its special enforcement authority and therefore determines a partnership-related item outside a BBA proceeding, "the period of limitations on making adjustments at the partnership level does not apply to that adjustment *or determination*" (emphasis added).[44]

VII. BBA Closed Years

The IRS's creation of a special enforcement rule that permits it to make adjustments, and apparently also to make determinations, that would otherwise be time-barred under section 6235 strongly implies that the agency believes, or at least has concerns, that section 6235 restricts its ability to adjust partnership-related items in closed years. Based on the plain language of section 6235 and the existing authorities discussed above, it appears that the IRS's concern is justified. Section 6235 imposes a time limitation on the IRS's ability to make partnership adjustments, rather than limiting the time to assess tax. Historically, courts and the IRS have navigated time limitations on making assessments, not making adjustments, and the ability to "adjust" closed-year items has turned on the timeliness of the ultimate tax assessment as opposed to the adjustment itself. Thus, the existing authorities that permit closed-year adjustments so long as the period to assess tax is open are not dispositive when it comes to interpreting section 6235's time limitation on making adjustments.

The IRS's inability to adjust closed-year partnership-related items could have significant ramifications for future-year items. Consider a corporate partner carrying forward an NOL that consists mainly of its share of losses flowing through from a BBA partnership.[45] If those losses were overstated by the partnership on closed-year returns, and the IRS does not discover that issue until the corporate partner uses the NOL carryover on an open-year return, is there a position for the IRS to adjust the overstated partnership losses if the special enforcement rule under reg. section 301.6241-7(f) does not apply? If the IRS cannot "adjust" the losses as reported on the partnership return, could it make a "determination" under reg. section 301.6241-7(b) that the losses were overstated and adjust the corporate partner's NOL on that ground? Similar questions could arise in the case of credits overstated on a closed-year partnership return.

As another example, consider a BBA partnership that misallocated losses on a closed-

[40] The regulations under section 6221(a) provide that "any legal or factual determinations underlying any adjustment or determination . . . are also determined at the partnership level" under the BBA. *See* reg. section 301.6221(a)-1.

[41] For reg. section 301.6241-7(b) to apply, three criteria must be present:

[42] Preamble to T.D. 9969, 87 F.R. at 75484.

[43] *Id.* The final regulations remove the word "adjusted" from prop. reg. section 301.6241-7(b). The proposed regulations provided that prop. reg. section 301.6241-7(b) may apply when "a partnership-related item is adjusted, or a determination regarding a partnership-related item is made." Preamble to REG-123652-18, 85 F.R. at 74954.

[44] Preamble to T.D. 9969, 87 F.R. at 75485.

[45] Assume that the requirements that would trigger the special enforcement rule under reg. section 301.6241-7(f) are not met.

year return and, as a result, Partner A has a higher basis in the partnership than it would have had if those losses had been allocated correctly. If there is a transaction the taxation of which depends on Partner A's basis, such as a distribution from the partnership or a sale of Partner A's interest, can the IRS adjust or redetermine those prior-year allocations to reduce the amount of Partner A's basis? Absent application and invocation by the IRS of the special enforcement regulations, it appears the answer would be no.

VIII. Conclusion

In a way, the BBA adjustment period under section 6235 flips the dynamic that has historically existed between the assessment and refund periods and closed-year adjustments. In the jurisprudence discussed above, including in the TEFRA context, the label given to the IRS action taken for the closed-year item was not dispositive so long as the IRS was not *assessing* a tax for the closed year (or the taxpayer was not claiming a *refund* for that closed year).[46] In contrast, under the BBA it may be the case that although the assessment period is open, the period to make an adjustment to the underlying partnership-related item is closed. In that scenario, absent invocation of its special enforcement authority, it would appear that the IRS is barred from adjusting the partnership-related item for the closed year, even if it would be able to timely assess the resulting tax.[47] ■

[46] *See J&J Fernandez Ventures*, 84 Fed. Cl. at 376 ("Regardless of the terminology used, it is clear that the IRS is not attempting to assess tax" for a closed year.).

[47] The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only, and does not necessarily represent the views or professional advice of KPMG LLP.