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Procedural Issues in Partnership Audits and Tax Litigation

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Procedural Issues in Partnership Audits and Litigation

- TEFRA Overview
- The Tax Matters Partner
- Statutes of Limitations
- Partnership Refund Claims (AARs)
- Audit Process
- Judicial Review
- Tips and Traps
TEFRA Overview

- Purpose of TEFRA
- TEFRA Defined Terms
As with any effort to simplify the Code, the TEFRA provisions created a complex process with new problems and traps for the unwary. The Tax Court describes these rules as "distressingly complex and confusing."
Purpose of TEFRA

- Pre-TEFRA
  - Audits were only conducted at the partner level; if the IRS wanted to audit a partnership item, the IRS had to audit each partner individually.
  - Created duplication of effort and administrative difficulties.
  - Also led to inconsistencies in how partners were treated.

- TEFRA was designed to address these problems by allowing an audit of partnership items to be conducted at the partnership level. The TEFRA provisions are incorporated in Sections 6221-6234 of the Code.
TEFRA Defined Terms

- Partnership
- Partner
- Partnership Items
- Nonpartnership Item
- Affected Item
- Computational Adjustment
- Notice Partners
The TEFRA rules apply to audits of all partnerships, unless

- the partnership has 10 or fewer partners; and

- all partners are individuals, C corporations, or an estate of a deceased partner.

**TRAP:** A disregarded entity is counted as a partner and causes the partnership to be a TEFRA partnership. Rev. Rul. 2004-88, 2004-2 C.B. 165.

I.R.C. 6231(a)(1).
● A “partner” is any actual partner in the partnership and “any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership.” I.R.C. § 6231(a)(2).
The definition of a partner includes:

- **Pass-thru partners**
  - “A partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership with respect to which proceedings under this subchapter are conducted.” I.R.C. § 6231(a)(9).

- **Indirect partners:**
  - “a person holding an interest in a partnership through 1 or more pass-thru partners.” I.R.C. § 6231(a)(10).
  - Thus, indirect partners include S corporation shareholders, partners, LLC members, trust beneficiaries, and subtrusts.
Partners – Tiered Entity Example

- B, C, D, E, F and G are all partners for TEFRA purposes
- D, E, F and G are all indirect partners
- C and E are pass-thru partners
● “Partnership items” are those items “required to be taken into account for the partnership’s taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.” I.R.C. § 6231(a)(3).

● A TEFRA partnership audit can address only partnership items. Nonpartnership items are determined at the individual partner level.
Partnership items include all items reported on IRS Form 1065 and Schedules K-1, such as:

- A partner’s distributive share of the partnership’s income, gain, loss, deduction, or credit;
- Partnership liabilities; and
- Guaranteed payments.

Treas. Reg. § 301.6231(a)(3)-1(a).
Partnership items also include:


- The determination of who is a partner of the partnership. *Blonien v. Comm’r*, 118 T.C. No. 34 (2002)
A “nonpartnership item” is an item that is not a partnership item. I.R.C. § 6231(a)(4).

Nonpartnership items are addressed at the partner level, often after the partnership-level proceeding ends.

Example: A purchases a partnership interest in Partnership X for $5,000. The amount A paid for the partnership interest is a nonpartnership item and would not be audited at the partnership level.
TEFRA Defined Terms
Affected Items

- An “affected item” is any item to the extent such item is affected by a partnership item. I.R.C. § 6231(a)(5); Treas. Reg. § 301.6231(a)(5)-1(a).

- Affected items include items on a partner’s return that are computed in part based on partnership items.

- **Examples:*
  
  - Partner’s outside basis – the amount of a partner’s outside basis is affected by a partner’s distributive share of partnership items. Treas. Reg. § 301.6231(a)(5)-1(b).

  - Miscellaneous itemized deductions – the amount allowed is based on adjusted gross income, which is affected by a partner’s distributive share of partnership items. Treas. Reg. § 301.6231(a)(5)-1(a).
A “computational adjustment” is the change in tax liability that properly reflects the correct treatment of a partnership item. I.R.C. § 6231(a)(6).

Computational adjustments are the bridge between the partnership-level proceeding and the partner’s tax liability. They are the tax assessments or abatements.
• There are two categories of computational adjustments:
  
  ► Affected items that do not require partner-level determinations. The adjustments are mechanical. When no partner-level determinations are required, the computational adjustment is directly assessed. Treas. Reg. § 301.6231(a)(6)-1(a)(2).
    
    – *Example:* Partnership A underreported its income by $100. Corporation B has a 50% interest in Partnership A, and B’s income increases by $50. B is in the 35% tax bracket, and a computational adjustment is made that increases B’s tax liability by $17.50. This amount plus interest is assessed.

  ► Affected items that do require partner-level determinations. These can be assessed against the partner only through normal deficiency procedures. Treas. Reg. § 301.6231(a)(6)-1(a)(3).
    
    – *Exception:* Penalties require partner-level determination but fall outside of the normal deficiency procedures and can be directly assessed.
• Certain rights are provided to “notice partners.” I.R.C. § 6231(a)(8).

• A notice partner includes:
  ► Any partner in a partnership with 100 or fewer partners.
  ► A partner in a partnership with more than 100 partners who holds at least a 1% interest in the partnership.
  ► Partners who hold a 5% aggregate interest and form a “notice group.”
  ► Indirect partners for whom the IRS has their name, address, and profits interest.
  ► **Tip:** Most partners will be – or can be, in the case of indirect partners -- notice partners.

I.R.C. § 6223(a), (b), (c); Treas. Reg. § 301.6223(b)-1(a).

• If an indirect partner is not entitled to notice from the IRS, the pass-thru partner is required to forward any notice to the indirect partners. I.R.C. § 6223(h).
TEFRA Defined Terms
Notice Partners - Tiered Entity Example

- IRS audits Partnership A.
- IRS must give notice to partners B and C.
- IRS must also give notice to the indirect partners, D, E, F and G, if it has the necessary contact information to do so.
- The passthrough partners, C and E, are required to give notice to their partners if the IRS is not required to do so.
  - C notifies D and E.
  - E notifies F and G.
The Tax Matters Partner ("TMP")
Overview

- Who can be the TMP and for how long?
- What is the Role of the TMP?
- How long does the TMP’s authority survive?
Who Can be the TMP?

- The TMP must be a partner with the authority to bind the partnership.
  - General partnership: any partner
  - Limited partnership: a general partner
  - LLC: a member-manager or, if none, any member
  - Trap: Limited partners, non-managing members, and non-partners may not be the TMP. But a disregarded entity can be the TMP, if it has the authority to bind the partnership under state law.

Who Can Be the TMP?

- If ABC is a limited partnership and A is a general partner, A can be the TMP.
- If ABC is an LLC and A is a managing member, A can be the TMP.
- If ABC is an LLC and there are no managing members, A can be the TMP.
- If ABC is an LLC and A is an entity and a managing member, A can be the TMP. An officer of A cannot be the TMP.
Example 8 from Addendum (Delegation of TMP role to ineligible TMP):

- The General Partner delegates to [ineligible TMP] in its capacity as Tax Agent, to the extent permitted under the Code and applicable Treasury regulations, its authority as Tax Matters Partner of the Partnership, and [ineligible TMP] accepts this delegation.

- To the extent that the Internal Revenue Service does not recognize the General Partner’s delegation of its authority as tax matters partner to the Tax Agent pursuant to this Agreement or otherwise refuses to treat the Tax Agent as the Tax Matters Partner, the General Partner will execute and discharge its duties and obligations as Tax Matters Partner in accordance with the advice, and at the direction, of the Tax Agent.
The TMP is the IRS’s single-point liaison during audits and the single representative for litigation.

- The TMP plays a notice role and keeps other partners informed of the audit proceedings. I.R.C. § 6223(g).
- The TMP may file suit on behalf of the partnership. I.R.C. § 6226(a).
- The TMP may file a partnership-level refund claim on behalf of the partnership. I.R.C. § 6227(c).
- The TMP may extend the statute of limitations on behalf of the partnership. I.R.C. § 6229(b)(1)(B).

**Tip and Trap:** The TMP’s role is limited unless expanded contractually by the partnership or LLC agreement.
TMP

Contractual Role

● Drafting Considerations:
  ► Should restrictions be imposed on the TMP’s statutory duties?
  ► Should the TMP’s authority be expanded and, if so, to what extent and with what restrictions?
  ► Are the TMP’s interests aligned with the other partners or does the GP have a 0% economic interest (e.g., 0% GP)?
Example 1 from Addendum (Limited to statutory and regulatory authority and restrictions imposed):

- The tax matters partner shall promptly notify the Members if any tax return or report of the Company is audited or if any adjustments are proposed by any governmental body. In addition, the tax matters partner shall promptly furnish to the Members all notices concerning administrative or judicial Proceedings relating to federal income tax matters as required under the Internal Revenue Code. During the pendency of any such administrative or judicial Proceeding, the tax matters partner shall furnish to the Members periodic reports, not less often than monthly, concerning the status of any such Proceeding.

- Without the consent of a majority of the Board of Managers, the tax matters partner shall not extend the statute of limitations, file a request for administrative adjustment, file suit concerning any tax refund or deficiency relating to any Company administrative adjustment or enter into any settlement agreement relating to any Company item of income, gain, loss, deduction or credit for any fiscal year of the Company.
 TMP  
Sample Provisions

- **Example 3 from Addendum (Very broad authority):**
  - The Tax Matters Member is authorized to take such actions, **including making tax elections, and to execute and file all tax returns, statements and forms on behalf of the Company** that may be permitted or required by the applicable provisions of the Internal Revenue Code or Treasury Regulations issued thereunder.

  - The Tax Matters Member shall have **full and exclusive power and authority on behalf of the Company to represent the Company** (at the Company’s expense) in connection with all examinations of the Company’s affairs by tax authorities, including resulting administrative and judicial proceedings, and to expend Company funds for professional services and costs associated therewith. Such power and authority shall include, without limitation, the power and authority to extend the statute of limitations and file a request for administrative adjustment.
Example 4 from Addendum (Broad with consultation requirement):

- The General Partner has the right at its discretion to make all elections for the Partnership provided for in the Code, including, but not limited to, the election provided for in Code Section 754, provided that, upon the written request of any Limited Partner to make the election provided for in Code Section 754, the General Partner will not unreasonably refuse to make such election.

- The General Partner is hereby designated as the “Tax Matters Partner” pursuant to the requirements of Code Section 6231(a)(7) and in such capacity shall represent the Partnership in any disputes, controversies or proceedings with the United States Internal Revenue Service or any other taxing authority. The General Partner agrees, subject to confidentiality or regulatory compliance considerations, to consult with the ABC Limited Partner in good faith with respect to such disputes, controversies or proceedings.
Example 5 from Addendum (Broad with restrictions on tax controversies):

- The Tax Matters Partner is authorized to take such actions, including making tax elections, and to execute and file all tax returns, statements and forms on behalf of the Partnership which may be permitted or required by the applicable provisions of the Internal Revenue Code or Treasury Regulations issued thereunder.

- Without first obtaining the approval of a Majority Interest of the Partners, the Tax Matters Partner shall not, with respect to Partnership tax matters, (i) enter into a settlement agreement with respect to any tax matter which purports to bind Partners, (ii) intervene in any action pursuant to Internal Revenue Code Section 6226(b)(5), (iii) enter into an agreement extending the statute of limitations, or (iv) file a petition pursuant to Internal Revenue Code Section 6226(a) or 6228. If an audit of any of the Partnership’s tax returns shall occur, the Tax Matters Partner shall not settle or otherwise compromise assertions of the auditing agent which may be adverse to any Partner as compared to the position taken on the Partnership’s tax returns without the prior written consent of each such affected Partner.
Example 6 from Addendum (Significant restrictions imposed on TMP):

- The Tax Matters Member shall take no action without the authorization of a Supermajority Interest, other than such action as may be required by Law.

- The Tax Matters Member shall not enter into any extension of the period of limitations for making assessments on behalf of the Members without first obtaining the consent of a Supermajority Interest. The Tax Matters Member shall not bind any Member to a settlement agreement without obtaining the consent of such Member.
TMP

How Long does its Authority Survive?

- A TMP’s designation as TMP for a specific taxable year remains in effect until:
  - He dies, is incapacitated, resigns, or liquidates;
  - The partnership items of the TMP become nonpartnership items; or
  - A designation of a successor TMP or revocation of the TMP’s designation is made pursuant to applicable regulations.

Treas. Reg. § 301.6231(a)(7)-1(l). Thus, a TMP’s designation for a specific taxable year typically survives the disposition of the TMP’s partnership interest.

- However, the designation of the TMP for one year does not automatically carryover to the next year. A TMP designation is made on a year by year basis and is made through the designation on the partnership's tax return. Treas. Reg. § 301.6231(a)(7)-1(a), (c).
Statutes of Limitation

"Things look much better long-term, once we pass the statute of limitations."
Statutes of Limitation
Overview

- Partner-Level
- Partnership-Level
Statutes of Limitation
Partner-Level

- Tax at the partner-level shall be assessed “within 3 years after the return was filed.” I.R.C. § 6501(a).

- The statute of limitations can be extended by agreement. I.R.C. § 6501(c)(4).

- IRS Form 872 extends the period of limitations for assessing tax attributable to partnership items, because it now expressly so states. I.R.C. § 6229(b)(3).
The partner-level limitations period becomes six years when there is a substantial omission of gross income. I.R.C. § 6501(e).

- Does an overstatement of basis result in an omission of income?

- This was a common issue in recent tax shelter cases and was resolved recently by the U.S. Supreme Court favorably to taxpayers in *Home Concrete & Supply, LLC v. United States*, 109 A.F.T.R.2d 2012-661 (2012). The Supreme Court held that an overstatement of basis was not a substantial omission from gross income.

- This result was changed by Treasury regulations that were finalized in 2010. They provide that an overstatement of basis is an omission of gross income. Treas. Reg. §§ 301.6501(e)-1, 301.6229(c)(2)-1.
“Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of (1) the date on which the partnership return for such taxable year was filed, or (2) the last day for filing such return for such year (determined without regard to extensions).” I.R.C. § 6229(a).

It is now settled that this provision may not shorten – but may extend – the partner-level period of limitations. See, e.g., Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm’r, 114 T.C. 533 (2000); Curr-Spec Partners, L.P. v. Comm’r, 579 F.3d 391 (5th Cir. 2009), AD Global Fund, LLC v. United States, 481 F.3d 1351 (Fed. Cir. 2007).

Tip: An assessment of tax attributable to a partnership item is timely as long as either the partner-level or partnership-level period of limitations remains open.
The partnership-level statute of limitations can also be extended by agreement.

- By the TMP for all partners.
- By any partner for that partner.

I.R.C. § 6229(b)(1).
Partnership Refund Claims -- AARs

An Administrative Adjustment Request ("AAR") is the equivalent of a refund claim for partnerships but is subject to different procedural requirements.
AARs
Overview

- Statutes of Limitations
- Who can file
- Judicial Review
AARs
Statutes of Limitation

- **General Rule for Refund Claims:**
  - A claim for refund must be filed within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever is later. I.R.C. § 6511(a). This period may be extended by agreement. I.R.C. § 6511(c)(1).

- **Special Rules for AARs:**
  - A partner must file an AAR within 3 years after the partnership return is filed. I.R.C. § 6227(a)(1).
  - If the limitations period for the assessment of partnership items is extended by agreement, the limitations period for filing an AAR is also extended for the same period plus 6 months. I.R.C. § 6227(b).
  - A partner may extend the limitations period for the assessment of partnership items and thereby extend the limitations period for the filing of an AAR. I.R.C. §§ 6227(b), 6229(b)(1).
  - **Trap:** The time when the tax is paid has no impact on when an AAR may be filed.
AARs
Statutes of Limitation

- **Trap**: The time for filing an AAR is governed by when the partnership return is filed, not when the partner’s return is filed.

  - *McFerrin v. United States*, 492 F. Supp. 2d 695 (S.D. Tex. 2007) (an AAR was untimely when it was filed more than three years after the partnership’s return was filed but less than three years after the partner’s return was filed).

- **Example**:
  - 4/15/11: Partnership’s 2010 return filed
  - 10/15/11: Partner’s 2010 return filed
  - 9/30/14: The partner files an AAR within 3 years of when his return was filed but more than 3 years from when the partnership’s return was filed. The AAR is **untimely** filed.
Who Can File?

- TMP can file an AAR on behalf of the partnership. I.R.C. § 6227(c).
AARs
Who Can File?

- If Form 1065X is filed, the partners do not need to file anything else, even in the case of multi-tiered entities.

- The TMP can request “substitute return” treatment. I.R.C. § 6227(c)(1).
  - That allows the IRS to treat any changes as corrections of mathematical or clerical errors and to make assessments without a partnership-level proceeding. I.R.C. § 6230(b)(1).
  - If not treated as a substitute return, the IRS can conduct a partnership-level audit, allow credits or refunds from the AAR to all partners, or simply do nothing. I.R.C. § 6227(c)(2).
AARs
Who Can File?

- Any partner can file an AAR (its own amended return, e.g., 1120X, with Form 8082 attached) on its own behalf. I.R.C. § 6226(d).

- The partner can file an AAR even if the TMP has already filed an AAR for the same tax year. FSA 587 (Feb. 2, 1993); CCA 200908031 (Nov. 5, 2008).

- The partner may not request substitute return treatment. I.R.C. § 6227(c).

- Tip: A partner should seriously consider filing its own AAR to protect its right to seek judicial review.
If the IRS does not allow in full an AAR filed by the TMP, the TMP can file a petition for judicial review. I.R.C. § 6228(a)(1).

- Suit can be filed in the Tax Court, a district court, or the Court of Federal Claims.

- The petition must be filed at least six months, but no later than two years, after filing the AAR. I.R.C. § 6228(a)(2)(A).

- Trap: The two-year period for filing suit is based on when the AAR was filed, not when it is disallowed.
• The other partners are allowed to participate in the suit filed by the TMP, as long as they have an interest in the outcome. I.R.C. § 6228(a)(4).

• *Trap*: If only the TMP files an AAR and the TMP does not file suit, no other partner may file suit. The partner must have filed its own AAR to seek judicial review. I.R.C. § 6228(a)(1).
If a partner files an AAR on its own behalf and the TMP does not file an AAR or a suit, the partner can file a regular refund suit. I.R.C. § 6228(b)(2)(A).

The partner’s suit is a regular refund suit, rather than a petition under the TEFRA procedures. I.R.C. § 6228(b)(2)(A)(ii).

The period for filing suit is at least six months, and not later than two years, after the AAR was filed. I.R.C. § 6228(b)(2)(B)(i).
Audit Process
Audit Process Overview

- **SB/SE:**
  - Audits partnerships with $10 million or less in assets.
  - Conducted about 5150 partnership audits in 2011.
  - Plans to increase partnership audits in 2014.

- **LB&I:**
  - Audits partnerships with more than $10 million in assets.
  - In 2011, almost 200,000 passthrough entities had more than $10 million in assets.
  - LB&I audited about 150 partnership audits in 2011, which was an increase of 20% over 2010.

- **Most likely audit areas:**
  - Adjustments to partnerships in the real estate and construction industries with two partners and a reported loss;
  - Loss limitations; and
  - Distributions of partnership assets.
Audit Process Overview

- Notice Requirements
- Partners’ Right to Participate
- Summary Report and Closing Conference
- Appeals
- Administrative Settlements
The IRS must give notice to all notice partners of the beginning and end of a partnership audit – sort of.

- Notice of the Beginning of the Audit at the Partnership level (NBAP) – at least 120 days before the FPAA is mailed to the TMP.

- Notice of the Final Administrative Adjustment (FPAA) resulting from the partnership audit – within 60 days of when the FPAA was mailed to the TMP.

I.R.C. § 6223(a).
Audit Process

Notice Requirements

● The TMP provides other notices to other partners. These notice requirements mostly arise at the conclusion of the audit.
  ► Closing conference with the examining agent;
  ► Proposed adjustments, rights of appeal, and requirements for filing of a protest;
  ► Time and place of any Appeals conference;
  ► Acceptance by the IRS of any settlement offer;
  ► Consent to extend the period of limitations for all partners;
  ► Filing of an AAR on behalf of the partnership;
  ► Filing by the TMP or any other partner of any petition for judicial review;
  ► Filing of any appeal with respect to a judicial determination; and
  ► Final judicial redetermination.

Treas. Reg. § 301.6223(g)-1(b).
Audit Process
Notice Requirements

- Notice must be given by the TMP to the other partners within 30 days of taking the action or receiving the information. Treas. Reg. § 301.6223(g)-1(b)(3).

- The notices should be sent by certified mail, return receipt requested, so that the TMP has proof of mailing, should a question later arise.

- The TMP is required to comply with these regulatory notice requirements, even if the partnership agreement imposes less stringent notice requirements.
Audit Process
Partners’ Right to Participate

● Any partner, including an indirect partner, has the right to participate in the administrative proceeding. I.R.C. § 6224(a); Treas. Reg. § 301.6224(a)-1(a).

● The IRS and the TMP will determine the time and place for all administrative proceedings. Arrangements will generally not be changed merely for the convenience of another partner. Treas. Reg. 301.6224(a)-1(a).

Audit Process
Summary Report and Closing Conference

- When the audit ends, the IRS will issue a Summary Report that includes both the information relating to the Closing Conference and the proposed adjustments. I.R.M. § 4.31.2.2.6.3 (Oct. 1, 2010).

- The Closing Conference will be scheduled 30 days or more after the issuance of the final Summary Report. I.R.M. § 4.31.2.2.7 (June 1, 2004).

- The TMP must transmit the final Summary Report to the other partners and advise them as to when and where the Closing Conference will be held. Treas. Reg. § 301.6223(g)-1(b).

- Although the TMP may waive the Closing Conference, it will be held if another partner requests it. The TMP cannot waive the other partners’ right to the closing conference. Treas. Reg. § 301.6224(b)-1; I.R.M. § 4.31.2.2.7 (June 1, 2004).
60-Day Letter

- Standard IRS procedure is to send a 60-day letter to the TMP providing partners with the opportunity to go to Appeals. IRM 4.31.2.4.2.2 (Oct. 1, 2010).

- The TMP must send the 60-day letter to all notice partners within 30 days of receiving it. Treas. Reg. § 301.6223(g)-1(b).

- The 60-day letter will again set forth the proposed adjustments and advise as to the rights to appeal and file a protest.
Audit Process

Appeals

- **Protests and Appeals Conference**
  - Any notice partner may file a protest and request an Appeals conference.
  - The Service will combine all of the protests received and forward them to Appeals, and there will be a consolidated Appeals conference to discuss all protests.
  - Any notice partner is entitled to attend the IRS Appeals conference if it does not agree with the IRS’s findings.

I.R.C. § 6224(a); Treas. Reg. § 301.6223(g)-1(b)(1); I.R.M. §§ 8.19.1.6.8.4(4), 8.19.1.6.12(2), 8.19.3.5(1).
Audit Process
Administrative Settlements

- Any partner can settle with the IRS by signing Form 870-P, Settlement Agreement for Partnership Adjustments. I.R.C. § 6224(c)(1).

- If the IRS enters into a settlement agreement with any partner, the IRS must offer the same terms to any other partner who requests them. I.R.C. § 6224(c)(2).

- The TMP may not bind other partners to a settlement agreement, except for certain non-notice partners. I.R.C. § 6224(c)(3)(B).
Judicial Review Overview

- Notice of Final Administrative Adjustment – FPAA
- Choice of Forum
- Right to Participate in the Action
- Scope of Judicial Review
- Final Determination
- Adjustment to Partners’ Tax Liabilities
Judicial Review
FPAA

- If any partner does not settle the disputed issues with Appeals, then Appeals will issue an FPAA (Notice of Final Administrative Adjustment).

- An FPAA is the equivalent of a statutory notice of deficiency for partnerships, but only partnership items are adjusted and no deficiency is proposed.

- The FPAA is mailed to the TMP and to all notice partners. I.R.C. § 6223(a)(2).
Judicial Review
Choice of Forum

- The TMP may file a petition in Tax Court within 90 days after the FPAA is mailed. I.R.C. § 6226(a)(1).
- If the TMP does not file suit, any notice partner may file a petition within the next 60 days. I.R.C. § 6226(b)(1).
- Either the TMP or a notice partner may also file suit in U.S. District Court or the U.S. Court of Federal Claims. I.R.C. § 6226(a)(2), (3).
  - If multiple petitions are filed within the 90-150 day period, the first action brought in Tax Court shall go forward.
  - If multiple petitions are filed, but none in Tax Court, the first action brought shall go forward.
  - The other actions are dismissed.
- **Trap**: These are the only time periods for filing suit. Unlike in a non-partnership proceeding, the partners may not wait to pay the tax and then file a refund suit.
Judicial Review
Choice of Forum

- There are deposit requirement for suits filed in Court of Federal Claims or district court, but not in the Tax Court. I.R.C. § 6226(e).
  - The deposit is made by the partner filing the petition.
    - The deposit equals the amount by which the partner’s tax liability would increase if the partner’s return were made consistent with the partnership return as adjusted by the FPAA.
    - A pass-thru partner is required to deposit an amount based on the potential tax liability of all indirect partners who own interests through the pass-thru partner. Treas. Reg. § 301.6226(e)-1(a)(1).
Judicial Review
Right to Participate in the Action

● Any person who was a partner at any time during that tax year is allowed to participate in the action, as long as the partner has an interest in the outcome. I.R.C. § 6226(c), (d).

● To participate, the partner files a notice of election to participate with the court. See T.C. Rule 245(b), RCFC App. F, Rule 4(a), (b).

● Partners who participate in a suit in the Court of Federal Claims or a district court, but did not file the petition, are not required to make a deposit. See I.R.C. § 6226(e)(1).
Judicial Review

Scope of Judicial Review

● The court has jurisdiction to determine any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. I.R.C. § 6226(f).
  
► Thus, the court may consider the reasonable cause and good faith defense to penalties, taking into account the state of mind of the general partner or managing member. 106 Ltd. v. Comm’r, 684 F.3d 84 (D.C. Cir. 2012); New Millennium Trading, LLC v. Comm’r, 131 T.C. 275 (2008).

● But suit may not cover non-partnership items. See I.R.C. § 6226(f).
  
► Thus, the court may not consider partner-level penalty defenses. Treas. Reg. § 301.6226(f)-1(a); Treas. Reg. § 301.6221-1(d).
Judicial Review
Scope of Judicial Review

- Suit may also cover partnership items other than those raised in the FPAA. Treas. Reg. § 301.6226(f)-1(a).

- Example:
  - The Internal Revenue Service issues an FPAA adjusting the depreciation of ABC Partnership.
  - A petition for judicial review is filed. During the judicial proceeding, partner B raises an issue relating to the treatment of intangible drilling costs (IDCs).
  - The court has jurisdiction to determine both the depreciation and IDC issues.

Treas. Reg. § 301.6226(f)-1(b).
Judicial Review
Final Determination

- The court’s determination concludes the partnership proceedings for all partners, subject to appeal. I.R.C. § 6226(f).

- The right to appeal is limited to the TMP and notice partners. I.R.C. § 6226(g).
Judicial Review
Adjustment to Partners’ Tax Liabilities

- Once the court’s decision has become final, the IRS can assess the partners. I.R.C. § 6225(a).
- The IRS does not have to issue a partner-level notice of deficiency and provide another opportunity to challenge the assessment. I.R.C. § 6230(a)(1).
- The IRS simply mails a notice of computational adjustment to each partner.
Judicial Review
Penalties

- The IRS can simply assess the penalty amount, without providing a notice of deficiency. Treas. Reg. § 301.6231(a)(6)-1(a)(3).

- To contest the penalty, the partner must pay the penalty and then file a refund claim. I.R.C. § 6230(c)(1)(C); Treas. Reg. § 301.6221-1(c).

- The refund claim must be filed within 6 months from when the notice of computational adjustment was mailed to the partner. I.R.C. § 6230(c)(2).

- A partner may raise only partner-level defenses to the penalty. Treas. Reg. § 301.6221-1(c), (d).

- **Tip**: If the primary issue in a case is the penalty and the defenses to that penalty are at the partner level, you should consider accepting the partnership level adjustments. Then, you can spend your resources defending the penalty.
Top Tips

● Most partners will be notice partners.

● The TMP’s role may be expanded contractually by the partnership or LLC agreement.

● An assessment of tax attributable to a partnership item is timely as long as either the partner-level or partnership-level period of limitations remains open.

● A partner should seriously consider filing its own AAR to protect its right to seek judicial review.

● If the primary issue in a case is the penalty and the defenses to that penalty are at the partner level, you should consider accepting the partnership level adjustments. Then, you can spend your resources defending the penalty.
Top Traps

- A disregarded entity is counted as a partner and causes the partnership to be a TEFRA partnership.
- The TMP may not be an officer of the GP entity.
- The time for filing an AAR is governed by when the partnership return is filed, not when the partner’s return is filed or when the tax is paid.
- The two-year period for filing suit is based on when the AAR was filed, not when it is disallowed.
- Suit must be filed within 90-150 days of receiving an FPAA. Unlike in a non-partnership proceeding, the partners may not wait to pay the tax and then file a refund suit.