Department of the Treasury	Internal Revenue Service	Office of Chief Counsel	**Notice**

CC-2016-007

March 21, 2016

Subject:	Application of the Results of TEFRA Partnership Procedures in Collection Due Process Cases	**Cancel Date**:	Effective until further notice

PURPOSE

This Notice instructs Chief Counsel attorneys on how the results of the unified partnership audit and litigation procedures (I.R.C. §§ 6221-6234) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)[1] should be applied in Collection Due Process (CDP) Tax Court cases.

DISCUSSION

TEFRA partnership procedures apply to all entities required to file a partnership return that have more than 10 partners, or who have 10 or fewer partners if one of those partners is a partner other than a U.S. individual, a C corporation, or an estate of a deceased partner. I.R.C. § 6231(a). The purpose of the TEFRA partnership procedures was to create a single unified procedure for determining the tax treatment of partnership items at the partnership level and to eliminate duplicate proceedings that could potentially lead to inconsistent results on questions that apply equally to all partners. United States v. Woods, 134 S. Ct. 557, 565 (2013); Crowell v. United States, 305 F.3d 474, 478 (6th Cir. 2002). When TEFRA applies, section 6221 mandates that the tax treatment of partnership items is to be determined at the partnership level. Partnership items are defined as items required to be taken into account for the partnership's taxable year under subtitle A to the extent regulations provide that an item is more appropriately determined at the partnership level than at the partner level, and include "the legal and factual determinations that underlie the determination" of partnership income. I.R.C. § 6231(a)(3); Treas. Reg. § 301.6231(a)(3)-1(b); see also Prati v. United States, 81 Fed. Cl. 422, 433 (Fed. Cl. 2008). This includes affirmative defenses to the assessment period of limitations. See, e.g., Blak Invs. v. Commissioner, 133 T.C. 431, 437-38, 456 (2009) (Thornton, J., concurring) (under section 6226 and PCMG Trading Partners XX, L.P. v. Commissioner, 131 T.C. 206 (2008), the court has the authority to address a partner's contention that the period of limitations for assessing tax attributable to partnership items has expired; a statute of limitations defense as it pertains to a final notice of partnership adjustments should be prosecuted in the context of the partnership-level proceeding rather than in a partner-level proceeding); Crowell v. Commissioner, 102 T.C. 683, 693 (1994) (statute of limitations defense should have been

[1] On November 2, 2015, the Bipartisan Budget Act (BBA) enacted a new partnership regime and repealed TEFRA for tax years beginning after December 31, 2017. TEFRA will have a continuing impact beyond 2017 as the Service completes its TEFRA audits of tax years that pre-date BBA and as those years are litigated to finality.

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prosecuted in a partnership-level proceeding and not in an affected-item proceeding); McConnell v. Commissioner, T.C. Memo. 2008-167; see generally I.R.C. §§ 6221, 6226.

In order for the Service to adjust a partnership item, the Service must send within specified periods a Notice of Final Partnership Administrative Adjustment (FPAA) to the Tax Matters Partner (TMP) of the partnership and to any partners who are entitled to notice under section 6223. I.R.C. § 6223(a), (d). If the Service fails to mail a Notice of Beginning of Administrative Proceeding or an FPAA to a partner entitled to notice within the period specified in section 6223(d), the partner may elect to have the results of any completed partnership-level proceeding apply to the partner's partnership items; otherwise the partnership items convert to nonpartnership items. I.R.C. § 6223(e).

The mailing of the FPAA to the TMP starts the running of the time period for filing a petition for judicial review.[2] I.R.C. § 6226; Taurus FX Partners, LLC v. Commissioner, T.C. Memo. 2013-168, at *7. After the mailing of the FPAA, the TMP has 90 days to petition the U.S. Tax Court, a U.S. District Court, or the U.S. Court of Federal Claims for a readjustment of the partnership items. I.R.C. § 6226(a). If the TMP does not file a petition within 90 days, any notice partner or any 5-percent group may file a petition within 60 days of the close of the TMP's 90-day period. I.R.C. §§ 6226(b), 6231(a)(8), 6231(a)(11). If a petition is filed, the court obtains jurisdiction over all of the partnership items of the partnership for the taxable year. I.R.C. § 6226(f); Prati, 81 Fed. Cl. at 429. If no one petitions the FPAA within those 150 days, the FPAA is considered defaulted, and the courts lack jurisdiction to redetermine any of the adjustments in the FPAA. Genesis Oil & Gas, Ltd. v. Commissioner, 93 T.C. 562, 565 (1989) (noting that "Congress has provided for limited access to the courts to raise any and all questions pertaining to a partnership action. . . .").

Once the partnership-level proceedings are complete, either because of a final adjudication by a court or default of the FPAA, the Service makes corresponding computational adjustments to each partner's return. Desmet v. Commissioner, 581 F.3d 297, 302 (6th Cir. 2009). An affected-item statutory notice of deficiency may be required before assessing a deficiency in tax attributable to computational adjustments if the tax effects of a partnership item cannot be determined without first making factual determinations at the partner level. Id.; Treas. Reg. § 301.6231(a)(6)-1(a)(3). The court, however, may not redetermine any partnership item in a deficiency proceeding resulting from an affected-item statutory notice of deficiency. If the computational adjustments to a partner's return do not require any partner-level determinations, the Service sends the taxpayer a notice of computational adjustment and directly assesses the tax by notice and demand. Desmet, 581 F.3d at 302; Treas. Reg. § 301.6231(a)(6)-1(a)(2). If the FPAA is defaulted, the deficiency attributable to the computational adjustments is assessed against the partners in accordance with the adjustments in the FPAA.

Before the Service may levy and after the filing of a Notice of Federal Tax Lien to collect an unpaid tax liability, the Service generally must notify the taxpayer in writing of their right to a collection due process hearing. I.R.C. § 6330(a)(1). If the taxpayer timely requests a hearing in response to the notice, a hearing is held in the Office of Appeals. I.R.C. § 6330(b). At the hearing, the Office of Appeals "shall . . . obtain verification . . . that the requirements of any

[2] The mailing of an FPAA to the TMP also suspends the period of limitations for assessing against all partners any tax attributable to any partnership item (or affected item) for the 150-day period during which an action may be brought and for one year after the FPAA is defaulted or is finally adjudicated by a court. I.R.C. § 6229(d).

applicable law or administrative procedure have been met." I.R.C. § 6330(c)(1). Verification is required to be a part of every collection due process determination. Hoyle v. Commissioner, 131 T.C. 197, 202 (2008); see also Chief Counsel Notice 2014-002, Proper Standard of Review for Collection Due Process Determinations (May 5, 2014). At a CDP hearing, a taxpayer may raise any relevant issue relating to the unpaid tax or the proposed levy, including spousal defenses and challenges to the appropriateness of the collection action, and may offer collection alternatives. I.R.C. § 6330(c)(2)(A). A taxpayer may "raise . . . challenges to the existence or amount of the underlying liability" unless the taxpayer received a statutory notice of deficiency or otherwise had an opportunity to dispute such liability. I.R.C. § 6330(c)(2)(B).

1. Matters that Should Be Determined in a TEFRA Partnership-Level Proceeding May Not Be Addressed in a Partner-Level CDP Proceeding

    a. Section 6221 Precludes Challenges to Partnership Items in CDP Proceedings

Section 6221 mandates that the tax treatment of partnership items shall be determined at the partnership level and not in a partner-level proceeding. Because CDP is a partner-level proceeding, a taxpayer may not challenge the underlying liability regarding the tax treatment of partnership items in a CDP proceeding even if the taxpayer never actually received an FPAA that was properly addressed and mailed. See Hudspath v. Commissioner, T.C. Memo. 2005-83, aff'd, 177 Fed. Appx. 326 (4th Cir. 2006) (taxpayer was precluded from challenging partnership items from a TEFRA case in his affected- item proceeding or in CDP); Crowell, 102 T.C. at 692-93. If the taxpayer in a CDP proceeding attempts to challenge the underlying liability by disputing the tax treatment of a partnership item, attorneys should argue that section 6221 precludes the taxpayer from challenging any deficiency attributable to a partnership item that was determined under the TEFRA partnership procedures, either through final adjudication by a court or default of the FPAA.[3]

    b. Res Judicata Precludes Review of Items that Could Have Been Raised in any Partnership Action that was Filed in Response to an FPAA

Section 6330(c)(2)(B) does not displace other statutory or common law preclusions on challenging the underlying liability, including res judicata's prohibition on relitigating claims that were, or could have been, the subject of a previous court proceeding. See Goodman v. Commissioner, T.C. Memo. 2006-220 (res judicata and section 6330(c)(2)(B) both apply to preclude relitigation of liability determined in prior stipulated Tax Court decision). Res judicata bars relitigation of claims that were raised, or could have been raised, by the same parties or those with whom they are in privity in prior proceedings. See, e.g., Dial USA, Inc. v. Commissioner, 95 T.C. 1, 6 (1990); Meier v. Commissioner, 91 T.C. 273, 282 (1988). See generally Chicot Cnty. Drainage Dist. v. Baxter State Bank, 308 U.S. 371, 375-78 (1940) (failure to raise an issue in a prior proceeding does not affect the application of res judicata or allow a party to collaterally attack the judgment in a subsequent proceeding, even if the issue was jurisdictional).

[3] Section 6221 does not preclude a taxpayer from challenging non-partnership aspects of their tax liability. Accordingly, section 6330(c)(2)(B) should be pleaded if the taxpayer in fact received a statutory notice of deficiency or otherwise had an opportunity to dispute the non-partnership aspects of the taxpayer's liability.

If a petition for readjustment of partnership items is filed in response to an FPAA, all partners of the subject partnership are treated as parties to the proceeding. I.R.C. § 6226(c). Section 6231(a)(2)(B) defines a partner to include anyone whose liability is determined by taking into account (directly or indirectly) partnership items.[4] If a partner wishes to challenge their status as a party to the proceeding, the partner must participate in the action for the purpose of challenging their status as a party. See Blak Invs., 133 T.C. at 452-57 (Thornton, J., concurring). See also I.R.C. § 6226(d) (providing jurisdiction to raise party status). Therefore, if a partnership action is filed in response to an FPAA, res judicata applies to bar any partner from challenging, in CDP, any item that could have been raised in the partnership-level proceeding, regardless of whether the issue was in fact raised in the proceeding. Res judicata applies even if the taxpayer alleges that the TMP, or the pass-thru partner, did not notify the taxpayer of the partnership-level proceeding or settlement of the proceeding. I.R.C. § 6230(f). Section 6223(g) requires the TMP to keep each partner notified of the partnership-level proceeding, including providing notice of any proposed stipulated decision or settlement agreement. See also Tax Ct. R. 248. If a partner does not wish to be bound by entry of a stipulated decision, the partner must move to participate in the proceeding. Id. By failing to take the necessary steps to object to the entry of the decision, the partner is treated as relinquishing any objection.

2. Taxpayers May Not Challenge the Statute of Limitations for Assessing Tax Attributable to Partnership Items in CDP

A partnership does not pay income tax but instead passes through items of income to its partners for taxation at the partner level. See generally I.R.C. §§ 701, 702. Accordingly, a TEFRA partnership-level proceeding does not determine underlying tax liability; it determines the tax treatment (including the taxability) of partnership items. See I.R.C. § 6221. The resulting change in the taxpayer's underlying liability is defined as a computational adjustment. I.R.C. § 6231(a)(6) (defining computational adjustment as "the change in the tax liability of a partner which properly reflects the treatment under [TEFRA] of a partnership item"). The tax treatment of partnership items includes affirmative defenses to the assessment of tax attributable to partnership items. See, e.g., Genesis Oil, 93 T.C. at 564. See generally I.R.C. §§ 6221, 6226.

The statute of limitations on the assessment of tax attributable to partnership items (or affected items) is an affirmative defense that may only be raised in a timely-filed petition in response to the FPAA.[5] Taurus FX Partners, T.C. Memo. 2013-168, at *18; Genesis Oil, 93 T.C. at 564-65 (statute of limitations is an affirmative defense that must be raised in a timely petition in response to an FPAA). See also Blak Invs., 133 T.C. at 436-38, 452-57 (statute of limitations must be raised in partnership proceeding because it is not subject to challenge in later partner-

[4] This includes indirect partners. Accordingly, indirect partners are parties to the action, even though they cannot directly petition unless they elect notice partner treatment under section 6223(c)(3) or form a 5-percent group. I.R.C. § 6226(b). Therefore, indirect partners are the same as direct partners in how they are bound by the partnership-level proceeding.

[5] Six circuit courts of appeals have concluded that the period for assessing partnership items is a partnership item because it is a critical legal/factual determination affecting the tax treatment of a partnership item. See Irvine v. United States, 729 F.3d 455, 462 (5th Cir. 2013); Keener v. United States, 551 F.3d 1358, 1363 (Fed. Cir. 2009); Davenport Recycling Assocs. v. Commissioner, 220 F.3d 1255, 1260-61 (11th Cir. 2000); Chimblo v. Commissioner, 177 F.3d 119, 125 (2d Cir. 1999); Williams v. United States, 165 F.3d 30 (6th Cir. 1998) (table decision); Kaplan v. United States, 133 F.3d 469, 473 (7th Cir. 1998).

level proceedings); Prati, 81 Fed. Cl. at 436 (plaintiffs waived their statute of limitations defense by not participating in the partnership-level proceeding and raising it); Overstreet v. Commissioner, T.C. Memo. 2001-13 (the expiration of the period of limitations is an affirmative defense that must be raised in a partnership-level proceeding); Columbia Bldg. v. Commissioner, 98 T.C. 607, 611, 612 (1992)(statute of limitations is affirmative defense treated as a merits determination of underlying partnership item). If a partner fails to raise the statute of limitations in a timely-filed petition in response to the FPAA, the partner may not raise the statute of limitations on the assessment of the tax attributable to partnership items at a later time. Chimblo, 177 F.3d at 125; see also section 6226(d)(1). Although no court has directly addressed the issue in the CDP context, in situations in which the FPAA is defaulted, the partner may not later contest the statute of limitations with respect to partnership items because a partnership action would have been the exclusive opportunity for raising that issue. Therefore, neither the Tax Court nor the Service may consider the issue in a partner-level CDP hearing.

3. Verification Under Section 6330(c)(1) is Generally Limited to Verifying Proper Notice Under Section 6223 and Assessment of Tax Attributable to Partnership Items Within the One-Year Suspension Period of Section 6229(d)

As stated above, verification is required to be part of every CDP determination. Hoyle, 131 T.C. at 202. In verifying that all requirements of any applicable law or administrative procedure have been met, an Appeals or Settlement Officer must verify that a valid and timely assessment was made, that notice and demand was issued, that the liability was not paid, and that a CDP notice was properly issued to the taxpayer. Ron Lykins, Inc. v. Commissioner, 133 T.C. 87, 97 (2009). If the Service was required to issue a statutory notice of deficiency prior to assessment, Appeals must also obtain verification that either a valid and timely statutory notice of deficiency was sent to the taxpayer at his or her last known address, or that a waiver was signed. Hoyle, 131 T.C. at 204. An Appeals or Settlement Officer may rely on computer transcripts to satisfy this requirement, but must go beyond transcripts and the administrative file if an irregularity is identified by the taxpayers or by the Appeals or Settlement Officer. Craig v. Commissioner, 119 T.C. 252, 261-62 (2002); IRM 8.22.5.4.2(5).

As stated above, if TEFRA applies, sections 6221 and 6226(d)(1) mandate that the tax treatment of partnership items and statute of limitations defenses must be determined at the partnership level. Because such items must be determined at the partnership level, they cannot be determined, or redetermined, in a partner-level proceeding such as CDP. Pursuant to Chief Counsel Notice 2014-002, the Appeals or Settlement Officer in a CDP case is to verify that the assessment underlying the collection action was timely. An Appeals or Settlement Officer satisfies the verification requirements when it is verified that the Service properly mailed notice under section 6223 and assessed the tax attributable to partnership items within the one-year suspension period described in section 6229(d).[6]

[6] If the assessment following the conclusion of the partnership-level proceeding was made after the one-year suspension period of section 6229(d) expired, there may be partner-level suspensions or extensions that would apply to make the assessment timely. The Appeals or Settlement Officer may verify that those partner-level suspensions or extensions operated to extend the period of limitations beyond the one-year suspension period of section 6229(d).

Questions regarding this notice or related issues should be directed to Procedure & Administration Branches 3 or 4 at (202) 317-3600 or (202) 317-6832 and Branches 6 or 7 at (202) 317-6833 or (202) 317-6834, respectively.

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