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INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ROBERT F. GERAGHTY
ASSOCIATE AREA COUNSEL, AREA 5 (LMSB)
CC:LM:CTM:SEA

FROM: Jasper L. Cummings, Jr.
Associate Chief Counsel (Corporate) CC:CORP

SUBJECT: Extending Limitations Period for TEFRA Partnership

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LEGEND

Parent =

Subsidiary =

Partnership =

Corporation X =

Company Official =

y =

z =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

ISSUES

- (1) Whether Parent's bankruptcy converted Subsidiary's partnership items to nonpartnership items pursuant to Temp. Treas. Reg. § 301.6231(c)-7T(a), thereby terminating Subsidiary's status as tax matters partner (TMP) pursuant to Treas. Reg. § 301.6231(a)(7)-1(l)(1)(iv).

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- (2) Whether the statute of limitations for assessment under § 6229 of the Internal Revenue Code remains open with respect to the partners.

CONCLUSIONS

- (1) Parent's bankruptcy did not convert Subsidiary's partnership items to nonpartnership items and did not terminate Subsidiary's status as TMP.
- (2) The recently executed Consent to Extend the Time to Assess Tax Attributable to Items of a Partnership (Form 872-P) is valid.

FACTS

Parent is the common parent of a consolidated group (the "P group"). Subsidiary is a subsidiary of Parent and a member of the P group. Subsidiary is a general partner and the TMP of Partnership, a TEFRA partnership in which it owns a y% partnership interest. Corporation X, an unrelated corporation, is also a general partner of Partnership and owns the remaining z% partnership interest.

On Date 1, Parent filed a petition in bankruptcy. Parent's bankruptcy case was closed on Date 2.

Partnership timely filed its Year 1 partnership information return (Form 1065) on Date 3. A Form 872-P signed by Company Official provides that the limitations period on assessing the partners' tax attributable to partnership items for the Year 1 partnership year expires on Date 4. The information submitted indicates that your office is unclear whether Subsidiary, or Parent on Subsidiary's behalf, signed the Form 872-P. It is our understanding, however, that a new Form 872-P has been secured, signed by Company Official on behalf of Parent.

A Form 872 for the P group provides that the limitations period on assessing tax due relating to the period ending on Date 2 expires on Date 5.

LAW AND ANALYSIS

Issue One: Whether Parent's bankruptcy converted Subsidiary's partnership items to nonpartnership items and terminated Subsidiary's status as TMP

Section 6231(a)(2) provides that for purposes of subchapter C of Chapter 63 of the Code (the "TEFRA provisions") the term partner is defined as follows:

- (A) a partner in the partnership, and

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(B) 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.

Section 6231(a)(3) provides that a partnership item is any item 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 such item is more appropriately determined at the partnership level than at the partner level.

Section 6231(a)(4) provides that a nonpartnership item is an item which is (or is treated as) not a partnership item.

Section 6231(a)(7) provides that the TMP of any partnership is the general partner designated as the tax matters partner as provided in regulations, or if there has been no designation, the general partner having the largest profits interest in the partnership at the close of the taxable year involved.

Section 6231(b)(1)(D) provides, in part, that the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date a change occurs under subsection (c) of § 6231.

Section 6231(c) provides that in certain special enforcement areas the Secretary may provide by regulations for the conversion of a partner's partnership items into nonpartnership items.

Treas. Reg. § 301.6231(a)(7)-1(l)(1)(iv) provides that a designation of a TMP for a taxable year shall remain in effect until the partnership items of the TMP become nonpartnership items under § 6231(c) (relating to special enforcement areas).

Temp. Treas. Reg. § 301.6231(c)-7T(a) provides that the treatment of items as partnership items with respect to a partner named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition naming the partner as debtor is filed in bankruptcy.

Section 1501 provides, in part, that an affiliated group of corporations shall, subject to the provisions of Chapter 6 of the Code, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns.

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Treas. Reg. § 1.1502-2 provides, in part, that the tax liability of a group for a consolidated return year, before credits, shall be determined by adding together various taxes, including the tax imposed by § 11 on the consolidated taxable income for such year as computed under § 1.1502-11.

Treas. Reg. § 1.1502-6(a) provides generally that the common parent corporation and each subsidiary which was a member of the group during any part of the consolidated return year shall be severally liable for the tax for such year.

Treas. Reg. § 1.1502-11(a) provides, in part, that the consolidated taxable income for a consolidated return year shall be determined by taking into account the separate taxable income of each member of the group as computed under § 1.1502-12.

Treas. Reg. § 1.1502-12 provides generally that the separate taxable income of a member is computed in accordance with the provisions of the Code covering the determination of taxable income of separate corporations, subject to specified modifications.

Treas. Reg. § 1.1502-76(b)(1)(i) provides, in part, that a consolidated return must include the common parent's items of income, gain, deduction, loss, and credit for the entire consolidated return year, and each subsidiary's items for the portion of the year for which it is a member.

Pursuant to the TEFRA provisions of subchapter C of Chapter 63 of the Code (§§ 6221 through 6234), the tax treatment of "partnership items" is determined through a unified proceeding at the partnership level. Callaway v. Commissioner, 231 F.3d 106, 108 (2d Cir. 2000). A partnership item is defined as any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent such item is more appropriately determined at the partnership rather than at the partner level. § 6231(a)(3). A nonpartnership item is an item which is (or is treated as) not a partnership item. § 6231(a)(4).

Section 6231(c) authorizes the Secretary to provide by regulations for the conversion of a partner's partnership items into nonpartnership items in certain special enforcement areas. Under Temp. Treas. Reg. § 301.6231(c)-7T(a), the filing of a petition naming a partner as a debtor in a bankruptcy proceeding converts the partnership items "of such a partner" to nonpartnership items. See Computer Programs Lambda, Ltd. v. Commissioner, 89 T.C. 198, 203 (1987). The effect of the conversion is to remove the debtor-partner from the TEFRA proceeding, thereby subjecting the converted items to the notice and deficiency

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procedures applicable to the partner's individual return under subchapter B of Chapter 63. Callaway, 231 F.3d at 108.

In this case, Subsidiary, a member of the P consolidated group, is the TMP and general partner of Partnership, a TEFRA partnership. Under § 6231(a)(2)(A), Subsidiary is a "partner" subject to the TEFRA procedures. For purposes of the TEFRA provisions, § 6231(a)(2)(B) also defines a partner to include 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. This raises the threshold question of the relationship, if any, between the consolidated group and the TEFRA partnership.

Section 1501 of the Code permits an affiliated group of corporations to file a consolidated return. In general, the consolidated return must include the common parent's items of income, gain, deduction, loss, and credit for the entire consolidated return year, and each subsidiary's items for the portion of the year for which it is a member. Treas. Reg. § 1.1502-76(b)(1)(i). Under Treas. Reg. § 1.1502-6(a), the common parent and each member of the group is severally liable for the entire tax for such year. Pursuant to Treas. Reg. § 1.1502-2, the group's tax liability for a consolidated return year, before credits, is determined by adding together various taxes, including the tax imposed by § 11 on the consolidated taxable income for such year, as computed under Treas. Reg. § 1.1502-11. Treas. Reg. § 1.1502-11(a) in turn provides that the consolidated taxable income of the group is determined by taking into account the separate taxable income (STI) of each member, as computed under Treas. Reg. § 1.1502-12. Where a group member is a partner in a partnership, such member's STI will take into account the pass-through of items from the partnership. Because the group's income tax liability is determined by taking into account the partnership items of the partnership, the common parent and all other group members are "partners" for TEFRA purposes under § 6231(a)(2)(B).

Parent, the common parent of the P group, filed for bankruptcy on Date 1. Subsidiary did not file for bankruptcy. The issue presented by this case is whether Parent's bankruptcy converts Subsidiary's partnership items to nonpartnership items under Temp. Treas. Reg. § 301.6231(c)-7T(a).¹ This is a question of first

¹ We note that a further consequence of such a conversion in this case would be the termination of Subsidiary's status as TMP pursuant to Treas. Reg. § 301.6231(a)(7)-1(l)(1)(iv). This, in turn, would invalidate any consent to extend the period of limitations with respect to partnership items signed by Subsidiary after Parent's bankruptcy petition was filed.

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impression. The analogous issue, however, has been analyzed in two separate court decisions with respect to a husband and wife who file a joint return.

The most recent decision is Callaway v. Commissioner, 231 F.3d 106 (2d Cir. 2000). In Callaway, James Callaway was a limited partner in a TEFRA partnership. He filed a joint income tax return with his wife Elizabeth. Subsequently, James died. The estate requested a prompt assessment, which is a conversion event under Temp. Treas. Reg. § 301.6231(c)-8T.

The Second Circuit, reversing the Tax Court, found that when the estate requested prompt assessment, all partnership items converted to nonpartnership items with respect to the estate and to Elizabeth. Callaway, 231 F.3d at 119. The Second Circuit held that since only the decedent owned a partnership interest in the partnership and Elizabeth was treated as a partner for purposes of the TEFRA partnership provisions solely by reason of her filing joint returns with the decedent, then the partnership items converted to nonpartnership items with respect to the decedent and Elizabeth. Id. at 120. The Second Circuit's reasoning was as follows: A partnership item is defined, in relevant part, as each partner's share of that item. Treas. Reg. § 301.6231(a)(3)-1. Elizabeth did not own a share of the partnership items because she did not own an interest in the partnership. The filing of a joint return had no effect on James' separate ownership of the partnership interest. Therefore, when James' items converted to nonpartnership items, they converted to nonpartnership items with respect to Elizabeth. Callaway, 231 F.3d at 117-118.

In reaching the above conclusion, the Second Circuit distinguished Dubin v. Commissioner, 99 T.C. 325 (1992), acq. 2000-52 I.R.B. 605. In Dubin, the Tax Court held that the partnership items did not convert as to the wife when the husband filed for bankruptcy. The Second Circuit noted, however, that the wife in Dubin owned a separate share of the partnership items, unlike Elizabeth Callaway who was considered a partner in the TEFRA proceeding based solely on the joint return. Callaway, 231 F.3d at 124.

In Dubin, the husband and wife each had a joint interest in a partnership as a result of the state's community property laws. The husband filed for bankruptcy. The Service issued one statutory notice of deficiency to the couple disallowing partnership losses claimed on their joint return. The TEFRA proceeding had not concluded at the time the statutory notice of deficiency was issued. The Tax Court held that the conversion of the husband's partnership items to nonpartnership items by operation of Temp. Treas. Reg. § 301.6231(c)-7T(a) did not also convert the wife's partnership items because she was not a debtor in a bankruptcy proceeding.

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Id. at 335. Therefore, the statutory notice of deficiency was invalid as to the wife because it was issued prior to the close of the partnership proceedings. See § 6225(a).

Under both Callaway and Dubin, a husband and wife who each own an interest in a partnership are considered separate with respect to a conversion event; i.e., a conversion event with respect to one spouse does not convert the partnership items of the separate spouse, even if a joint return is filed. Under Callaway, however, a conversion event with respect to one spouse will convert the partnership items of the separate spouse if a joint return is filed and the separate spouse does not own a separate partnership interest. The Callaway holding is specifically based on the ownership of the partnership interest.

Like a husband and wife who file a joint return, each member of a consolidated group is severally liable for the entire tax. Treas. Reg. § 1.1502-6(a). In the instant case, the partnership interest is owned by Subsidiary, not Parent. Moreover, Parent filed for bankruptcy, not Subsidiary. Because the partnership interest is owned by Subsidiary and Subsidiary did not file for bankruptcy, there is no conversion event with regard to Subsidiary. Because the partnership items of Subsidiary did not convert, Subsidiary's status as TMP is not in doubt.

Issue Two: Whether the statute of limitations for assessment under § 6229 of the Code remains open with respect to the partners

Section 6229(a) sets forth the general rule that, except as otherwise provided in § 6229, 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).

Section 6229(f)(1) provides in part that if, before the expiration of the period otherwise provided in § 6229 for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of § 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not

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expire before the date which is 1 year after the date on which the items become nonpartnership items.

Treas. Reg. § 1.1502-77(a) provides that the common parent, with certain exceptions not applicable here, shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. Except as provided in the preceding sentence, no subsidiary shall have authority to act for or to represent itself in any such matter. Section 1.1502-77(a) further provides that the common parent in its name will give waivers, and any waiver so given shall be considered as having also been executed by each such subsidiary.

Treas. Reg. § 1.1502-77(c)(1) provides, in part, that unless the district director agrees to the contrary, an agreement entered into by the common parent extending the time within which an assessment may be made or levy or proceeding in court begun in respect of the tax for a consolidated return year shall be applicable to each corporation which was a member of the group during any part of such taxable year.

Rev. Rul. 63-104, 1963-1 C.B. 172, holds, in part, that an affiliated group of corporations, which has filed consolidated returns for prior taxable years, is required to file a consolidated return for a subsequent taxable year even though a member of the group is involved in bankruptcy proceedings and the trustee in bankruptcy fails or refuses to file a Form 1122 consenting to the filing of such a return.

Based on our conclusion supra that Parent's bankruptcy did not convert Subsidiary's partnership items to nonpartnership items under Temp. Treas. Reg. § 301.6231(c)-7T(a), the applicable limitations period remains the one set forth in § 6229(a). A Form 872-P² signed by Company Official provides that the limitations period on assessing the partners' tax attributable to partnership items for the Year 1 partnership year has been extended to Date 4. The information submitted, however, indicates that your office is unclear whether Company Official signed the Form 872-P for Subsidiary, or for Parent on behalf of Subsidiary. It is our understanding that a new Form 872-P has since been secured, signed by Company Official for Parent on behalf of Subsidiary.

² The form 872-P is used to extend the statute of limitations at the partnership level. This form provides the following three signature lines: (1) the partnership name, (2) the tax matters partner, and (3) the authorized person.

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As a general rule, the common parent of a consolidated group is the sole agent of the group and is authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. Treas. Reg. § 1.1502-77(a). Thus, the common parent is the proper party to sign consents, including the Form 872 waiver to extend the period of limitations, for all members in the group. Moreover, the bankruptcy of the common parent does not terminate its status as sole agent of the group. J & S Carburetor Co. v. Commissioner, 93 T.C. 166, 169 (1989). Cf. Rev. Rul. 63-104 (bankrupt corporation is still a group member required to join in the filing of the group's consolidated return).

In cases where the TMP of a TEFRA partnership is a subsidiary of a consolidated group, we recommend that the consent be signed by an officer of the parent corporation on behalf of the subsidiary and by an officer of the TMP subsidiary. Accordingly, we recommend that the following signatures be obtained.

The signature block for the common parent should appear as follows on the Form 872-P:

[Name of common parent], common parent of [name of consolidated group],
by [name of authorized representative, title], on behalf of [name of
subsidiary], Tax Matters Partner of [name of TEFRA partnership].

The signature block for the TMP-subsiary should appear as follows on the Form 872-P:

[Name of TMP subsidiary], by [name of authorized representative, title], Tax
Matters Partner of [name of TEFRA partnership].

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The information submitted indicates that Parent and Subsidiary have each changed their name to [REDACTED]. Our advice in this memorandum might differ if it is determined that Parent and Subsidiary are not separate entities but hold themselves out as one entity – this, however, is not what the facts state.

Please call if you have any further questions.

By: Jasper L. Cummings, Jr.
Associate Chief Counsel (Corporate)
GERALD B. FLEMING
Senior Technician Reviewer
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