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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG-120232-17; REG-120233-17]

RIN 1545-BO03; RIN 1545-BO04

Centralized Partnership Audit Regime: Rules for Election Under Sections 6226 and 6227, Including Rules for Tiered Partnership Structures, and Administrative and Procedural Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations implementing section 1101 of the Bipartisan Budget Act of 2015 (BBA), which was enacted into law on November 2, 2015. Section 1101 of the BBA repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level. These proposed regulations provide rules addressing how pass-through partners take into account adjustments under the alternative to payment of the imputed underpayment described in section 6226 and under rules similar to section 6226 when a partnership files an administrative adjustment request under section 6227. To make corresponding changes, these proposed regulations amend portions of the previously proposed regulations under sections 6226 and 6227. Additionally, these proposed regulations provide rules regarding assessment and collection, penalties and interest, and period of

limitations under the new centralized partnership audit regime. The proposed regulations also address the rules for seeking judicial review of partnership adjustments.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-120232-17; REG-120233-17), room 5207, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG-120232-17; REG-120233-17), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-120232-17; REG-120233-17).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations under sections 6225, 6231, and 6234 of the Internal Revenue Code, Joy E. Gerdy-Zogby of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834; concerning the proposed regulations under sections 6227, 6232, and 6233, Steven L. Karon of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834; concerning the proposed regulations under sections 6226 and 6235, Jennifer M. Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834; concerning the submission of comments and a request for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) under Subpart – Tax Treatment of Partnership Items regarding how pass-through partners (as defined in proposed §301.6241-1(a)(5)) take into account adjustments under the alternative to payment of the imputed underpayment described in section 6226 under the new centralized partnership audit regime and under rules similar to section 6226 when a partnership files an administrative adjustment request (AAR) under section 6227. This document also contains proposed regulations regarding assessment and collection, penalties and interest, periods of limitations, and judicial review under the new centralized partnership audit regime. The new regime was enacted into law by section 1101 of the BBA, Public Law 114-74, as amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113, div. Q. The provisions of section 1101 of the BBA are generally effective for partnership taxable years beginning after December 31, 2017. See the temporary regulations (TD 9780, 81 FR 51795) and the notice of proposed rulemaking (REG-105005-16, 81 FR 51835) published in the **Federal Register** on August 5, 2016, regarding the election into the centralized partnership audit regime for taxable years beginning after November 2, 2015 and before January 1, 2018.

On June 14, 2017, a notice of proposed rulemaking (REG-136118-15) was published in the **Federal Register** (82 FR 27334) (June 14 NPRM) implementing the new centralized partnership audit regime. The June 14 NPRM contained rules regarding the scope and election out of the new regime, consistent treatment by partners, the partnership representative, partnership adjustments made by the IRS and determination of the amount of the partnership's liability (referred to as the imputed

underpayment), AARs, and the election for partners to take the partnership adjustments into account (sections 6221 through 6227 and section 6241 of the Internal Revenue Code (Code)). The rules regarding how pass-through partners take into account adjustments under the alternative to payment of the imputed underpayment described in section 6226 and under rules similar to section 6226 under section 6227 were reserved in the June 14 NPRM. This document contains those proposed rules and also re-proposes certain rules under section 6226, including the imposition and computation of penalties that relate to partnership adjustments. This document also contains proposed regulations that supplement the June 14 NPRM by implementing the administrative and procedural provisions of the new centralized partnership audit regime (sections 6231 through 6235). For proposed rules regarding international provisions under the centralized partnership audit regime, see (REG-119337-17) published in the **Federal Register** on November 30, 2017 (82 FR 56765) (November 30 NPRM).

1. Pass-Through Partners and the Section 6226 Push Out Election

Under section 6225, a partnership subject to the centralized partnership audit regime is generally required to pay an imputed underpayment with respect to adjustments to the partnership's items of income, gain, loss, deduction, or credit, and any partner's distributive share thereof. However, a partnership may elect under section 6226 to have its partners for the year under audit (the reviewed year partners) take the adjustments into account.

Proposed §301.6226-1 (June 14 NPRM) provides rules relating to the election under section 6226 by a partnership to have its partners take into account the partnership adjustments in lieu of paying the imputed underpayment determined under

section 6225 (the push out election). Proposed §§301.6226-2 and 301.6226-3 (June 14 NPRM) provide rules for statements the partnership must send to its partners for the reviewed year (as defined in proposed §301.6241-1(a)(8) (June 14 NPRM)) and the computation and payment of the partners' liabilities as a result of taking into account the adjustments. Under proposed §301.6226-1(b)(2) (June 14 NPRM), if a partnership makes the election under section 6226 to push out the adjustments, the partnership is not required to pay the imputed underpayment but is instead required to furnish statements to "each partner of the partnership for the reviewed year." Those reviewed year partners are then required to take the adjustments into account as provided under section 6226(b).

The June 14 NPRM provides guidance on how a direct partner that is not a pass-through partner (generally defined under proposed §301.6241-1(a)(5) (June 14 NPRM) as a partnership, an S corporation, certain trusts, and a decedent's estate) takes the adjustments into account under section 6226(b).

The June 14 NPRM reserved, however, on the issue of how the adjustments are taken into account in the case of tiered partnership structures by partners that are pass-through partners. The preamble to the June 14 NPRM noted that the Treasury Department and the IRS were considering an approach under section 6226 for tiered partnerships to "push" the adjustments beyond the first tier partners that would be the subject of other proposed regulations to be published in the near future. These are those proposed regulations.

In the June 14 NPRM, the Treasury Department and the IRS sought comments on how the IRS might administer the requirements of section 6226 in tiered structures,

including comments on reducing noncompliance and collection risk in tiered structures, while at the same time reducing costs of effective tax administration. The Treasury Department and the IRS received numerous comments addressing the push out election for tiered structures which uniformly requested that pass-through partners be allowed to push out the adjustments under section 6226 beyond the first tier and through to the ultimate taxpaying partners or owners.

Partnerships, as such, are not subject to tax under chapter 1 of the Code with respect to items of income, gain, loss, deduction, and credit. Rather, these items of the partnership are allocated to its partners who then take them into account based on the partners' tax characteristics, including entity classification. The June 14 NPRM describes generally how adjustments to items of income, gain, loss, deduction, or credit made with respect to a partnership subject to the TEFRA partnership procedures flow through to the partnership's direct and indirect partners for assessment and collection of the resulting tax. Under certain circumstances, the assessment and collection of such tax required the IRS to follow deficiency procedures after the partnership-level proceeding. The enactment of the centralized partnership audit regime changed this paradigm by introducing the imputed underpayment, an entity-level liability, that is calculated based on the adjustments to a partnership's items of income, gain, loss, deduction, or credit, and that is assessed and collected at the partnership level, rather than being assessed and collected from the ultimate partners.

Section 6226 provides an alternative to the entity-level imputed underpayment, allowing a partnership to elect under section 6226(a) to push the adjustments out to its partners. In lieu of the partnership paying the imputed underpayment, section 6226(a)

provides that when a push out election is made the reviewed year partners “shall take such adjustments into account” as provided in section 6226(b). The language of section 6226(b), however, does not distinguish between partners that are subject to chapter 1 income taxes (for example, individuals and C corporations) and pass-through partners (for example, partnerships and S corporations), which are generally not subject to such taxes. Accordingly, the precise question of how a pass-through partner takes into account the adjustments when a partnership elects to push out the adjustments to its partners is not addressed by section 6226(b).

As discussed in the preamble to the June 14 NPRM, section 6226(b) could be interpreted to treat direct pass-through partners like individuals, allowing the IRS to collect the resulting tax from those direct pass-through partners without allowing them to push out the adjustments past the first tier. See June 14 NPRM, 82 Fed. Reg. at 27364 (citing Joint Comm. on Taxation, JCS-1-16, General Explanations of Tax Legislation Enacted in 2015, 70 (2016) (JCS-1-16)). Alternatively, section 6226(b) could be interpreted to allow a pass-through partner to take adjustments into account by passing the adjustments along to its reviewed year partners through the tiers until reaching an ultimate tax-paying owner. See June 14 NPRM, 82 FR at 27364-65. Technical corrections to the centralized partnership audit regime introduced in the last Congress, but not enacted, would have allowed pass-through partners to take adjustments into account under section 6226(b) by either paying an entity-level imputed underpayment or passing the adjustments along to their reviewed year partners. See June 14 NPRM, 82 Fed. Reg. at 27365 (citing the Tax Technical Corrections Act of 2016, H.R. 6439, 114th Cong. (2016)).

After considering all of the comments, the Treasury Department and the IRS have determined that adjustments pushed out to partners pursuant to an election under section 6226 should be permitted to be pushed out through the tiers to the ultimate tax-paying owners. Accordingly, these proposed regulations provide rules for pushing the adjustments through tiers of partners that are pass-through partners. Under proposed §301.6241-1(a)(5) (June 14 NPRM), a “pass-through partner” means a partnership (regardless of whether the partnership made a valid election under section 6221(b) to elect out of the centralized partnership audit regime), an S corporation, certain trusts, and a decedent’s estate.

As discussed more fully in the Explanation of Provisions section of this preamble, the proposed regulations provide rules for pushing the adjustments beyond the first tier. Under these rules, each pass-through partner in an ownership chain is given a choice to either push the adjustments to its partners, shareholders, or beneficiaries or pay tax with respect to the adjustments. This optionality is consistent with the framework of the centralized partnership audit regime where the partnership under audit, or the partnership initiating its own adjustments in an AAR, has the choice of either paying a tax amount with respect to the adjustments or pushing the adjustments out to its partners. It also provides maximum flexibility for each pass-through partner in the chain to determine the best course for that partner based on its own facts and circumstances.

The proposed regulations also provide a compliance mechanism to ensure that the section 6226 election does not negatively impact tax administration. As discussed in the June 14 NPRM, the centralized partnership audit regime is designed to improve the IRS’s ability not only to audit partnerships, including large, tiered partnerships, but

also to efficiently collect the tax due as a result of the audit. The centralized partnership audit regime has two main collection mechanisms. First, section 6225 creates a default entity-level imputed underpayment that the partnership must pay. Second, as an alternative to payment of the imputed underpayment by the partnership under section 6225, section 6226 allows the partnership to move the collection point from the partnership to its partners for the reviewed year. If a partnership complies with section 6226, the imputed underpayment determined under section 6225 is extinguished. Section 6226(a). Section 6226 does not, however, extinguish the tax obligation with respect to the adjustments underlying the imputed underpayment. Instead, the partnership's partners for the reviewed year must also satisfy the requirements of section 6226 with respect to the adjustments. Once the partnership allocates the adjustments to each reviewed year partner and sends the required statements under section 6226(a), the partners are required to take the adjustments into account and, in the case of partners that are not pass-through partners, pay the resulting tax through self-reporting. Section 6226(b). Thus, section 6226 moves assessment and collection from the partnership subject to the administrative proceeding to its partners.

Because section 6226 is a collection provision, the IRS must be able to collect any tax due as a result of the adjustments made at the partnership level, even if those adjustments are pushed out through multiple tiers of pass-through partners. Therefore, under a regime where the partnership is allowed to push adjustments through the tiers, there must be a feature that ensures compliance by each pass-through partner in the chain of ownership. Without such a feature, non-compliant entities in the tiers, and the current partners who control those entities, could frustrate collection of the tax due as a

result of the partnership audit, and the section 6226 election would become a means for avoidance of tax due with respect to adjustments determined in the audit, undermining the centralized partnership audit regime enacted under the BBA.

Therefore, these proposed regulations provide a mechanism to address pass-through partners in the tiers that fail to comply with the requirement to either push the adjustments out to their owners or pay the tax resulting from the adjustments allocable to that partner. That mechanism is to collect the tax due from the non-compliant pass-through partner. This balances the ability for the tiered structure to push out the partnership adjustments to the partnership's ultimate reviewed year partners while ensuring collection under section 6226.

In cases where the pass-through partner chooses (or, in the case of non-compliance, is required) to pay, the proposed regulations rely on existing rules to determine how an entity that generally does not pay chapter 1 tax would determine the amount due if that entity were to take the adjustments into account. Under these proposed rules, the pass-through partner calculates an amount in the same manner as the imputed underpayment under section 6225 is computed with respect to the partnership under audit, with some refinements, as described in more detail in the Explanation of Provisions section of this preamble, to reflect the fact that the adjustments are taken into account pursuant to a section 6226 election.

2. Pass-Through Partners and Administrative Adjustment Requests

The June 14 NPRM also reserved on how pass-through partners in a partnership that files an AAR take the adjustments into account under “rules similar to the rules of section 6226.” As discussed more fully in the Explanation of Provisions section of this

preamble, these proposed regulations provide for rules similar to the regulations under section 6226, with some minor changes to reflect the fact that an AAR permits taxpayers to receive refunds of any tax overpaid and to reflect that an AAR occurs outside of an examination.

3. Penalties in the Case of a Section 6226 Push Out Election

In the June 14 NPRM, the proposed regulations provide that defenses to any penalties, additions to tax, or additional amounts must be raised by the partnership during the partnership-level proceeding under the centralized partnership audit regime, regardless of whether the defense relates to facts and circumstances of the partnership or any other person, including a partner in the partnership. Additionally, those proposed regulations provide that penalties are calculated at the partnership level, even if the partnership makes an election under section 6226. As described more fully in the Explanation of Provisions section of this preamble, those rules are not consistent with the penalty rules proposed in these proposed regulations and, therefore, the rules proposed in the June 14 NPRM are being revised accordingly.

4. Section 6226 Push Out Election and the Safe Harbor Amount

In the June 14 NPRM, the proposed regulations under section 6226 provide a safe harbor amount and interest safe harbor amount that partners can pay in lieu of computing the tax and interest the partner owes as a result of taking the adjustments into account in the year under audit and determining the effect of this computation on tax attributes in subsequent years. These safe harbor amounts were intended to reduce the burden of the complex calculation of the tax and interest due for the reviewed year and the intervening years. These rules were crafted in light of the

proposed regulations under section 6226 in the June 14 NPRM, which did not yet provide rules for pushing the adjustments out through multiple tiers of pass-through partners. During the process of developing the rules to permit push out through multiple tiers of pass-through partners, it became apparent that the safe harbor rules no longer reduced burden. In fact, incorporating the safe harbor rules into the rules for pushing through the tiers became more complex and cumbersome than if the safe harbor amounts did not exist. In particular, the safe harbor amounts increased the reporting burden on a pass-through partner that elected to push the adjustments to its partners without a meaningful reduction in burden on the recipient partners. Accordingly, for these reasons, the proposed regulations regarding the safe harbor amount and the interest safe harbor amount have been amended to remove these provisions.

5. Administrative and Procedural Provisions Under the Centralized Partnership Audit Regime

Section 6231(a) provides that the Secretary shall mail to the partnership and the partnership representative (1) notice of any administrative proceeding (NAP) initiated at the partnership level with respect to an adjustment of any item of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, or any partner's distributive share thereof; (2) notice of any proposed partnership adjustment (NOPPA) resulting from such proceeding; and (3) notice of any final partnership adjustment (FPA) resulting from such proceeding. These three notices also apply to any proceeding with respect to an AAR filed by a partnership. Section 6231(a) further provides that any FPA shall be mailed no earlier than 270 days after the date on which the notice of the proposed partnership adjustment is mailed and such notices are sufficient if mailed to

the last known address of the partnership representative or the partnership, even if the partnership has terminated its existence.

Section 6225(a)(1) provides that in the case of any adjustment by the Secretary in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any partner's distributive share thereof, the partnership shall pay any imputed underpayment with respect to such adjustment in the adjustment year (as defined in proposed §301.6241-1(a)(1) (June 14 NPRM)) as provided in section 6232.

Section 6232(a) provides that any imputed underpayment shall be assessed and collected in the same manner as if it were a tax imposed for the adjustment year by subtitle A of the Code, except that in the case of an AAR to which section 6227(b)(1) applies, the underpayment shall be paid when the AAR is filed.

Section 6232(b) provides that except as otherwise provided in chapter 63 of the Code, no assessment of a deficiency may be made (and no levy or proceeding in any court for the collection of any amount resulting from such adjustment may be made, begun, or prosecuted) before (1) the close of the 90th day after the day on which an FPA was mailed and (2) if a petition for readjustment is filed under section 6234 with respect to such notice, the decision of the court has become final. A partnership may, at any time (whether or not any notice of partnership adjustment has been issued), by a signed notice in writing filed with the Secretary waive this restriction on the making of any partnership adjustment. Section 6232(d)(2).

Section 6232(c) provides that notwithstanding section 7421(a) (regarding prohibition on suits to restrain assessment or collection), any action that violates section 6232(b) may be enjoined in the proper court, including the Tax Court. The Tax Court

shall have no jurisdiction to enjoin any action under subsection 6232(c) unless a timely petition for readjustment has been filed under section 6234. If a timely petition has been filed, the Tax Court has jurisdiction only with respect to the adjustments that are the subject of such petition.

Section 6232(d) provides exceptions to the restrictions on making partnership adjustments. Section 6232(d)(1)(A) provides the general rule that if a partnership is notified that, on account of a mathematical or clerical error appearing on the partnership return, an adjustment to an item is required, rules similar to the rules of paragraphs (1) and (2) of section 6213(b) (relating to assessments on account of mathematical or clerical errors and abatement of such assessments) shall apply to such adjustments. Section 6232(d)(1)(B) provides a special rule that if a partnership is a partner in another partnership, any adjustment on account of such partnership's failure to comply with the requirements of section 6222(a) (requiring that a partner, on its return, treat items attributable to a partnership in a manner that is consistent with the treatment of such item on the partnership return) with respect to its interest in such other partnership shall be treated as an adjustment referred to in section 6232(d)(1)(A) except that paragraph (2) of section 6213(b) (providing the ability to request an abatement of an assessment on account of a mathematical or clerical error) shall not apply to such adjustment.

Section 6232(e) provides that if no proceeding under section 6234 is begun with respect to any FPA during the 90-day period described in section 6232(b), the amount for which the partnership is liable under section 6225 shall not exceed the amount determined in accordance with such FPA.

Section 6233 provides rules related to interest and penalties with respect to imputed underpayments. Except to the extent provided in section 6226(c) (providing rules for penalties and interest where the partnership elects under section 6226 the alternative to payment of the imputed underpayment), the interest computed with respect to any partnership adjustment for a reviewed year is the interest that would be determined under chapter 67 of the Code for the period beginning on the day after the return due date for the reviewed year and ending on the return due date for the adjustment year or, if earlier, the date payment of the imputed underpayment is made. Proper adjustments in the amount of interest determined shall be made for adjustments required for partnership taxable years after the reviewed year and before the adjustment year by reason of such partnership adjustment. Section 6233(a)(1) and (2).

Except to the extent provided in section 6226(c), the partnership shall be liable for any penalty, addition to tax, or additional amount imposed with respect to any partnership adjustment for a reviewed year. Any such penalty, addition to tax, or additional amount will be determined at the partnership level as if the partnership had been an individual subject to tax under chapter 1 of subtitle A of the Code for the reviewed year and the imputed underpayment were an actual underpayment (or understatement) for such year. Section 6233(a)(1) and (3).

Section 6233(a)(2) provides that interest with respect to a partnership adjustment for a reviewed year shall also take into account adjustments required by reason of such partnership adjustment for partnership taxable years after the reviewed year and before the adjustment year. The meaning of this provision is not clear because unless multiple years are audited, there may be no adjustments required for taxable years other than

the reviewed year. Because of this, the proposed regulations do not address this language from the statute. The IRS and the Treasury Department request comments about when and how this language in section 6233(a)(2) may have effect.

In the case of any failure to pay an imputed underpayment on the date prescribed therefor, the partnership shall be liable for interest determined by treating the imputed underpayment as an underpayment of tax imposed in the adjustment year. Section 6233(b)(1) and (2). In the case of any failure to pay an imputed underpayment on the date prescribed therefor, the partnership shall be liable for penalties, additions to tax, or additional amounts determined by applying section 6651(a)(2) to such failure to pay and by treating the imputed underpayment as an underpayment of tax for purposes of part II of subchapter A of chapter 68 of the Code (relating to accuracy-related and fraud penalties). Section 6233(b)(1) and (3).

Section 6234(a) provides that within 90 days after the date on which an FPA is mailed under section 6231 with respect to any partnership taxable year, the partnership may file a petition for readjustment for such taxable year with the Tax Court, the district court of the United States for the district in which the partnership's principal place of business is located, or the Court of Federal Claims. A petition for readjustment under section 6234 may be filed in a district court of the United States or the Court of Federal Claims only if the partnership filing the petition deposits with the Secretary, on or before the date the petition is filed, the amount of the imputed underpayment (as of the date of the filing of the petition) if the partnership adjustment was made as provided by the FPA. Section 6234(b)(1). The court may by order provide that the jurisdictional requirements of section 6234(b)(1) have been satisfied where there has been a good

faith attempt to satisfy such requirement and any shortfall of the amount required to be deposited is timely corrected. Any such amount deposited shall not, while deposited, be treated as a payment of tax for purposes of the Code (other than chapter 67 of the Code regarding interest). Section 6234(b)(2).

Under section 6234(c), a court with which a petition has been filed in accordance with section 6234 has jurisdiction to determine all items of income, gain, loss, deduction, or credit of the partnership for the partnership taxable year to which the notice of final partnership adjustment relates as well as the proper allocation of such items among the partners and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under subchapter C of chapter 63 of the Code. Any determination by a court under section 6234 will have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Court of Federal Claims, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision. Section 6234(d). Section 6234(e) provides that if an action brought under section 6234 is dismissed other than by reason of a rescission under section 6231(c), the decision of the court dismissing the action shall be considered as its decision that the FPA is correct, and an appropriate order shall be entered in the records of the court.

Section 6235 provides the period of limitations on making adjustments under the centralized partnership audit regime. Under section 6235(a), the general rule is that no adjustment for any partnership taxable year may be made after the later of three dates. The first date is the date that is three years after the latest of (a) the date on which the partnership return for such taxable year was filed, (b) the return due date for the taxable

year, or (c) the date on which the partnership filed an AAR under section 6227 with respect to such year. The second date is, in the case of any modification of the imputed underpayment under section 6225(c), the date that is 270 days (plus the number of days of any extension consented to by the Secretary under section 6225(c)(7)) after the date on which everything required to be submitted for purposes of modification is so submitted. The third date is, in the case of any NOPPA issued under section 6231(a)(2), the date that is 330 days (plus the number of days of any extension consented to by the Secretary under section 6225(c)(7)) after the date of such notice. Pursuant to section 6235(b), the period described in section 6235(a) (including an extension period under section 6235(b)) may be extended by agreement entered into by the Secretary and the partnership before the expiration of such period.

Section 6235(c) provides special rules in the case of fraud and other situations. In the case of a false or fraudulent partnership return with intent to evade tax or in the case of a failure by a partnership to file a return for a taxable year, an adjustment may be made at any time. Section 6235(c)(1) and (3). If any partnership omits from gross income an amount properly includable in gross income and such amount is described in section 6501(e)(1)(A) (describing situations where more than 25 percent of gross income has been omitted and situations where more than \$5,000 of gross income attributable to one or more assets to which information is required to be reported under section 6038D has been omitted), the period under section 6235(a) is applied by substituting “six” years for “three” years. Section 6235(c)(2). For purposes of section 6235, a return executed by the Secretary under section 6020(b) (concerning returns executed by the Secretary where a person fails to file a return required by the Code or

regulations) on behalf of a partnership shall not be treated as a return of the partnership. Section 6235(c)(4).

If an FPA with respect to any taxable year is mailed under section 6231, the period of limitations on making adjustments under section 6235(a) shall be suspended for the 90-day period during which an action may be brought under section 6234 (and, if a petition is filed under section 6234 with respect to such FPA, until the decision of the court becomes final) and for one year thereafter. Section 6235(d).

Explanation of Provisions

1. Pass-Through Partners and the Section 6226 Push Out Election

Proposed §301.6226-3(e)(1) provides that if a pass-through partner is furnished a statement described in proposed §301.6226-2 (June 14 NPRM) (including a statement described in proposed §301.6226-3(e)(3)(i)), the pass-through partner must take into account the adjustments reflected on that statement by either furnishing statements to its partners that held an interest in the pass-through partner at any time during the taxable year to which the adjustments relate or by paying an amount calculated like an imputed underpayment on the adjustments reflected in the statement plus any applicable penalties and interest. As provided in proposed §301.6226-3(e)(3)(i) and (iv), any statements furnished under these provisions are treated as statements described in proposed §301.6226-2 (June 14 NPRM), and any pass-through partner receiving a statement under proposed §301.6226-3(e)(3)(i) must also take the adjustments reflected on the statement into account by furnishing statements to its partners or paying an amount calculated like an imputed underpayment. Thus, there is an iterative application of the rules under proposed §301.6226-3(e) for tiered

partnership structures allowing the adjustments to be passed along through the tiers to the ultimate non-pass-through partners who then must take the adjustments into account under proposed §301.6226-3(a) and (b) (June 14 NPRM).

Under proposed §301.6226-3(e)(2), if a pass-through partner fails to timely take into account the adjustments in accordance with proposed §301.6226-3(e)(3) or (e)(4), the pass-through partner must take into account the adjustments by paying an amount calculated like an imputed underpayment plus any applicable penalties and interest, in accordance with the rules provided under proposed §301.6226-3(e)(4). As discussed in the Background section of this preamble, this rule is necessary to prevent tiered structures from electing to push out the adjustments to inappropriately shift the burden of collecting the tax due back to the IRS and to avoid paying the tax owed after completion of a partnership audit. Such behavior would frustrate the orderly administration of the election under section 6226 and the collection efforts of the IRS. Without imposing an entity-level liability against those pass-through entities that fail to pay or push out, there would be a disincentive to take any action upon receipt of a push out statement causing the push out election to become a potential vehicle for non-compliance and abuse. Such a result undermines the efficiencies and increased collections intended by enactment of the centralized partnership audit regime.

The additional burden placed on the IRS of locating the partners of pass-through partners, determining the proper allocation of adjustments, and assessing the resulting tax, if any, would frustrate tax administration in the same manner as the TEFRA partnership procedures, which were administratively untenable. The rule that requires a pass-through partner to pay an amount calculated like an imputed underpayment if it

fails to take the adjustments into account significantly alleviates administrative burden, comports with an iterative application of section 6226, and furthers the purpose of the statute by eliminating the ability for a partner to increase costs and inefficiencies of tax administration by failing to comply with the statute.

Proposed §301.6226-3(e)(3) provides the rules for a pass-through partner to take into account the adjustments in the statements furnished to it under proposed §301.6226-2 (June 14 NPRM) by furnishing statements to its own partners. Under proposed §301.6226-3(e)(3)(i), a pass-through partner takes the adjustments into account by furnishing statements to each person who was a partner in the pass-through partner at any time during the taxable year of the pass-through partner to which the adjustments in the statement relate (the “affected partner”). The statements furnished to the affected partners must include all of the information prescribed by proposed §301.6226-3(e)(3)(iii), and the pass-through partner must file the statements with the IRS, along with a transmittal that includes a summary of the statements and any other information required by forms, instructions, and other guidance. Additionally, the rules applicable to statements furnished under proposed §301.6226-2 (June 14 NPRM) are generally applicable to statements furnished under proposed §301.6226-3(e)(3)(i). For example, the rules regarding the address used for the statements mailed to affected partners (proposed §301.6226-2(b)(2) (June 14 NPRM)) and the correction of statements (proposed §301.6226-2(d) (June 14 NPRM)) apply to statements furnished under proposed §301.6226-3(e)(3)(i). However, there are different rules regarding the time for filing and furnishing the statements under proposed §301.6226-3(e)(3)(i), the content of those statements, and how partners of the pass-through partner take the

adjustments into account because the partner of the pass-through partner is not receiving the statement directly from the source partnership.

Under proposed §301.6226-3(e)(3)(ii), statements must be furnished no later than the extended due date for the return for the adjustment year of the partnership that made the election under proposed §301.6226-1 (June 14 NPRM). For purposes of determining the due date for the statements, the extended due date for the return for the adjustment year of the partnership that made the election under proposed §301.6226-1 (June 14 NPRM) is the extended due date under section 6081, regardless of whether the partnership that made the election under proposed §301.6226-1 (June 14 NPRM) is required to file a return for the adjustment year and regardless of whether an extension was actually requested. For example, if the adjustment year of the partnership that made the election under proposed §301.6226-1 (June 14 NPRM) ended on December 31, 2020, the pass-through partner would be required to furnish statements to its affected partners no later than September 15, 2021, the due date, including extensions, of a partnership return for a taxable year ending December 31, 2020. If a pass-through partner fails to issue statements by the due date under proposed §301.6226-3(e)(3)(ii), the pass-through partner has failed to take into account the adjustments as described in proposed §301.6226-3(e)(3).

The statements furnished to the affected partners must contain all of the information described in proposed §301.6226-3(e)(3)(iii) and any other information required by the forms, instructions, or other guidance prescribed by the IRS. This information is necessary for an affected partner to take into account the adjustments reflected in the statement furnished to the partner under these provisions in the correct

year, to identify the source of the adjustments, and for any affected partner that is also a pass-through partner to be able to take into account the adjustments under these provisions by the applicable due dates.

Proposed §301.6226-3(e)(3)(iv) provides that the statements furnished to the affected partners in accordance with proposed §301.6226-3(e)(3) are treated as if they were statements furnished under proposed §301.6226-2 (June 14 NPRM). Accordingly, an affected partner must take into account the adjustments as if the affected partner were a reviewed year partner. Under certain circumstances, the statements furnished to the affected partners may not be furnished until after the unextended due date of the affected partners' returns for the reporting year. To account for this situation, proposed §301.6226-3(e)(3)(iv) provides that the IRS will not impose any additions to tax under section 6651 related to any additional reporting year tax if the affected partner reports and pays any additional reporting year tax within 30 days of the due date for furnishing the statements to the affected partners under proposed §301.6226-3(e)(3)(ii).

Finally, proposed §301.6226-3(e)(3)(v) provides special rules for adjustments subject to withholding under chapters 3 and 4 of the Code. Consistent with the regulations proposed in the November 30 NPRM (regarding certain international tax rules under the centralized partnership audit regime), under proposed §301.6226-3(e)(3)(v), if a pass-through partner takes the adjustments into account by furnishing statements under proposed §301.6226-3(e)(3), the pass-through partner must comply with proposed §301.6226-2(h)(3) (November 30 NPRM) (providing rules for the payment of tax under chapters 3 and 4 when adjustments are pushed out), and an affected partner must comply with proposed §301.6226-3(f) (November 30 NPRM)

(providing rules for partners subject to withholding under chapters 3 and 4) as if the pass-through partner were the partnership that made the election under proposed §301.6226-1 (June 14 NPRM) and the affected partner were the reviewed year partner.

Proposed §301.6226-3(e)(4) provides rules for pass-through partners that take into account the adjustments reflected in a statement furnished under proposed §301.6226-2 (June 14 NPRM) by making a payment. Under proposed §301.6226-3(e)(4), a pass-through partner takes the adjustments into account by paying an amount computed like an imputed underpayment under section 6225 and any penalties and interest and by providing to the IRS the information required by forms, instructions, or other guidance.

Under proposed §301.6226-3(e)(4)(ii), all amounts required to be paid by a pass-through partner must be paid no later than the extended due date for the return for the adjustment year of the partnership that made the election under proposed §301.6226-1 (June 14 NPRM). The due date for paying the amounts required under proposed §301.6226-3(e)(4)(i) is the same as the due date for furnishings statements to partners under proposed 301.6226-3(e)(3)(iii). If a pass-through partner fails to pay and submit the required information by the due date, the pass-through partner has failed to take into account the adjustments as described in proposed §301.6226-3(e)(4).

Proposed §301.6226-3(e)(4)(iii) provides that the amount required to be paid by the pass-through partner is calculated in the same manner as an imputed underpayment under section 6225 and proposed §301.6225-1 (June 14 NPRM) as if the adjustments reflected on the statement furnished to the pass-through partner were partnership adjustments for the first affected year. The pass-through partner must

calculate a payment amount for the first affected year as well as a payment amount for any intervening year by treating the pass-through partner's share of partnership tax attributes for each intervening year as partnership adjustments for that intervening year. In addition, the pass-through partner can take into account modifications approved by the IRS during the audit of the partnership that made the election under proposed §301.6226-1 (June 14 NPRM) and reflected on the statement when determining the payment amount. This will result in a payment amount that more closely approximates the tax that would have been due by the partners of the pass-through partner had the adjustments been reported correctly on the reviewed year return. For instance, if the IRS approved a modification for an indirect partner (as defined in proposed §301.6241-1(a)(4) (June NPRM)) that is a tax-exempt entity, the payment amount computed like an imputed underpayment would be calculated by excluding the adjustments attributable to that tax-exempt indirect partner.

Proposed §301.6226-2(e) (June 14 NPRM) provides that the only modifications that must be included on statements are modifications based on an amended return filed or a closing agreement entered into by the reviewed year partner. Proposed §301.6226-2(e)(5) (June 14 NPRM) is amended. Newly proposed §301.6226-2(e)(5) expands this rule to require that all modifications approved with respect to the reviewed year partner (including any indirect partner that holds its interest in the partnership making the push out election through that reviewed year partner) be included on the statement. This proposed rule was changed to facilitate the calculation of the payment amount under the rules for push out to pass-through partners under proposed

§301.6226-3(e)(4)(iii). To further effectuate this change, proposed §301.6226-2(f)(2) (June 14 NPRM) is also amended in this notice of proposed rulemaking.

A pass-through partner that takes the adjustments into account in accordance with proposed §301.6226-3(e)(4) must also calculate and pay any applicable penalties, additions to tax, and additional amounts. The statement furnished to the pass-through partner must provide information about any penalties applicable to the adjustments allocated to that partner. The pass-through partner calculates the penalties, additions to tax, or additional amounts as if the payment amount required under proposed §301.6226-3(e)(4)(i)(A) were an imputed underpayment due in the first affected year or any intervening year, as applicable. The pass-through partner must also pay any interest in accordance with proposed §301.6226-3(d) (June 14 NPRM) as if the amount required under proposed §301.6226-3(e)(4)(i)(A) were due in the first affected year or any intervening year, as applicable.

In calculating the payment amount as if it were an imputed underpayment, there could be adjustments that would not result in an imputed underpayment (as defined in proposed §301.6225-1(c)(2) (June 14 NPRM)). In these cases, the pass-through partner takes into account the adjustments that do not result in an imputed underpayment in a manner similar to the rule in proposed §301.6225-3 (June 14 NPRM), but in the taxable year of the partnership that includes the date the partnership makes a payment under proposed §301.6226-3(e)(4)(i), or if the partnership has no liability when taking the adjustments into account under proposed §301.6226-3(e)(4), in the taxable year that includes the date the partnership is furnished the statement.

Proposed §301.6226-3(e)(4)(vi) provides rules for coordination with chapters 3 and 4 of the Code. If a pass-through partner pays an amount as described in proposed §301.6226-3(e)(4)(i), proposed §301.6225-1(a)(4) (November 30 NPRM) applies to the pass-through partner as if the pass-through partner were the partnership that made the election under proposed §301.6226-1 (June 14 NPRM). Accordingly, payment of the amount by the pass-through partner means the pass-through partner is treated as having paid the amount required to be withheld with respect to those adjustments under chapters 3 and 4 for purposes of applying §§1.1463-1 and 1.1474-4.

Proposed §301.6226-3(e)(5) clarifies that for purposes of the rules applicable to pass-through partners, S corporations, certain trusts, and estates are treated as a partnership, and their shareholders and beneficiaries are treated as partners. Imposing an amount calculated like an imputed underpayment on all non-compliant pass-through partners is consistent with the iterative application of section 6226 and ensures that the collection burden of a section 6226 election is not inappropriately shifted to the IRS. Accordingly, the rules of proposed §301.6226-3(e) generally apply equally to all pass-through partners, whether they are partnerships, S corporations, certain type of trusts, or estates.

The term “pass-through partner” as defined in proposed §301.6241-1(a)(5) (June 14 NPRM), includes entities that are subject to chapter 1 tax under certain circumstances. For example, certain S corporations are liable for the built-in gains tax under section 1374. Trusts and estates may also be required to take certain items into account at the entity level and pay tax under certain circumstances, but in other circumstances trusts and estates do not take items into account at the entity level.

Instead, the items flow through to their beneficiaries. To account for this, proposed §301.6226-3(e)(6) provides a specific rule to address how these types of entities take into account the adjustments. Under proposed §301.6226-3(e)(6), a pass-through partner must calculate any additional reporting year tax under proposed §301.6226-3(b) (June 14 NPRM) in the same manner as any other non-pass-through partner.

Additionally, if the pass-through partner would be required under chapter 1 to pay tax on only a portion of the adjustments (or a portion of a single adjustment) and flow some or all of the remaining adjustments to its owners or beneficiaries, the proposed regulations accommodate this situation by requiring the pass-through partner to furnish statements to its partners reflecting the adjustments that are properly taken into account by the pass-through partner's owners. For instance, if a trust is a pass-through partner and could be subject to tax under chapter 1 with respect to a partnership adjustment, the trust must calculate and pay its additional reporting year tax as if it were a non-pass through partner. In addition, if it would also be required under ordinary trust reporting rules to report adjustments to its beneficiaries as a result of taking the adjustments into account, the trust must report those adjustments to its beneficiaries who also must take the adjustments into account under proposed §301.6226-3 (June 14 NPRM). Finally, proposed §301.6226-3(e)(6) clarifies that if a pass-through partner that is subject to tax under chapter 1 fails to comply with the provisions of proposed §301.6226-3(e)(6), the rules of proposed §301.6226-3(e)(2) apply, and the pass-through partner will be required to take into account the adjustments under proposed §301.6226-3(e)(4).

Proposed §301.6226-3(j) clarifies that in the case of a disregarded entity or a trust that is a wholly-owned trust (if the trust reports the owner's information to payors

under §1.671-4(b)(2)(i)(A)), the owner of the disregarded entity or the trust must take into account the partnership adjustments. For instance, in the case of a disregarded entity wholly-owned by a C corporation, the C corporation must take into account the adjustments reflected on a statement furnished to the disregarded entity under proposed §301.6226-2 (June 14 NPRM). Accordingly, a partner that is a disregarded entity or wholly-owned trust is disregarded for purposes of taking the adjustments into account under proposed §301.6226-3(j).

In addition to proposing §301.6226-3(e), this notice of proposed rulemaking also adds examples in proposed §301.6226-3(g) to illustrate the concepts of proposed §301.6226-3(e).

2. Adjustments Requested in an Administrative Adjustment Request Taken into Account by a Pass-Through Partner

These proposed regulations also provide rules for pass-through partners to take into account adjustments requested in an AAR if the partnership elects to have its partners take into account the adjustments (or if the partnership is required to have its partners take into account the adjustments). The proposed regulations generally follow the rules in proposed §301.6226-3(e), with modifications to accommodate the rules applicable to AARs.

3. Penalties, Additions to Tax, and Additional Amounts in the Case of Section 6226 Push Out Election

Proposed §301.6226-3(i) provides the rules for the calculation of penalties, additions to tax, and additional amounts by the partner when a partnership has made an

election under section 6226. The applicability of any penalties, additions to tax, and additional amounts with respect to a partnership adjustment are determined at the partnership level in accordance with section 6221(a). Under proposed §301.6226-3(i)(2), when each partner takes the adjustments into account under section 6226 and proposed §301.6226-3 (June 14 NPRM), the partner must compute any penalties, additions to tax, or additional amounts applying any applicable rules or thresholds based on the particular facts and circumstances of that partner as if each correction amount were an underpayment or understatement for the first affected year (or intervening year, if applicable). Changes were made to other provisions in the June 14 NPRM to conform to the addition of proposed §301.6226-3(i).

Proposed §301.6226-3(i)(3) provides that a partner may assert a defense against a penalty based on a defense that is personal to the partner (partner-level defense), such as reasonable cause or good faith, by first paying the tax and penalty due and then filing a claim for refund that asserts the partner's specific penalty defense.

Proposed §301.6226-2(e)(7) (June 14 NPRM) is amended in this notice of proposed rulemaking. Under proposed §301.6226-2(e)(7) (as modified in these proposed regulations), instead of providing the reviewed year partner's share of any penalties, additions to tax, or additional amounts on the statement furnished to the reviewed year partner under proposed §301.6226-2 (June 14 NPRM), the partnership provides the applicability of any penalty, additions to tax, or additional amounts and the adjustments to which those penalties, additions to tax, or additional amounts relate. Under this proposed rule, the partnership furnishes the reviewed year partner the reviewed year partner's share of the adjustments to which the penalties, additions to

tax, and additional amounts relate and other information such as the applicable rate of any penalty and the Code section under which the penalty, addition to tax, or additional amount was imposed.

Proposed §301.6226-3(b)(4) (June 14 NPRM) is amended by removing the last sentence from the June 14 NPRM, which read “A deficiency dividend deduction under this paragraph (b)(4) and section 860(a) has no effect on a QIE’s liability for any penalties reflected in a statement described in §301.6226-2(a).” This change reflects that, under proposed §301.6226-3(i), a partner who is furnished a statement under proposed §301.6226-2 (June 14 NPRM) is not furnished its share of the penalty amount determined at the partnership level but instead must calculate the penalty utilizing the normal penalty rules applicable under the Code.

Proposed §301.6226-3(a) (June 14 NPRM) is amended below. The amended §301.6226-3(a) changes the requirement that reviewed year partners pay the reviewed year partner’s share of any penalties, additions to tax, or additional amounts, to a requirement that the reviewed year partner must calculate and pay any penalties, additions to tax, or additional amounts as determined under proposed §301.6226-3(i). In addition, proposed §301.6226-3(d)(3) (June 14 NPRM) regarding interest on penalties is amended below. Amended §301.6226-3(d)(3) conforms to the addition of proposed §301.6226-3(i) by providing that the reviewed year partner calculates and pays interest on any penalties, additions to tax, or additional amounts calculated by the partner instead of on the share of penalties, additions to tax, or additional amounts reflected in the statement furnished to the partner.

Finally, Example 1 in proposed §301.6226-3(g) (June 14 NPRM) and Example 6 in proposed §301.6226-3(g) (November 30 NPRM) are amended below with changes that conform to proposed §301.6226-3(i).

4. Changes to the June 14 NPRM to Reflect the Removal of the Safe Harbor

As described in the Background section of this preamble, these proposed regulations amended proposed §301.6226-2(g) (June 14 NPRM) and proposed §301.6226-3(c) and (d)(2) (June 14 NPRM) which concern the calculation of, and the election to pay, the safe harbor amount and interest safe harbor amount. In addition, these proposed regulations make conforming changes to the proposed rules in the June 14 NPRM to reflect the removal of the safe harbor amount and interest safe harbor amount. Proposed §§301.6226-1(d), 301.6226-3(a), and 301.6227-3(b)(1) (June 14 NPRM) are amended below. Finally, Examples 1, 2, 3, 4, and 5 in proposed §301.6226-3(g) (June 14 NPRM) and Example 6 in proposed §301.6226-3(g) (November 30 NPRM) are amended to reflect the removal of the safe harbor and interest safe harbor. See Examples 1, 2, 3, 4, 5 and 6 of proposed §301.6226-3(g).

5. Notices of Proceedings and Adjustments

Proposed §301.6231-1 provides rules with respect to the NAP described in section 6231(a)(1), the NOPPA described in section 6231(a)(2), and the FPA described in section 6231(a)(3). Under proposed §301.6231-1(c), such notices are sufficient if mailed to the last known address of the partnership and the partnership representative. An FPA may not be mailed earlier than 270 days after the date on which the NOPPA was mailed. Proposed §301.6231-1(b)(2) permits a partnership to waive this restriction to allow the IRS to mail the FPA before the expiration of the 270-day period.

Nothing in the centralized partnership audit regime limits the period for IRS to propose adjustments, and section 6231 does not restrict when a NOPPA may be mailed by the IRS. However, a reasonable time limit within which partnership adjustments must be proposed under the centralized partnership audit regime will provide certainty to partnerships and the IRS. Partnerships will know when a taxable year is no longer subject to audit, and the IRS will be better able to allocate resources for examinations under the centralized partnership audit regime. Accordingly, proposed §301.6231-1(b)(1) imposes a time limit on when adjustments may be proposed for a particular taxable year by providing that a NOPPA may not be mailed after the expiration of the period described in section 6235(a)(1), including any extensions of that period and after applying any of the special rules in section 6235(c) (providing additional time for situations where no return is filed, fraud, etc.). Once a NOPPA is mailed, the time period for mailing the FPA in order to make a final partnership adjustment is generally governed by section 6235(a)(2) or (3).

Proposed §301.6231-1(f) and (g) provide rules for withdrawal of a NAP or a NOPPA and rescission of an FPA. Section 6231(c) provides that rescission of “any notice of a partnership adjustment” requires consent of the partnership. Because the NAP merely notifies the partnership of the initiation of an examination and the NOPPA only proposes an adjustment, neither of these notices is a notice of a partnership adjustment for purposes of the consent requirement in section 6231(c). Accordingly, proposed §301.6231-1(g) requires consent of the partnership before rescission of an FPA, but proposed §301.6231-1(f) does not require consent of the partnership before withdrawing a NAP or a NOPPA.

In the November 30 NPRM, the Treasury Department and the IRS discussed the coordination of the special rules in section 905(c) (relating to certain adjustments to foreign tax credits) with the centralized partnership audit regime. The Treasury Department and the IRS specifically requested comments regarding whether the AAR process can be utilized for purposes of satisfying the notification requirements of section 905(c) with respect to foreign tax redeterminations relating to a foreign tax reported by a partnership as a creditable foreign tax expenditure. If the AAR process can be used, section 905(c) would possibly represent an exception to the normal timing rules discussed in the Explanation of Provisions section of this preamble, just as it represents a departure from the ordinary timing rules in circumstances outside the scope of the centralized partnership audit regime. If the AAR process can be adopted for section 905(c) purposes, these proposed regulations may be modified in separate guidance to account for that process.

6. Assessment, Collection, and Payment of Imputed Underpayments

Proposed §301.6232-1(a) restates the rule in section 6232(a) that any imputed underpayment determined under the centralized partnership audit regime must be assessed and collected as if the imputed underpayment were a tax imposed by subtitle A of the Code for the adjustment year. However, proposed §301.6232-1(a) also clarifies that because the centralized partnership audit regime under subchapter C of chapter 63 applies, the deficiency procedures under subchapter B of chapter 63 do not apply to an assessment of an imputed underpayment. Section 6232(b) and proposed §301.6232-1(c) explicitly provide the limitations on assessments under the centralized partnership audit regime. Generally, an imputed underpayment determined by the IRS

may be assessed only after the IRS sends an FPA, and the partnership has a chance to seek judicial review.

Proposed §301.6232-1(d)(1) describes exceptions to the restrictions on assessment, including the rules for assessment of amounts attributable to partnership adjustments on account of mathematical or clerical errors or where a partnership-partner (as defined in proposed §301.6241-1(a)(7) (June 14 NPRM)) is treated as if it had a mathematical or clerical error on its return because it failed to treat items consistently with the partnership's treatment of the items pursuant to section 6222(a). Any resulting assessment of an imputed underpayment attributable to that adjustment is not subject to the limitations under section 6232(b) and proposed §301.6232-1(c), and therefore may be assessed without the issuance of an FPA.

Under proposed §301.6232-1(d)(1)(ii)(A), the partnership generally has 60 days to request abatement of the assessment attributable to the mathematical or clerical error, and the IRS must abate the assessment. Consistent with section 6232(d), under proposed §301.6232-1(d)(1)(ii)(B), this rule does not apply if the assessment is attributable to an adjustment of an inconsistent item on a partnership-partner's return. However, the IRS intends to develop pre-assessment processes to provide the partnership-partner with an opportunity to correct the inconsistency by filing an AAR under section 6227 or, in situations where the partnership-partner has made an election under section 6221(b), an amended partnership return. Therefore, proposed §301.6232-1(d)(1)(ii)(B) provides that prior to assessment a partnership-partner that has failed to comply with section 6222(a) may correct the inconsistency by filing an AAR under section 6227 or an amended partnership return, as appropriate. Additionally,

proposed §301.6232-1(d)(1)(ii)(B) authorizes a partnership-partner that has elected out of the centralized partnership audit regime under section 6221(b) to furnish amended statements to its partners. This rule provides the consent required by section 6031(b), which prohibits a partnership from amending information required to be furnished by the partnership to its partners after the due date of the return, except as provided by the IRS.

Proposed §301.6232-1(d)(1)(iii) addresses the situation in which a partnership-partner that elected out of the centralized partnership audit regime pursuant to section 6221(b) for the reviewed year has failed to comply with section 6222(a). Under proposed §301.6232-1(d)(1)(iii), any tax resulting from an adjustment due to such partnership-partner's failure to comply with section 6222(a) may be assessed against the partners (or indirect partners) of the partnership-partner. The tax may be assessed in the same manner as if the tax were on account of a mathematical or clerical error appearing on the partner's or indirect partner's return. In accordance with section 6232(d)(1)(B), the procedures under section 6213(b)(2) for requesting abatement of such an assessment will not apply.

7. Interest and Penalties Related to Imputed Underpayments

A. Interest and penalties determined from the reviewed year

Proposed §301.6233(a)-1(a) provides that except to the extent provided in section 6226(c) and the regulations thereunder, in the case of a partnership adjustment for a reviewed year of the partnership, a partnership is liable for interest as computed under proposed §301.6233(a)-1(b) and for any penalty, addition to tax, or additional amount as determined in proposed §301.6233(a)-1(c).

Proposed §301.6233(a)-1(b) provides that interest with respect to an imputed underpayment is the interest that would be imposed under chapter 67 of the Code if the imputed underpayment were treated as an underpayment of tax for the reviewed year. Proposed §301.6233(a)-1(b) further provides that interest on such imputed underpayment begins on the day after the due date of the partnership return for the reviewed year and ends on the earlier of the date prescribed for payment (as described in proposed §301.6232-1(b)), the return due date of the partnership return for the adjustment year, or the date the imputed underpayment is fully paid by the partnership.

Proposed §301.6233(a)-1(c)(1) provides that the penalties, additions to tax, or additional amounts determined with respect to a partnership adjustment are those penalties, additions to tax, or additional amounts that would be imposed under part II of subchapter A of chapter 68 of the Code by treating the imputed underpayment as an underpayment (or understatement) of tax for the reviewed year and by treating the partnership as if it had been an individual subject to tax imposed by chapter 1 of subtitle A of the Code for the reviewed year.

Proposed §301.6233(a)-1(c)(2) coordinates the rules for determining penalties related to imputed underpayments with the accuracy-related and fraud penalties under sections 6662, 6662A, and 6663. Proposed §301.6233(a)-1(c)(2)(ii) provides rules to determine the portion of an imputed underpayment subject to penalties when there is at least one adjustment with respect to which no penalty has been imposed and at least one with respect to which a penalty has been imposed, or where there are at least two adjustments with respect to which penalties have been imposed and the penalties have been imposed at different rates. The rules under proposed §301.6233(a)-1(c)(2)(ii)

extend the existing ordering rules under §1.6664-3 to partnerships subject to the centralized partnership audit regime.

Proposed §301.6233(a)-1(c)(2)(ii)(B) provides that when computing the portion of the imputed underpayment subject to penalties under sections 6662, 6662A, and 6663, partnership adjustments that did not result in the imputed underpayment are not taken into account. To determine the portion of the imputed underpayment subject to a penalty, partnership adjustments are first grouped together according to whether the adjustments are subject to penalty and if so, by rate of penalty. Negative adjustments as defined in proposed §301.6233(a)-1(c)(2)(ii)(C) are included in these groupings according to the allocation rule in proposed §301.6233(a)-1(c)(2)(ii)(D) and are netted against the positive adjustments within each grouping to the extent provided in proposed §301.6233(a)-1(c)(2)(ii)(E). After grouping the partnership adjustments, each non-credit adjustment within a grouping is multiplied by the rate that applied to such adjustment when determining the imputed underpayment. After the appropriate rate is applied to each adjustment, the results within a grouping are totaled. The total within each grouping is then adjusted to account for any credit adjustments. The result is the portion of the imputed underpayment that is subject to the penalty rate corresponding to the grouping.

Proposed §301.6233(a)-1(c)(2)(ii)(F) through (iv) provide clarifying rules for applying the penalties for fraud under section 6663, reportable transaction understatements under section 6662A, and substantial understatements of tax under section 6662(d) to imputed underpayments determined under the centralized partnership audit regime.

Proposed §301.6233(a)-1(c)(2)(v) provides rules for application of the reasonable cause and good faith exception to the penalties under sections 6662, 6662A, and 6663. See sections 6664(c) and (d). Proposed §301.6233(a)-1(c)(2)(v) provides that for these purposes the partnership is treated as the taxpayer and, therefore, the facts and circumstances taken into account in determining whether the partnership has established reasonable cause and good faith are those facts and circumstances applicable to the partnership. This may include facts and circumstances with respect to partners or other individuals acting on behalf of the partnership. In addition, proposed §301.6233(a)-1(c)(2)(v) provides that any partner-level defense, for example a reasonable cause defense that is based on the personal circumstances of the partner, will not be considered in a partnership-level proceeding except in accordance with the amended return and closing agreement modification procedures set forth in the regulations under section 6225(c) and proposed §301.6225-2 (June 14 NPRM).

B. Interest and penalties from the adjustment year

Proposed §301.6233(b)-1(a) provides rules that apply when a partnership fails to pay an imputed underpayment by the date prescribed for such payment. In the case of such a failure, proposed §301.6233(b)-1(a) provides that the partnership is liable for interest, as well as any penalties, additions to tax, and additional amounts as determined under proposed §301.6233(b)-1(b) and (c). Proposed §301.6233(b)-1(b) clarifies that these rules apply to the portion of an imputed underpayment resulting from partnership adjustments determined by the IRS under section 6225(a)(1) that is unpaid after the date prescribed for payment under proposed §301.6232-1(b) (the date stated in a notice and demand) and to the portion of an imputed underpayment resulting from

adjustments requested by the partnership in an AAR under section 6227 that is unpaid after the date the AAR is filed.

8. Judicial Review of Partnership Adjustments

Proposed §301.6234-1 provides rules relating to judicial review of partnership adjustments. Proposed §301.6234-1(b) and (c) describe the jurisdictional deposit requirement for partnerships that wish to bring an action in a United States district court or the Court of Federal Claims and explain how the jurisdictional deposit is treated for purposes of the Code. Under proposed §301.6234-1(c), although the deposit is not generally treated as a payment of tax, the deposit will stop additional interest from accruing under section 6233(a) on the imputed underpayment. In addition, interest will be allowed and paid in accordance with section 6611. The Treasury Department and the IRS request comments on when interest under section 6611 should begin to run in this context.

In response to Notice 2016-23, 2016-13 I.R.B. 490 (March 28, 2016), which requested comments on the new centralized audit regime, one commenter requested that the IRS clarify that only a dismissal on the merits and with prejudice be considered a dismissal within the meaning of section 6234(e). This comment was not adopted. Section 6234 explicitly provides that any decision of the court dismissing the action “shall be considered as [the court’s] decision that the [FPA] is correct.” The only exception provided in section 6234 is in the case of a dismissal by reason of the rescission of an FPA under section 6231(c). See also JCS-1-16, at 75 (stating that “a decision to dismiss the proceeding (other than a dismissal because the [FPA] was rescinded under section 6231(c)), is a judgment on the merits upholding the final

partnership adjustments”). Accordingly, proposed §301.6234-1(e) reflects the language in section 6234(e) without the limitation suggested in the comment.

9. Period of Limitations on Making Adjustments

Proposed §301.6235-1 reflects the rules in section 6235 regarding the period within which the IRS must mail an FPA to make a partnership adjustment for a partnership taxable year. Under these rules, an FPA generally must be mailed before the later of: (1) three years from the later of the date the partnership return is filed or due, or the date an AAR with respect to the year is filed (see proposed §301.6235-1(a)(1)); (2) 270 days after the date everything required for a modification is submitted plus any extension of time granted by the IRS with respect to a request for modification under section 6225(c)(7) (see proposed §301.6235-1(b)); or (3) 330 days after the date of the NOPPA plus any extension of time granted by the IRS with respect to a request for modification under section 6225(c)(7) (see proposed §301.6235-1(c)). The 3-year period described under proposed §301.6235-1(a)(1) (plus any extensions of the period under proposed §301.6235-1(d) and taking into account any special rules under section 6235(c)) is also the time period within which the IRS must mail a NOPPA. See proposed §301.6231-1(b)(1).

The proposed regulations do not currently incorporate any rules outside of subchapter C of chapter 63 of the Code that might extend this period. As discussed in the Explanation of Provisions section of this preamble and in the November 30 NPRM, if the AAR process can be used to coordinate sections 905(c) and the adjustment rules under the centralized partnership audit regime, the proposed regulations may need to be modified to account for redeterminations under section 905(c). The Treasury

Department and the IRS request comments on whether additional guidance would be helpful with respect to any other specific provision, outside of subchapter C of chapter 63 of the Code, which might extend the adjustment period under the centralized partnership audit regime.

Once a NOPPA is mailed, proposed §301.6235-1(c) provides that the IRS will have at least 330 days from the date of the NOPPA to make a partnership adjustment regardless of whether the partnership requests modification of the imputed underpayment.

If the partnership requests modification of an imputed underpayment, proposed §301.6235-1(b) provides that the IRS will have at least 270 days from the date on which everything required to be submitted pursuant to section 6225(c) is so submitted to the IRS to make a partnership adjustment. Proposed §301.6235-1(b)(2) provides that, for purposes of section 6235(a)(2), the date on which everything required to be submitted pursuant to section 6225(c) is so submitted to the IRS is the earlier of: (1) the date on which the time for submitting the modification request and information (as described in proposed §301.6225-2(c)(3)(i) (June 14 NPRM)) ends (including extensions); or (2) the date on which the partnership and the IRS agree to waive the 270-day period under proposed §301.6231-1(b)(2)(ii) (June 14 NPRM) before an FPA can be mailed.

Therefore, once a NOPPA has been mailed, the IRS will have 330 days from the date the NOPPA is mailed to make a partnership adjustment and in general may have up to 540 days (270 days in the modification period and 270 days from the end of the modification period) from the date the NOPPA is mailed if there are no extensions or waivers executed by the taxpayer.

Proposed §301.6235-1(d) provides that any of the periods described in proposed §301.6235-1(a), (b), and (c) may be extended by an agreement, in writing, entered into by the partnership and the IRS before the expiration of such period. A partnership and the IRS may also agree to extend a period of time that has already been extended under proposed §301.6235-1(d).

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. Because the proposed regulations would not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. The

Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, then notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Jennifer M. Black, Joy E. Gerdy-Zogby, Brittany Harrison, and Steven L. Karon of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301--PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to be read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§301.6221(a)-1 [Amended]

Par. 2. Section 301.6221(a)-1, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by removing and reserving paragraph (c).

Par. 3. Section 301.6225-2, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by adding paragraph (d)(2)(viii) to read as follows:

§301.6225-2 Modification of imputed underpayment.

* * * * *

(d) * * *

(2) * * *

(viii) Penalties. The applicability of any penalties, additions to tax, or additional amounts that relate to a partnership adjustment is determined at the partnership level in accordance with section 6221(a). However, the amount of penalties, additions to tax, and additional amounts a reviewed year partner (or indirect partner) must pay under paragraph (d)(2)(ii) of this section for the first affected year (as defined in §301.6226-3(b)(2)) and for any modification year (as described in paragraph (d)(2)(iv) of this section) is based on the underpayment or understatement of tax, if any, that results from taking into account the adjustments in the first affected year or the modification year, as applicable. For instance, if after taking into account the adjustments, the partner would not have an underpayment, or has an understatement that falls below the applicable threshold for the imposition of a penalty, in the first affected year or any modification year, no penalty would be due from that partner for such year. A partner's claim that there is reasonable cause under section 6664(c) (or other partner-level defense as described in §301.6226-3(i)(3)) for an underpayment or understatement described in this paragraph (d)(2)(viii) may be submitted with an amended return filed under paragraph (d)(2) of this section, but only if the partner pays all tax, penalties, and interest due in accordance with paragraph (d)(2)(ii) of this section.

* * * * *

Par. 4. Section 301.6226-1, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by revising paragraph (d) to read as follows:

§301.6226-1 Election for an alternative to the payment of the imputed underpayment.

* * * * *

(d) Binding nature of statements. The election under this section, which includes filing and furnishing statements described in §301.6226-2, are actions of the partnership under section 6223 and the regulations thereunder and, unless determined otherwise by the IRS, the partner's share of the adjustments and the applicability of any penalties, additions to tax, and additional amounts as set forth in the statement are binding on the partner pursuant to section 6223. Accordingly, a partner may not treat items reflected on a statement described in §301.6226-2 on the partner's return inconsistently with how those items are treated on the statement that is filed with the IRS. See §301.6222-1(c)(2) (regarding items the treatment of which a partner is bound to under section 6223).

* * * * *

Par. 5. Section 301.6226-2, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by:

- a. Revising paragraphs (e)(5) and (7).
- b. Removing and reserving paragraph (e)(8).
- c. Revising paragraph (f)(2).
- d. Removing paragraph (f)(3).
- e. Removing and reserving paragraph (g).

The revisions read as follows:

§301.6226-2 Statements furnished to partners and filed with the IRS.

* * * * *

(e) * * *

(5) Modifications approved by the IRS with respect to the reviewed year partner (or with respect to any indirect partner (as defined in §301.6241-1(a)(4)) that holds its interest in the partnership through its interest in the reviewed year partner);

* * * * *

(7) The applicability of any penalty, addition to tax, or additional amount determined at the partnership level that relates to any adjustments allocable to the reviewed year partner and the adjustments to which the penalty, addition to tax, or additional amount relates, the section of the Internal Revenue Code under which each penalty, addition to tax, or additional amount is imposed, and the applicable rate of each penalty, addition to tax, or additional amount determined at the partnership level;

* * * * *

(f) * * *

(2) Treatment of modifications disregarded. Any modifications approved by the IRS with respect to the reviewed year partner (or with respect to any indirect partner (as defined in §301.6241-1(a)(4)) that holds its interest in the partnership through its interest in the reviewed year partner) under §301.6225-2 are disregarded for purposes of determining each partner's share of the adjustments under paragraph (f)(1) of this section.

* * * * *

Par. 6. Section 301.6226-3, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by:

- a. Revising paragraphs (a) and (b)(4).
- b. Removing and reserving paragraphs (c) and (d)(2).
- c. Revising paragraphs (d)(3), (e), and (g).
- d. Adding paragraphs (i) and (j).

The revisions and additions read as follows:

§301.6226-3 Adjustments Taken Into Account by Partners.

(a) Tax imposed by chapter 1 increased by additional reporting year tax. The tax imposed by chapter 1 of subtitle A of the Internal Revenue Code (chapter 1 tax) for each reviewed year partner (as defined in §301.6241-1(a)(9)) for the taxable year that includes the date a statement was furnished in accordance with §301.6226-2 (the reporting year) is increased by the additional reporting year tax. The additional reporting year tax is the aggregate of the adjustment amounts (determined in accordance with paragraph (b) of this section). In addition to being liable for the additional reporting year tax, a reviewed year partner must also calculate and pay for the reporting year any penalties, additions to tax, and additional amounts (as determined under paragraph (i) of this section). Finally, a reviewed year partner must also calculate and pay for the reporting year any interest (as determined under paragraph (d) of this section).

(b) * * *

(4) Coordination of sections 860 and 6226. If a qualified investment entity (QIE) within the meaning of section 860(b) receives a statement described in §301.6226-2(a)

and correctly makes a determination within the meaning of section 860(e)(4) that one or more of the adjustments reflected in the statement is an adjustment within the meaning of section 860(d) with respect to that QIE for a taxable year, the QIE may distribute deficiency dividends within the meaning of section 860(f) for that taxable year and avail itself of the deficiency dividend procedures set forth in section 860. If the QIE utilizes the deficiency dividend procedures with respect to adjustments in a statement described in §301.6226-2(a), the QIE may claim a deduction for deficiency dividends against the adjustments furnished to the QIE in the statement in calculating any correction amounts under paragraphs (b)(2) and (3) of this section, and interest on such correction amounts under paragraph (d) of this section, to the extent that the QIE makes deficiency dividend distributions under section 860(f) and complies with all requirements of section 860 and the regulations thereunder.

* * * * *

(d) * * *

(3) Interest on penalties. Interest on any penalties, additions to tax, or additional amounts determined under paragraph (i) of this section is calculated at the rate set forth in paragraph (d)(4) of this section from the due date (without extension) of the reviewed year partner's return for the first affected year (as defined in paragraph (b)(2) of this section) until the amount is paid.

* * * * *

(e) Pass-through partners—(1) In general. Except as provided in paragraph (e)(6) of this section, if a pass-through partner (as defined in §301.6241-1(a)(5)) is furnished a statement described in §301.6226-2 (including a statement described in

paragraph (e)(3)(i) of this section) with respect to adjustments of a partnership that made an election under §301.6226-1, the pass-through partner must take into account the adjustments reflected on that statement in accordance with either paragraph (e)(3) or (4) of this section.

(2) Failure to take into account adjustments. If any pass-through partner fails to take into account the adjustments reflected on a statement described in §301.6226-2 in accordance with paragraph (e)(3), (4), or (6) of this section, the pass-through partner must pay an amount that is calculated like an imputed underpayment, as well as any penalties, additions to tax, additional amounts, and interest with respect to such adjustments as described under paragraph (e)(4) of this section.

(3) Furnishing statements to partners—(i) In general. A pass-through partner described in paragraph (e)(1) of this section takes into account the adjustments under paragraph (e)(3) of this section by furnishing a statement that includes the items required by paragraph (e)(3)(iii) of this section to the partners that held an interest in the pass-through partner at any time during the taxable year of the pass-through partner to which the adjustments in the statement furnished to the pass-through partner relate (affected partner). The statements described in this paragraph (e)(3)(i) must be filed with the IRS, along with a transmittal that includes a summary of all statements filed under this paragraph (e)(3)(i), and such other information as required in forms, instructions, and other guidance, by the due date prescribed in paragraph (e)(3)(ii) of this section. Except as otherwise provided in paragraphs (e)(3)(ii), (iii), and (v) of this section, the rules applicable to statements described in §301.6226-2 are applicable to statements described in this paragraph (e)(3)(i).

(ii) Time for filing and furnishing the statements. The pass-through partner must file with the IRS and furnish to its affected partners the statements described in paragraph (e)(3)(i) of this section no later than the extended due date for the return for the adjustment year (as defined in §301.6241-1(a)(1)) of the partnership that made the election under §301.6226-1. For purposes of the preceding sentence, the extended due date is the extended due date under section 6081 regardless of whether the partnership that made the election under §301.6226-1 is required to file a return for the adjustment year or timely files a request for an extension under section 6081 and the regulations thereunder.

(iii) Contents of statements. Each statement described in paragraph (e)(3)(i) of this section must include the following information –

(A) The name and correct taxpayer identification number (TIN) of the partnership that made the election under §301.6226-1 with respect to the adjustments reflected on the statements described in paragraph (e)(3)(i) of this section;

(B) The adjustment year of the partnership described in paragraph (e)(3)(iii)(A) of this section;

(C) The extended due date for the return for the adjustment year of the partnership described in paragraph (e)(3)(iii)(A) of this section (as described in paragraph (e)(3)(ii) of this section);

(D) The date on which the partnership described in paragraph (e)(3)(iii)(A) of this section furnished its statements required under §301.6226-2(b);

(E) The name and correct TIN of the partnership that furnished the statement to the pass-through partner if different from the partnership described in paragraph (e)(3)(iii)(A) of this section;

(F) The name and correct TIN of the pass-through partner;

(G) The pass-through partner's taxable year to which the adjustments reflected on the statements described in paragraph (e)(3)(i) of this section relates;

(H) The name and correct TIN of the affected partner to whom the statement is being furnished;

(I) The current or last address of the affected partner that is known to the pass-through partner;

(J) The affected partner's share of items as originally reported to such partner under section 6031(b) and, if applicable, section 6227, for the taxable year to which the adjustments reflected on the statement furnished to the pass-through partner relate;

(K) The affected partner's share of partnership adjustments determined under §301.6226-2(f)(1) as if the affected partner were the reviewed year partner and the partnership were the pass-through partner;

(L) Modifications approved by the IRS with respect to the affected partner or an indirect partner (as defined in §301.6241-1(a)(4)) that holds its interest in the partnership that made the election under §301.6226-1 through the affected partner;

(M) The affected partner's share of any amounts attributable to adjustments to tax attributes (as defined in §301.6241-1(a)(10)) for any intervening year (as defined in paragraph (b)(3) of this section) resulting from the adjustments in the reviewed year with respect to the partnership described in paragraph (e)(3)(iii)(A) of this section;

(N) The applicability of any penalties, additions to tax, or additional amounts that relate to any adjustments allocable to the affected partner (as determined under §301.6226-2(f)(3)) and the adjustments allocated to the affected partner to which such penalties, additions to tax, or additional amounts relate, the section of the Internal Revenue Code under which each penalty, addition to tax, or additional amount is imposed, and the applicable rate of each penalty, addition to tax, or additional amount; and

(O) Any other information required by forms, instructions, and other guidance prescribed by the IRS.

(iv) Affected partner must take into account the adjustments. A statement furnished to an affected partner in accordance with paragraph (e)(3) of this section is treated as if it were a statement described in §301.6226-2. An affected partner that is a pass-through partner must take into account its share of the adjustments reflected on such a statement in accordance with paragraph (e) of this section. An affected partner that is not a pass-through partner must take into account its share of the adjustments reflected on such a statement in accordance with this section by treating references to “reviewed year partner” as “affected partner”. For purposes of this paragraph (e)(3)(iv), an affected partner that is not a pass-through partner takes into account the adjustments in accordance with this section by determining its reporting year based on the date upon which the partnership that made the election under §301.6226-1 furnished its statements to its reviewed year partners (as described in paragraph (a) of this section). No addition to tax under section 6651 related to any additional reporting year tax will be imposed if an affected partner that is not a pass-through partner reports

and pays the additional reporting year tax within 30 days of the extended due date for the return for the adjustment year of the partnership that made the election under §301.6226-1 (as described in paragraph (e)(3)(ii) of this section).

(v) Adjustments subject to chapters 3 and 4 of the Internal Revenue Code. If a pass-through partner furnishes statements to its affected partners in accordance with paragraph (e)(3) of this section, the pass-through partner must comply with the requirements of §301.6226-2(h)(3), and an affected partner must comply with the requirements of paragraph (f) of this section. For purposes of applying both §301.6226-2(h)(3) and paragraph (f) of this section, as appropriate, references to the “partnership” should be replaced with references to the “pass-through partner”; references to the “reviewed year partner” should be replaced with references to the “affected partner”; references to the statement required under paragraph (a) of this section and its due date should be replaced with references to the statement required under paragraph (e)(3)(i) of this section and its due date described in paragraph (e)(3)(ii) of this section; and references to the “reporting year” should be read in accordance with paragraph (e)(3)(iv) of this section.

(4) Pass-through partner makes a payment--(i) In general. A pass-through partner that is furnished a statement described in §301.6226-2 takes into account the adjustments reflected on that statement under paragraph (e)(4) of this section when the pass-through partner—

(A) Pays an amount computed under paragraph (e)(4)(iii) of this section;

(B) Pays any penalties, additions to tax, and additional amounts and interest computed under paragraph (e)(4)(iv) of this section; and

(C) Provides the IRS with information related to such payment as required by forms, instructions, and other guidance.

(ii) Time of payment. A pass-through partner must report and pay the amounts described in paragraphs (e)(4)(i)(A) and (B) of this section in accordance with forms, instructions, and other guidance no later than the extended due date for the return for the adjustment year of the partnership that made the election under §301.6226-1. For purposes of the preceding sentence, the extended due date is the extended due date under section 6081 regardless of whether the partnership that made the election under §301.6226-1 is required to file a return for the adjustment year or timely filed a request for an extension under section 6081 and the regulations thereunder.

(iii) Computation of payment amount. The payment required under paragraph (e)(4)(i)(A) of this section is computed in the same manner as an imputed underpayment is calculated under section 6225 and §301.6225-1 by treating the adjustments reflected on the statement furnished to the pass-through partner under §301.6226-2 as partnership adjustments (as defined in §301.6241-1(a)(6)) for the first affected year. Separate calculations must also be made for each intervening year by treating the pass-through partner's share of partnership tax attributes for each intervening year as partnership adjustments for that intervening year. The sum of the amounts calculated for the first affected year and each intervening year under this paragraph (e)(4)(iii) is the payment required under paragraph (e)(4)(i)(A) of this section. Any modification approved by the IRS under §301.6225-2 with respect to the pass-through partner (including any modifications with respect to an indirect partner that holds its interest in the partnership that made the election under §301.6226-1 through

its interest in the pass-through partner) reflected on the statement furnished to the pass-through partner under §301.6226-2 (or paragraph (e)(3) of this section) is taken into account in calculating the amounts under this paragraph (e)(4)(iii).

(iv) Penalties and interest—(A) Penalties. A pass-through partner must compute and pay any applicable penalties, additions to tax, and additional amounts on the amounts calculated under paragraph (e)(4)(iii) of this section as if such amounts were actual imputed underpayments for the pass-through partner's first affected year or any intervening year, as applicable. See §301.6233-1(c).

(B) Interest. A pass-through partner must pay interest on the amounts calculated under paragraph (e)(4)(iii) of this section in accordance with paragraph (d) of this section as if such amounts were amounts due for the first affected year or any intervening year, as applicable.

(v) Adjustments that do not result in an imputed underpayment. Adjustments taken into account under paragraph (e)(4) of this section that would not result in an imputed underpayment (as defined in §301.6225-1(c)(2)) if the amounts calculated under paragraph (e)(4)(iii) of this section were actual imputed underpayments are taken into account by the pass-through partner in accordance with §301.6225-3 in the taxable year of the pass-through partner that includes the date the payment required under paragraph (e)(4)(i)(A) of this section is made or, if no payment is required under paragraph (e)(4)(i)(A) of this section, the date the statement described in §301.6226-2 (or paragraph (e)(3)(i) of this section) is furnished to the pass-through partner.

(vi) Coordination with chapters 3 and 4 of the Code. If a pass-through partner pays an amount computed under paragraph (e)(4)(iii) of this section, §301.6225-1(a)(4) applies to the pass-through partner by substituting "pass-through partner" for

“partnership” where §301.6225-1(a)(4) refers to the partnership that made the election under §301.6226-1.

(5) Treatment of pass-through partners that are not partnerships--(i) S corporations. For purposes of paragraph (e) of this section, an S corporation is treated as a partnership and its shareholders are treated as partners.

(ii) Trusts and estates. Except as provided in paragraph (j) of this section, for purposes of paragraph (e) of this section, a trust and its beneficiaries, and an estate and its beneficiaries are treated in the same manner as a partnership and its partners.

(6) Pass-through partners subject to chapter 1 tax. A pass-through partner that is subject to tax under chapter 1 of the Code for the first affected year or any intervening year on the adjustments (or a portion of the adjustments) reflected on the statement furnished to such partner under §301.6226-2 (or paragraph (e)(3) of this section) takes the adjustments into account under this paragraph (e)(6) when the pass-through partner calculates and pays the additional reporting year tax as determined under paragraph (b) of this section and furnishes statements to its partners in accordance with paragraph (e)(3) of this section. Notwithstanding the prior sentence, a pass-through partner is only required to include on a statement under paragraph (e)(3) of this section the adjustments that would be required to be included on statements furnished to owners or beneficiaries under sections 6037 and 6034A, as applicable, if the pass-through partner had correctly reported the items for the year to which the adjustments relate. If the pass-through partner fails to comply with the requirements of this paragraph (e)(6), the provisions of paragraph (e)(2) of this section apply.

* * * * *

(g) Examples. The following examples illustrate the rules of this section. For purposes of these examples, each partnership is subject to subchapter C of chapter 63 of the Code, each partnership and partner has a calendar year taxable year, no modifications are requested by any partnership under §301.6225-2 (unless otherwise stated), no penalties, additions to tax, or additional amounts are determined at the partnership level (unless otherwise stated), all persons are U.S. persons (unless otherwise stated), and the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods.

Example 1. On its partnership return for the 2020 tax year, Partnership reported ordinary income of \$1,000 and charitable contributions of \$400. On June 1, 2023, the IRS mails a notice of final partnership adjustment (FPA) to Partnership for Partnership's 2020 year disallowing the charitable contribution in its entirety and determining that a 20 percent accuracy-related penalty under section 6662(b) applies to the disallowance of the charitable contribution. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments. The Tax Court determines that Partnership is not entitled to any of the claimed \$400 in charitable contributions and upholds the applicability of the penalty. The decision regarding Partnership's 2020 tax year becomes final on December 15, 2025. Pursuant to §301.6226-2(b), the partnership adjustments are finally determined on December 15, 2025. On February 2, 2026, Partnership files the statements described under §301.6226-2 with the IRS and furnishes to partner A, an individual who was a partner in Partnership during 2020, a statement described in §301.6226-2. A had a 25 percent interest in Partnership during all of 2020 and was allocated 25 percent of all items from Partnership for that year. The statement shows A's share of ordinary income reported on Partnership's return for the reviewed year of \$250 and A's share of the charitable contribution reported on Partnership's return for the reviewed year of \$100. The statement also shows no adjustment to A's share of ordinary income, but does show an adjustment to A's share of the charitable contribution, a reduction of \$100 resulting in \$0 charitable contribution allocated to A from Partnership for 2020. In addition, the statement reports that a 20 percent accuracy-related penalty under section 6662(b) applies. A must pay the additional reporting year tax as determined in accordance with paragraph (b) of this section, in addition to A's penalties and interest. A computes his additional reporting year tax as follows. First, A determines the correction amount for the first affected year (the 2020 taxable year) by taking into account A's share of the partnership adjustment (<100> reduction in charitable contribution) for the 2020 taxable year. A determines the amount by which his chapter 1 tax for 2020 would have increased if the \$100 adjustment to the charitable

contribution from Partnership were taken into account for that year. There is no adjustment to tax attributes in A's intervening years as a result of the adjustment to the charitable contribution for 2020. Therefore, A's aggregate of the adjustment amounts is the correction amount for 2020, A's first affected year. In addition to the aggregate of the adjustment amounts being added to the chapter 1 tax that A owes for 2026, the reporting year, A must calculate a 20 percent accuracy-related penalty on A's underpayment attributable to the \$100 adjustment to the charitable contribution, as well as interest on the correction amount for the first affected year and the penalty determined in accordance with paragraph (d) of this section. Interest on the correction amount for the first affected tax year runs from April 15, 2021, the due date of A's 2020 return (the first affected tax year) until A pays this amount. In addition, interest runs on the penalty from April 15, 2021, the due date of A's 2020 return for the first affected year until A pays this amount. On his 2026 income tax return, A must report the additional reporting year tax determined in accordance with paragraph (b) of this section, which is the correction amount for 2020, plus the accuracy-related penalty determined in accordance with paragraph (i) of this section, and interest determined in accordance with paragraph (d) of this section on the correction amount for 2020 and the penalty.

Example 2. On its partnership return for the 2020 tax year, Partnership reported an ordinary loss of \$500 million. On June 1, 2023, the IRS mails an FPA to Partnership for the 2020 taxable year determining that \$300 million of the \$500 million in ordinary loss should be recharacterized as a long-term capital loss. Partnership has no long-term capital gain for its 2020 tax year. The FPA for Partnership's 2020 tax year reflects an adjustment of an increase in ordinary income of \$300 million (as a result of the disallowance of the recharacterization of \$300 million from ordinary loss to long-term capital loss) and an imputed underpayment related to that adjustment, as well as an adjustment of an additional \$300 million in long-term capital loss for 2020 which does not result in an imputed underpayment pursuant to under §301.6225-1(c)(2)(ii). Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA and does not file a petition for readjustment under section 6234. Accordingly, under §301.6226-1(b)(2) and §301.6225-3(b)(6), the adjustment year partners (as defined in §301.6241-1(a)(2)) do not take into account the \$300 million long-term capital loss that does not result in an imputed underpayment. Rather, the reviewed year partners will take into account the \$300 million long-term capital loss. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-2(b), the partnership adjustments become finally determined on August 30, 2023. On September 30, 2023, Partnership files with the IRS statements described in §301.6226-2 and furnishes statements to all of its reviewed year partners in accordance with §301.6226-2. One partner of Partnership in 2020, B (an individual), had a 25 percent interest in Partnership during all of 2020 and was allocated 25 percent of all items from Partnership for that year. The statement filed with the IRS and furnished to B shows B's allocable share of the ordinary loss reported on Partnership's return for the 2020 taxable year as \$125 million. The statement also shows an adjustment to B's allocable share of the ordinary loss in the amount of <\$75 million>, resulting in a corrected ordinary loss allocated to B of \$50 million for taxable year 2020 (\$125 million originally allocated to B less \$75 million which is B's share of

the adjustment to the ordinary loss). In addition, the statement shows an increase to B's share of long-term capital loss in the amount of \$75 million (B's share of the adjustment that did not result in the imputed underpayment with respect to Partnership). B must pay the additional reporting year tax as determined in accordance with paragraph (b) of this section. B computes his additional reporting year tax as follows. First, B determines the correction amount for the first affected year (the 2020 taxable year) by taking into account B's share of the partnership adjustments (a \$75 million reduction in ordinary loss and an increase of \$75 million in long-term capital loss) for the 2020 taxable year. B determines the amount by which his chapter 1 tax for 2020 would have increased if the \$75 million adjustment to ordinary loss and the \$75 million adjustment to long-term capital loss from Partnership were taken into account for that year. Second, B determines if there is any increase in chapter 1 tax for any intervening year as a result of the adjustment to the ordinary and capital losses for 2020. B's aggregate of the adjustment amounts is the correction amount for 2020, B's first affected year plus any correction amounts for any intervening years. B is also liable for any interest on the correction amount for the first affected year and for any intervening year as determined in accordance with paragraph (d) of this section.

Example 3. On its partnership return for the 2020 tax year, Partnership, a domestic partnership, reported U.S. source dividend income of \$2,000. On June 1, 2023, the IRS mails an FPA to Partnership for Partnership's 2020 year increasing the amount of U.S. source dividend income to \$4,000 and determining that a 20 percent accuracy-related penalty under section 6662(b) applies to the increase in U.S. source dividend income. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-2(b), the partnership adjustments become finally determined on August 30, 2023. On September 30, 2023, Partnership files the statements described under §301.6226-2 with the IRS and furnishes to partner C, a nonresident alien individual who was a partner in Partnership during 2020 (and remains a partner in Partnership in 2023), a statement described in §301.6226-2. C had a 50 percent interest in Partnership during all of 2020 and was allocated 50 percent of all items from Partnership for that year. The statement shows C's share of U.S. source dividend income reported on Partnership's return for the reviewed year of \$1,000 and an adjustment to U.S. source dividend income of \$1,000. In addition, the statement reports that a 20 percent accuracy-related penalty under section 6662(b) applies. Under §301.6226-2(h)(3)(i), because the additional \$1,000 in U.S. source dividend income allocated to C is an amount subject to withholding (as defined in §301.6226-2(h)(3)(i)), Partnership must pay the amount of tax required to be withheld on the adjustment. See §§1.1441-1(b)(1) and 1.1441-5(b)(2)(i)(A) of this chapter. Under §301.6226-2(h)(3)(ii), Partnership may reduce the amount of withholding tax it must pay because it has valid documentation from 2020 that establishes that C was entitled to a reduced rate of withholding in 2020 on U.S. source dividend income of 10 percent pursuant to a treaty. Partnership withholds \$100 of tax from C's distributive share, remits the tax to the IRS, and files the necessary return and information returns required by §1.1461-1 of this chapter. On his 2023

return, C must report the additional reporting year tax determined in accordance with paragraph (b) of this section, the accuracy-related penalty determined in accordance with paragraph (i) of this section, and interest determined in accordance with paragraph (d) of this section on the correction amount for the first affected year, the correction amount for any intervening year, and the penalty. Under paragraph (f) of this section, C may claim the \$100 withholding tax paid by Partnership pursuant to §301.6226-2(h)(3)(i) as a credit under section 33 against C's income tax liability on his 2023 return.

Example 4. On its partnership return for the 2020 tax year, Partnership reported ordinary income of \$100 million and a long-term capital gain of \$40 million. Partnership had four equal partners during the 2020 tax year: E, F, G, and H, all of whom were individuals. On its partnership return for the 2020 tax year, the entire long-term capital gain was allocated to partner E and the ordinary income was allocated to all partners based on their equal (25 percent) interest in Partnership. The IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year and determines that the long-term capital gain should have been allocated equally to all four partners and that Partnership should have recognized an additional \$10 million in ordinary income. On June 1, 2023, the IRS mails an FPA to Partnership reflecting the reallocation of the \$40 million long-term capital gain so that F, G, and H each have \$10 million increase in long-term capital gain and E has a \$30 million reduction in long-term capital gain for 2020. In addition, the FPA reflects the partnership adjustment increasing ordinary income by \$10 million. The FPA reflects a general imputed underpayment with respect to the increase in ordinary income and a specific imputed underpayment with respect to the increase in long-term capital gain allocated to F, G, and H. In addition, the FPA reflects a \$30 million partnership adjustment that does not result in an imputed underpayment, that is, the reduction of \$30 million in long-term capital gain with respect to E. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the specific imputed underpayment relating to the reallocation of long-term capital gain. Partnership does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-2(b), the partnership adjustments become finally determined on August 30, 2023. Partnership timely pays and reports the general imputed underpayment relating to the partnership adjustment to ordinary income. On September 30, 2023, Partnership files with the IRS statements described in §301.6226-2 and furnishes statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA that relate to the specific imputed underpayment, that is, the reallocation of long-term capital gain. The statements for F, G, and H each reflect a partnership adjustment of an additional \$10 million of long-term capital gain for 2020. The statement for E reflects a partnership adjustment of a reduction of \$30 million of long-term capital gain for 2020. All partners must pay the additional reporting year tax as determined in accordance with paragraph (b) of this section in the partners' reporting year, which is 2023. They compute their additional reporting year tax as follows. First, they determine the correction amount for the first affected year (the 2020 taxable year) by taking into account their share of the partnership adjustments for the 2020 taxable year. They each determine the amount by which their chapter 1 tax for 2020 would have increased if the adjustment to long-term

capital gain from Partnership were taken into account for that year. Second, they determine if there is any increase in chapter 1 tax for any intervening year as a result of the adjustment to the long-term capital gain for 2020. Their aggregate of the adjustment amounts is the correction amount for 2020, their first affected year plus any correction amounts for any intervening years. They are also liable for any interest on the correction amount for the first affected year and for any intervening year as determined in accordance with paragraph (d) of this section. In accordance with paragraph (b) of this section, the correction amounts may not be less than zero. Accordingly, E's additional reporting year tax is zero because E only has a reduction in capital gain which would not result in an increase in chapter 1 tax.

Example 5. On its partnership return for the 2020 taxable year, Partnership reported a long-term capital loss of \$5 million. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS mails a notice of proposed partnership adjustment (NOPPA) in which it proposes to disallow \$2 million of the reported \$5 million long-term capital loss. F, a C corporation partner with a 50 percent interest in Partnership, received 50 percent of all long-term capital losses for 2020. As part of the modification process described in §301.6225-2(d)(2), F files an amended return for 2020 taking into account F's share of the partnership adjustment (\$1 million reduction in long-term capital loss) and pays the tax owed for 2020, including interest. Also as part of the modification process, F also files amended returns for 2021 and 2022 and paid additional tax (and interest) for these years because the reduction in long-term capital loss for 2020 affected the tax due from F for 2021 and 2022. See §301.6225-2(d)(2)(iv). The reduction of the long-term capital loss in 2020 did not affect any other taxable year of F. The IRS approves the modification with respect to F and on June 1, 2023, mails an FPA to Partnership for Partnership's 2020 year reflecting the partnership adjustment reducing the long-term capital loss in the amount of \$2 million. The FPA also reflects the modification to the imputed underpayment based on the amended returns filed by F taking into account F's share of the reduction in the long-term capital loss. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and files a timely petition in the Tax Court challenging the partnership adjustments. The Tax Court upholds the determinations in the FPA and the decision regarding Partnership's 2020 tax year becomes final on December 15, 2025. Pursuant to §301.6226-2(b), the partnership adjustments are finally determined on December 15, 2025. On February 1, 2026, Partnership files the statements described under §301.6226-2 with the IRS and furnishes to its partners statements reflecting their shares of the partnership adjustment. The statement issued to F reflects F's share of the partnership adjustment for Partnership's 2020 taxable year as finally determined by the Tax Court. The statement shows F's share of the long-term capital loss adjustment for the reviewed year of \$1 million and the \$1 million reduction in long-term capital losses taken into account by F as part of the amended return modification. Accordingly, in accordance with paragraph (b) of this section, when F computes its correction amounts for the first affected year (the 2020 taxable year) and the intervening years (the 2021 through 2026 taxable years), F computes any additional chapter 1 tax for those

years using the returns for the 2020, 2021, and 2022 taxable years as amended during the modification process.

Example 6. Partnership has two equal partners for the 2020 tax year: I (an individual) and J (a partnership). For the 2020 tax year, J has two equal partners -- K and L -- both individuals. On June 1, 2023, the IRS mails a notice of final partnership adjustment (FPA) to Partnership for Partnership's 2020 year increasing Partnership's ordinary income by \$500,000 and asserting an imputed underpayment of \$200,000. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-1(b), the partnership adjustments become finally determined on August 30, 2023. Therefore, Partnership's adjustment year is 2023, the due date of the adjustment year return is March 15, 2024, and if requested, the extended due date for the adjustment year return is September 16, 2024. On October 12, 2023, Partnership timely files with the IRS statements described in §301.6226-2 and timely furnishes statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA. The statements to I and J each reflect a partnership adjustment of \$250,000 of ordinary income. I takes its share of the adjustments reflected on the statements furnished by Partnership into account on I's return for the 2023 tax year in accordance with paragraph (b) of this section. On April 1, 2024, J takes the adjustments into account under paragraph (e)(3) of this section by timely filing the information required by that section with the IRS and furnishing statements to K and L reflecting each partner's share of the adjustments reflected on the statements Partnership furnished to J. K and L must take their share of adjustments reflected on the statements furnished by J into account on their returns for the 2023 tax year in accordance with paragraph (b) of this section by treating themselves as reviewed year partners for purposes of that paragraph.

Example 7. On its partnership return for the 2020 tax year, Partnership reported that it placed Asset, which had a depreciable basis of \$210,000, into service in 2020 and depreciated Asset over 5 years, using the straight-line method. Accordingly, Partnership claimed depreciation of \$42,000 in each year related to Asset. Partnership has two equal partners for the 2020 tax year: M (a partnership) and N (an S corporation). For the 2020 tax year, N has one shareholder, O, who is an individual. On June 1, 2023, the IRS mails an FPA to Partnership for Partnership's 2020 year. In the FPA, the IRS determines that Asset should have been depreciated over 7 years instead of 5 years and adjusts the depreciation for the 2020 tax year to \$30,000 instead of \$42,000 resulting in a \$12,000 adjustment. This adjustment results in an imputed underpayment of \$4,800. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-1(b), the partnership adjustments become finally determined on August 30, 2023. On October 12, 2023, Partnership timely files with the IRS statements described in §301.6226-2 and furnishes statements to its partners reflecting their share of the

partnership adjustments as finally determined in the FPA. The statements to M and N reflect a partnership adjustment of \$6,000 of ordinary income for the 2020 tax year as well as a \$6,000 increase in ordinary income for each of the 2021 and 2022 tax years relating to the change to the depreciable life of Asset. On February 1, 2024, N takes the adjustments into account under paragraph (e)(3) of this section by issuing a statement to O reflecting her share of the adjustments reported to N on the statement it received from Partnership. Although not due until September 15, 2024 (the extended due date of the adjustment year return of Partnership), on March 22, 2024, M takes the adjustments into account under paragraph (e)(4) of this section by paying an amount calculated like an imputed underpayment equal to \$7,200 ($(\$6,000 \text{ for } 2020 + \$6,000 \text{ for } 2021 + \$6,000 \text{ for } 2022) \times 40 \text{ percent}$) on the adjustments reflected on the statement it received from Partnership including M's share of the partnership tax attributes plus interest on the amount calculated in accordance with paragraph (e)(4)(iv)(B) of this section. On her 2023 return, O takes the adjustments into account under this section. Therefore, O reports and pays the additional reporting year tax determined in accordance with paragraph (b) of this section, which is the correction amount for 2020 plus the correction amount for 2021 (related to the adjustment to tax attributes) plus the correction amount for 2022 (related to the adjustment to tax attributes), and pays interest determined in accordance with paragraph (d) of this section on the correction amounts for each of those years.

Example 8. On its partnership return for the 2020 tax year, Partnership reported \$1 million of ordinary loss. Partnership has two equal partners for the 2020 tax year: P and Q, both S corporations. For the 2020 tax year, P had one shareholder, R, an individual. For the 2020 tax year, Q had two shareholders, S and T, both individuals. On June 1, 2023, the IRS mails a notice of final partnership adjustment (FPA) to Partnership for Partnership's 2020 year determining \$500,000 of the \$1 million of ordinary loss should be recharacterized as \$500,000 of long-term capital loss and \$500,000 of the ordinary loss should be disallowed. The FPA asserts an imputed underpayment of \$400,000 ($\$1 \text{ million} \times 40 \text{ percent}$) on the \$1 million reduction to ordinary loss and reflecting an adjustment that does not result in an imputed underpayment of a \$500,000 capital loss. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and does not file a petition for readjustment under section 6234. The time to file a petition expires on August 30, 2023. Pursuant to §301.6226-1(b), the partnership adjustments become finally determined on August 30, 2023. On October 12, 2023, Partnership timely files with the IRS statements described in §301.6226-2 and furnishes statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA. The statements to P and Q each reflect a partnership adjustment of \$500,000 increase in ordinary income and an increase in capital loss of \$250,000 in accordance with §301.6225-3(b)(6). P takes the adjustments into account under paragraph (e)(3) of this section by timely furnishing a statement to R. Q takes the adjustments into account under paragraph (e)(4) of this section by paying an amount calculated like an imputed underpayment under paragraph (e)(4)(iii) of this section, as well as interest determined under paragraph (e)(4)(iv)(B) of this section on the amount. After applying the rules set

forth in §301.6225-1 regarding the netting and grouping of adjustments, Q calculates an amount of \$200,000 which is equal to the residual grouping of \$500,000 multiplied by 40 percent. The residual grouping contains the \$500,000 attributable to the adjustment to ordinary income. Q also has one adjustment that does not result in an imputed underpayment – the \$250,000 increase to capital loss. On its 2023 return, Q reports and allocates the \$250,000 capital loss to its shareholders for its 2023 taxable year as a capital loss as provided in §301.6225-3. Q must report and pay the amounts due under paragraph (e)(4) of section no later than September 15, 2024, the extended due date of Partnership's return for the 2023 year, which is the adjustment year.

Example 9. On its partnership return for the 2020 tax year, Partnership reported a \$1 million long-term capital gain on the sale of Stock. Partnership has two equal partners for the 2020 tax year: U (an individual) and V (a partnership). For the 2020 tax year, V has two equal partners: W (an individual) and X (a partnership). For the 2020 tax year, X has two equal partners: Y and Z, both of which are C corporations. On June 1, 2023, the IRS mails a NOPPA to Partnership for Partnership's 2020 year proposing a \$500,000 increase in the long-term capital gain from the sale of Stock and an imputed underpayment of \$200,000 ($\$500,000 \times 40$ percent). On July 17, 2023, Partnership timely submits a request to modify the rate used in calculating the imputed underpayment under §301.6225-2(d)(4). Partnership submits sufficient information demonstrating that \$375,000 of the \$500,000 adjustment is allocable to individuals (50 percent of the \$500,000 adjustment allocable to U and 25 percent of the \$500,000 adjustment allocable to W) and the remaining \$125,000 is allocable to C corporations (the indirect partners Y and Z). The IRS approves the modification and the imputed underpayment is reduced to \$118,750 ($(\$375,000 \times 20 \text{ percent}) + (\$125,000 \times 35 \text{ percent})$). See §301.6225-2(b)(3). On February 28, 2024, the IRS mails an FPA to Partnership for Partnership's 2020 year determining a \$500,000 increase in the long-term capital gain on the sale of Stock and asserting an imputed underpayment of \$118,750 after the approved modifications. Partnership makes a timely election under section 6226 in accordance with §301.6226-1 with respect to the imputed underpayment in the FPA for Partnership's 2020 year and does not file a petition for readjustment under section 6234. The time to file a petition expires on May 28, 2024. Pursuant to §301.6226-1(b), the partnership adjustments become finally determined on May 28, 2024. On July 26, 2024, Partnership timely files with the IRS statements described in §301.6226-2 and furnishes statements to its partners reflecting their share of the partnership adjustments as finally determined in the FPA. The statements to U and V each reflect a partnership adjustment of a \$250,000 increase in long-term capital gain. V takes the adjustments into account under paragraph (e)(4) of this section by paying an amount calculated like an imputed underpayment under paragraph (e)(4)(iii) of this section, as well as interest determined under paragraph (e)(4)(iv)(B) of this section on the amount. On February 3, 2025, V takes the adjustments into account under paragraph (e)(4) of this section by paying an amount equal to \$68,750 ($(\$125,000 \times 35 \text{ percent for the adjustments allocable to X}) + (\$125,000 \times 20 \text{ percent for the adjustments allocable to W})$) which includes the rate modifications approved by the IRS with respect to Y and Z. V must also pay any interest on the amount as determined in accordance with paragraph (e)(4)(iv)(B) of this section. V must report and pay the

amounts due under paragraph (e)(4) of this section no later than September 15, 2025, the extended due date of Partnership's return for the 2024 year, which is the adjustment year.

* * * * *

(i) Penalties--(1) In general. In the case of a partnership that makes an election under section 6226, the applicability of penalties, additions to tax, and additional amounts that relate to a partnership adjustment are determined at the partnership level in accordance with section 6221(a). The partnership's reviewed year partners are liable for such penalties, additions to tax, and additional amounts as determined under paragraph (i)(2) of this section.

(2) Determining the amount of each reviewed year partner's penalties. To determine a reviewed year partner's penalties, additions to tax, and additional amounts for the reporting year, each reviewed year partner computes the penalty, addition to tax, or additional amount imposed with respect to the correction amount (or portion thereof) calculated under paragraph (b) of this section for the first affected year or intervening year, as applicable. The reviewed year partner calculates the penalty, addition to tax, or additional amount as if the correction amount were an underpayment or understatement for the first affected year or intervening year, as applicable. If after taking into account the adjustments in accordance with this section, the reviewed year partner would not have an underpayment, or has an understatement that falls below the applicable threshold for the imposition of a penalty, no penalty would be due from that reviewed year partner for the reporting year under this paragraph (i)(2). For penalties in the case of a pass-through partner that makes a payment under paragraph (e)(4) of this section, see paragraph (e)(4)(iv) of this section.

(3) Partner-level defenses to penalties. A partner claiming that a penalty, addition to tax, or additional amount that relates to an adjustment reflected on a statement described in §301.6226-2 (or paragraph (e)(3)(i) of this section) would not be due because of a partner-level defense must first pay the penalty and file a claim for refund. Partner-level defenses are limited to those that are personal to the partner (for example, a reasonable cause and good faith defense under section 6664(c) that is based on the facts and circumstances applicable to the partner).

(j) Treatment of disregarded entities and wholly-owned trusts. In the case of a reviewed year partner that is an entity described in §301.7701-2(c)(2)(i) or a trust that is wholly owned by only one person, whether the grantor or another person, and where the trust reports the owner's information to payors under §1.671-4(b)(2)(i)(A) of this chapter and that is furnished a statement described in §301.6226-2 (or paragraph (e)(3)(i) of this section), the owner of the disregarded entity or wholly-owned trust must take into account the adjustments reflected on that statement in accordance with this section as if the owner were the reviewed year partner.

Par. 7. Section 301.6227-3, as proposed to be amended at 82 FR 27334 (June 14, 2017), is further amended by revising paragraphs (b)(1) and (c) to read as follows:
§301.6227-3 Adjustments requested in an administrative adjustment request taken into account by reviewed year partners.

* * * * *

(b) * * *

(1) In general. A reviewed year partner that is furnished a statement described in paragraph (a) of this section must treat the statement as if it were issued under section

6226(a)(2) and, on or before the due date for the reporting year must pay the additional reporting year tax (as defined in §301.6226-3(a)), if any, determined after taking into account that partner's share of the adjustments requested in the AAR in accordance with §301.6226-3. For purposes of paragraph (b) of this section, the rule under §301.6226-3(d)(4) (regarding the increased rate of interest) does not apply and the last sentence in §301.6226-3(b)(1) (regarding the prohibition on correction amounts being less than zero) is disregarded. Nothing in this section entitles any partner to a refund of tax imposed by chapter 1 of subtitle A of the Internal Revenue Code (chapter 1 tax) to which such partner is not entitled. For instance, a partnership-partner (as defined in §301.6241-1(a)(7)) may not claim a refund with respect to its share of any adjustment.

* * * * *

(c) Reviewed year partners that are pass-through partners—(1) In general.

Except as provided in paragraphs (c)(2) and (3) of this section, if a statement described in paragraph (a) of this section (including a statement described in this paragraph (c)(1)) is furnished to a pass-through partner (as defined in §301.6241-1(a)(5)), the pass-through partner must take into account the adjustments reflected on that statement in accordance with §301.6226-3(e) by treating the partnership that filed the AAR as the partnership that made an election under §301.6226-1. For purposes of this paragraph (c)(1), the statement furnished to the pass-through partner by the partnership filing the AAR is treated as if it were a statement issued under section 6226(a)(2) and described in §301.6226-2.

(2) Adjustments that do not result in an imputed underpayment. If the adjustments requested in an AAR do not result in an imputed underpayment (as

described in §301.6227-2(d)), §301.6226-3(e)(2) does not apply, and the pass-through partner must take into account the adjustments reflected on the statement described in paragraph (a) or (c)(1) of this section in accordance with §301.6226-3(e)(3).

(3) Contents of statements. Each statement described in paragraph (c)(1) of this section must include the following information –

(i) The name and correct taxpayer identification number (TIN) of the partnership that filed the AAR with respect to the adjustments reflected on the statements described in paragraph (c)(1) of this section;

(ii) The adjustment year of the partnership described in paragraph (c)(3)(i) of this section;

(iii) The extended due date for the return for the adjustment year of the partnership described in paragraph (c)(3)(i) of this section (as described in §301.6226-3(e)(3)(ii));

(iv) The date on which the partnership described in paragraph (c)(3)(i) of this section furnished its statements required under §301.6227-2(d);

(v) The name and correct TIN of the partnership that furnished the statement to the pass-through partner if different from the partnership described in paragraph (c)(3)(i) of this section;

(vi) The name and correct TIN of the pass-through partner;

(vii) The pass-through partner's taxable year to which the adjustments set forth in the statement described in paragraph (c)(1) of this section relate;

(viii) The name and correct TIN of the affected partner (as defined in §301.6226-3(e)(3)(i)) to whom the statement is being furnished;

(ix) The current or last address of the affected partner that is known to the pass-through partner;

(x) The affected partner's share of items as originally reported to such partner under section 6031(b) and, if applicable, section 6227, for the taxable year to which the adjustments reflected on the statement furnished to the pass-through partner relate;

(xi) The affected partner's share of partnership adjustments determined under §301.6227-2(e)(2) as if the affected partner were the reviewed year partner and the partnership were the pass-through partner; and

(xii) Any other information required by forms, instructions, and other guidance prescribed by the IRS.

(4) Partners of the pass-through partner must take into account the adjustments.

For purposes of paragraph (c) of this section, when taking into account the adjustments as described in §301.6226-3(e)(3)(iv), the rules under §301.6226-3(d)(4) (regarding the increased rate of interest) do not apply, and the last sentence in §301.6226-3(b)(1) (regarding the prohibition on correction amounts being less than zero) is disregarded. Therefore, an affected partner may reduce chapter 1 tax for the reporting year by the amount determined in accordance with §301.6226-3.

* * * * *

Par. 8. Section 301.6231-1 is added to read as follows:

§301.6231-1 Notice of proceedings and adjustments.

(a) Notices to which this section applies. In the case of any administrative proceeding under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63), including an administrative proceeding with respect to an

administrative adjustment request (AAR) filed by a partnership under section 6227, the following notices must be mailed to the partnership and the partnership representative (as described in section 6223 and §301.6223-1)—

(1) Notice of any administrative proceeding initiated at the partnership level with respect to an adjustment of any item of income, gain, loss, deduction, or credit (as defined in §301.6221(a)-1(b)(1)) of a partnership for a partnership taxable year, or any partner's distributive share (as described in §301.6221(a)-1(b)(2)) thereof, under subchapter C of chapter 63 (notice of administrative proceeding (NAP));

(2) Notice of any proposed partnership adjustment resulting from an administrative proceeding under subchapter C of chapter 63 (notice of proposed partnership adjustment (NOPPA)); and

(3) Notice of any final partnership adjustment resulting from an administrative proceeding under subchapter C of chapter 63 (notice of final partnership adjustment (FPA)).

(b) Time for mailing notices—(1) Notice of proposed partnership adjustment. A NOPPA is timely if it is mailed before the expiration of the period for making adjustments under section 6235(a)(1) (including any extensions under section 6235(b) and any special rules under section 6235(c)).

(2) Notice of final partnership adjustment. An FPA may not be mailed earlier than 270 days after the date on which the NOPPA is mailed unless the partnership agrees, in writing, with the Internal Revenue Service (IRS) to waive the 270-day period. See §301.6225-2(c)(3)(iii) for the effect of a waiver under this paragraph (b)(2) on the 270-period for requesting a modification under section 6225(c). See §301.6232-

1(d)(2) for the rules regarding a waiver of the limitations on assessment under §301.6232-1(c).

(c) Last known address. A notice described in paragraph (a) of this section is sufficient if mailed to the last known address of the partnership representative and the partnership (even if the partnership or partnership representative has terminated its existence).

(d) Notice mailed to partnership representative--(1) In general. A notice described in paragraph (a) of this section will be treated as mailed to the partnership representative if the notice is mailed to the partnership representative that is reflected in the IRS records as of the date the letter is mailed.

(2) No partnership representative in effect. In any case in which no partnership representative designation is in effect in accordance with §301.6223-1(f)(2), a notice described in paragraph (a) of this section mailed to “PARTNERSHIP REPRESENTATIVE” at the last known address of the partnership satisfies the requirements of section 6231(a).

(e) Restrictions on additional FPAs after petition filed. The IRS may mail more than one FPA to any partnership for any partnership taxable year. However, except in the case of fraud, malfeasance, or misrepresentation of a material fact, the IRS may not mail an FPA to a partnership with respect to a partnership taxable year after the partnership has filed a timely petition for readjustment under section 6234 with respect to an FPA issued with respect to such partnership taxable year.

(f) Withdrawal of NAP or NOPPA. The IRS may, without consent of the partnership, withdraw any NAP or NOPPA. A NAP or NOPPA that has been withdrawn

by the IRS has no effect for purposes of subchapter C of chapter 63. For instance, if the IRS withdraws a NAP with respect to a partnership taxable year, the prohibition under section 6227(c) on filing an AAR after the mailing of a NAP no longer applies with respect to such taxable year.

(g) Rescission of FPA. The IRS may, with the consent of the partnership, rescind any FPA. An FPA that is rescinded is not an FPA for purposes of subchapter C of chapter 63, and the partnership cannot bring a proceeding under section 6234 with respect to such FPA.

(h) Applicability date--(1) In general. Except as provided in paragraph (h)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Par. 9. Section 301.6232-1 is added to read as follows:

§301.6232-1 Assessment, collection, and payment of imputed underpayment.

(a) In general. An imputed underpayment determined under subchapter C of chapter 63 of the Internal Revenue Code (Code) is assessed and collected in the same manner as if the imputed underpayment were a tax imposed by subtitle A of the Code for the adjustment year (as defined in §301.6241-1(a)(1)) except that the deficiency procedures under subchapter B of chapter 63 of the Code do not apply to an assessment of an imputed underpayment. Accordingly, no notice under section 6212 is required for, and the restrictions under section 6213 do not apply to, the assessment of

any imputed underpayment. See paragraph (c) of this section for limitations on assessment and paragraph (d) of this section for exceptions to restrictions on adjustments.

(b) Payment of the imputed underpayment. Upon receipt of notice and demand from the Internal Revenue Service (IRS), an imputed underpayment must be paid by the partnership at the place and time stated in the notice. In the case of an adjustment requested in an administrative adjustment request (AAR) under section 6227(b)(1) that is taken into account by the partnership under §301.6227-2(b), payment of the imputed underpayment is due on the date the AAR is filed. The IRS may assess the amount of the imputed underpayment reflected on the AAR on the date the AAR is filed. For interest with respect to an imputed underpayment, see §301.6233(a)-1(b).

(c) Limitation on assessment. Except as otherwise provided by this section, no assessment of an imputed underpayment may be made (and no levy or proceeding in any court for the collection of an imputed underpayment may be made, begun, or prosecuted) before—

(1) The close of the 90th day after the day on which a notice of a final partnership adjustment (FPA) was mailed under section 6231(a)(3); and

(2) If a petition for readjustment is filed under section 6234 with respect to such FPA, the decision of the court has become final.

(d) Exceptions to restrictions on adjustments and assessments--(1) Adjustments treated as mathematical or clerical errors--(i) In general. A notice to a partnership that, on account of a mathematical or clerical error appearing on the partnership return or as a result of a failure by a partnership-partner (as defined in §301.6241-1(a)(7)) to comply

with section 6222(a), the IRS has adjusted or will adjust items of income, gain, loss, deduction, or credit (as defined in §301.6221(a)-1(b)(1)) to correct the error or to make the items consistent under section 6222(a) and has assessed or will assess any imputed underpayment (determined in accordance with §301.6225-1) resulting from the adjustment is not considered an FPA under section 6231(a)(3). A petition for readjustment under section 6234 may not be filed with respect to such notice. The limitations under section 6232(b) and paragraph (c) of this section do not apply to an assessment under this paragraph (d)(1)(i). For the definition of mathematical or clerical error generally, see section 6213(g)(2). For application of mathematical or clerical error in the case of inconsistent treatment by a partner that fails to give notice, see §301.6222-1(b).

(ii) Request for abatement--(A) In general. Except as provided in paragraph (d)(1)(ii)(B) of this section, a partnership that is mailed a notice described in paragraph (d)(1)(i) of this section may file with the IRS, within 60 days after the date of such notice, a request for abatement of any assessment of an imputed underpayment specified in such notice. Upon receipt of the request, the IRS must abate the assessment. Any subsequent assessment of an imputed underpayment with respect to which abatement was made is subject to the provisions of subchapter C of chapter 63 of the Code, including the limitations under paragraph (c) of this section.

(B) Adjustments with respect to inconsistent treatment by a partnership-partner. If an adjustment that is the subject of a notice described in paragraph (d)(1)(i) of this section is due to the failure of a partnership-partner to comply with section 6222(a), paragraph (d)(1)(ii)(A) of this section does not apply, and abatement of any assessment

specified in such notice is not available. However, prior to assessment, a partnership-partner that has failed to comply with section 6222(a) may correct the inconsistency by filing an administrative adjustment request under section 6227 or filing an amended partnership return and furnishing amended statements, as appropriate.

(iii) Partnerships that have an election under section 6221(b) in effect. In the case of a partnership-partner that has an election under section 6221(b) in effect for the reviewed year (as defined in §301.6241-1(a)(8)), any tax resulting from an adjustment due to the partnership-partner's failure to comply with section 6222(a) may be assessed with respect to the reviewed year partners (as defined in §301.6241-1(a)(9)) of the partnership-partner (or indirect partners of the partnership-partner, as defined in §301.6241-1(a)(4)). Such tax may be assessed in the same manner as if the tax were on account of a mathematical or clerical error appearing on the reviewed year partner's or indirect partner's return, except that the procedures under section 6213(b)(2) for requesting an abatement of such assessment do not apply.

(2) Partnership may waive limitations. A partnership may at any time by a signed notice in writing filed with the IRS waive the limitations under paragraph (c) of this section (whether or not an FPA has been mailed under section 6231(a)(3) by the IRS at the time of the waiver).

(e) Limit on amount of imputed underpayment where no proceeding is begun. If no proceeding under section 6234 is begun with respect to an FPA mailed under section 6231(a)(3) before the close of the 90th day after the day on which such FPA was mailed, the amount for which the partnership is liable under section 6225 with respect to such FPA cannot exceed the amount determined in such FPA.

(f) Applicability date--(1) In general. Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Par. 10. Section 301.6233(a)-1 is added to read as follows:

§301.6233(a)-1 Interest and penalties determined from reviewed year.

(a) Interest and penalties with respect to the reviewed year. Except to the extent provided in section 6226(c) and the regulations thereunder, in the case of a partnership adjustment (as defined in §301.6241-1(a)(6)) for a reviewed year (as defined in §301.6241-1(a)(8)), a partnership is liable for—

- (1) Interest computed in accordance with paragraph (b) of this section; and
- (2) Any penalty, addition to tax, or additional amount as provided under paragraph (c) of this section.

(b) Computation of interest with respect to partnership adjustments for the reviewed year. The interest imposed on an imputed underpayment resulting from partnership adjustments for the reviewed year is the interest that would be imposed under chapter 67 of the Internal Revenue Code (Code) if the imputed underpayment were treated as an underpayment of tax for the reviewed year. The interest imposed on an imputed underpayment under this paragraph (b)(1) begins on the day after the due date of the partnership return (without regard to extension) for the reviewed year and ends on the earlier of —

(1) The date prescribed for payment (as described in §301.6232-1(b));

(2) The due date of the partnership return (without regard to extension) for the adjustment year (as defined in §301.6241-1(a)(1)); or

(3) The date the imputed underpayment is fully paid.

(c) Penalties with respect to partnership adjustments for the reviewed year--(1) In general. In accordance with section 6221(a), the applicability of any penalties, additions to tax, and additional amounts that relate to a partnership adjustment for the reviewed year is determined at the partnership level as if the partnership had been an individual subject to tax imposed by chapter 1 of subtitle A of the Code for the reviewed year, and the imputed underpayment were an actual underpayment of tax or understatement for such year. Nothing in this paragraph (c)(1) affects the application of any penalty, addition to tax, or additional amount that may apply to the partnership or to any reviewed year partner (as defined in §301.6241-1(a)(9)) or to any indirect partner (as defined in §301.6241-1(a)(4)) that is unrelated to a partnership adjustment under subchapter C of chapter 63 of the Code.

(2) Coordination with accuracy-related and fraud penalty provisions--(i) In general. In the case of penalties imposed under section 6662, section 6662A, and section 6663 with respect to partnership adjustments in accordance with paragraph (c)(1) of this section, the rules described in paragraphs (c)(2)(ii), (iii), (iv), and (v) of this section apply.

(ii) Determining the portion of the imputed underpayment to which a penalty applies--(A) In general. In the case of penalties imposed under section 6662, section 6662A, and section 6663, paragraph (c)(2)(ii) of this section applies if--

(1) There is at least one adjustment with respect to which no penalty has been imposed and at least one adjustment with respect to which a penalty has been imposed;
or

(2) There are at least two adjustments with respect to which penalties have been imposed and the penalties have different rates.

(B) Calculating the portion of the imputed underpayment to which the penalty applies. In computing the portion of an imputed underpayment to which a penalty applies, adjustments that do not result in the imputed underpayment (as described in §301.6225-1(c)(2)) are not taken into account. The portion of an imputed underpayment to which a penalty applies is calculated as follows -

(1) All the partnership adjustments that resulted in the imputed underpayment are grouped together according to whether they are adjustments with respect to which a penalty has been imposed and, if so, according to rate of penalty. Negative adjustments as defined in paragraph (c)(2)(ii)(C) of this section are grouped in accordance with paragraphs (c)(2)(ii)(D) and (E) of this section.

(2) Within each grouping described in paragraph (c)(2)(ii)(B)(1) of this section, multiply the portion of each non-credit partnership adjustment by the rate that applied to such portion when calculating the imputed underpayment. See §§301.6225-1(c)(1)(i); 301.6225-2(b)(3)(iii)(B), (d)(4).

(3) Within each grouping, add the amounts that were calculated under paragraph (c)(2)(ii)(B)(2) of this section.

(4) Within each grouping, increase or decrease the amounts that were calculated under paragraph (c)(2)(ii)(B)(3) of this section by any credit adjustments.

(C) Negative adjustments. An adjustment that resulted in the imputed underpayment that is an increase in an item of loss, deduction, or credit or a decrease to an item of income or gain is a negative adjustment.

(D) Grouping of negative adjustments. Negative adjustments are grouped under paragraph (c)(2)(ii)(B)(1) of this section in the following order—

(1) Partnership adjustments with respect to which no penalties have been imposed;

(2) Adjustments with respect to which a penalty has been imposed at a 20 percent rate;

(3) Adjustments with respect to which a penalty has been imposed at a 30 percent rate;

(4) Adjustments with respect to which a penalty has been imposed at a 40 percent rate;

(5) Adjustments with respect to which a penalty has been imposed at a 75 percent rate.

(E) Negative adjustments that reduce a grouping to zero. If when allocating the negative adjustments under paragraph (c)(2)(ii)(D) of this section, the amount calculated in paragraph (c)(2)(ii)(B) of this section for a particular grouping equals zero, any remaining negative adjustments (or portion thereof) that would otherwise reduce the amount to less than zero are allocated to the next grouping in sequential order under paragraph (c)(2)(ii)(D) of this section.

(F) Fraud penalties under section 6663. If any portion of an imputed underpayment is determined by the IRS to be attributable to fraud, the entire imputed

underpayment is treated as attributable to fraud. This paragraph (c)(2)(ii)(F) does not apply to any portion of the imputed underpayment the partnership establishes by a preponderance of the evidence is not attributable to fraud.

(iii) Substantial understatement penalty under section 6662(d)—(A) In general. For purposes of application of the penalty under section 6662(d) (substantial understatement of income tax), the imputed underpayment is treated as an understatement under section 6662(d)(2). To determine whether an imputed underpayment treated as an understatement under this paragraph (c)(3)(iii)(A) is a substantial understatement under section 6662(d)(1), the rules of section 6662(d)(1)(A) apply by treating the amount described in paragraph (c)(3)(iii)(B) of this section as the tax required to be shown on the return for the taxable year under section 6662(d)(1)(A)(i).

(B) Amount of tax required to be shown on the return. The amount described in this paragraph (c)(3)(iii)(B) is the tax that would result by treating the net ordinary business income or loss of the partnership for the reviewed year, reflecting any partnership adjustments as finally determined, as taxable income described in section 1(c) (determined without regard to section 1(h)).

(iv) Reportable transaction understatement under section 6662A. For purposes of application of the penalty under section 6662A (reportable transaction understatement penalty), the portion of an imputed underpayment attributable to an item described under section 6662A(b)(2) is treated as a reportable transaction understatement under section 6662A(b).

(v) Reasonable cause and good faith. For purposes of determining whether a partnership satisfies the reasonable cause and good faith exception under section 6664(c) or (d) with respect to a penalty under section 6662, section 6662A, or section 6663, the partnership is treated as the taxpayer. See §1.6664-4 of this chapter. Accordingly, the facts and circumstances taken into account to determine whether the partnership has established reasonable cause and good faith are the facts and circumstances applicable to the partnership. A partner-level defense (as described in §301.6226-3(i)(3)) may not be raised in a proceeding of the partnership except as provided under the modification procedures set forth in §301.6225-2(d)(2) (amended returns) or in §301.6225-2(d)(8) (partner closing agreements).

(3) Examples. The following examples illustrate the rules of paragraph (c) of this section. For purposes of these examples, each partnership has a calendar taxable year, and the highest tax rate in effect for all taxpayers is 40 percent for all relevant periods.

Example 1. One adjustment with respect to which a penalty is imposed. In an administrative proceeding with respect to Partnership's 2018 partnership return, the IRS determines that Partnership understated ordinary income by \$100. The \$100 understatement is due to negligence or disregard of rules or regulations under section 6662(c), and a 20-percent accuracy-related penalty applies under section 6662(a). The IRS also determines that Partnership understated long-term capital gain by \$300, but no penalty applies with respect to that adjustment. Partnership does not request modification of the imputed underpayment under section 6225 and does not raise any penalty defenses prior to issuance of the notice of final partnership adjustment (FPA). In the FPA, the IRS determines that the imputed underpayment is \$160 ($(\$100 + \$300) \times 40$ percent). In determining the penalty, the \$100 adjustment (to which the 20-percent penalty relates) is grouped separately from the \$300 adjustment (to which no penalty applies). The portion of the imputed underpayment to which the 20-percent penalty applies is \$40 ($\100×40 percent), and the penalty is \$8 ($\40×20 percent).

Example 2. More than one adjustment with respect to which the same rate of penalty is imposed. The facts are the same as in Example 1 of this paragraph (c)(3), except that the IRS determines that Partnership also overstated its credits by \$10. The

overstatement of credits is due to negligence or disregard of rules or regulations under section 6662(c), and a 20-percent accuracy-related penalty applies under section 6662(a). Because the Partnership did not request modification, the imputed underpayment is \$170 $((\$100 + \$300) \times 40 \text{ percent}) + \10 . In determining the penalty, the \$10 credit adjustment and the \$100 understatement of income, both of which are adjustments with respect to which the 20-percent accuracy-related penalty is imposed, are grouped together. Accordingly, the portion of the imputed underpayment to which the 20-percent accuracy-related penalty applies is \$50 $((\$100 \times 40 \text{ percent}) + \$10)$, and the penalty is \$10 $(\$50 \times 20 \text{ percent})$.

Example 3. Negative adjustment. The facts are the same as in Example 2 of this paragraph (c)(3), except that there is also an adjustment that reduces ordinary income by \$50. In calculating the imputed underpayment under §301.6225-1, the \$50 decrease to ordinary income is netted with the \$100 increase in ordinary income. Therefore, the \$50 decrease in ordinary income is an adjustment that resulted in the imputed underpayment and therefore a negative adjustment described in paragraph (c)(2)(ii)(C) of this section. Because Partnership did not request modification, the imputed underpayment is \$150 $((\$100 - \$50) + \$300) \times 40 \text{ percent}) + \10 . To determine the portion of the imputed underpayment to which the 20-percent accuracy-related penalty applies, the \$50 reduction to ordinary income is grouped with the \$300 adjustment to long-term capital gain (in accordance with paragraph (c)(2)(ii)(D) of this section). Accordingly, the portion of the imputed underpayment to which the 20-percent accuracy-related penalty applies is \$50 $((\$100 \times 40 \text{ percent}) + \$10)$, and the penalty is \$10 $(\$50 \times 20 \text{ percent})$.

Example 4. Two adjustments with respect to which penalties of different rates have been imposed. The facts are the same as in Example 3 of this paragraph (c)(3), except that the \$300 adjustment to long-term capital gain is due to a gross valuation misstatement. A 40-percent accuracy-related penalty under section 6662(a) and (h) applies to the portion of the imputed underpayment attributable to the gross valuation misstatement. The imputed underpayment is \$150 $((\$100 - \$50) + \$300) \times 40 \text{ percent}) + \10 . Under paragraph (c)(2)(ii)(B) of this section, the adjustment to long-term capital gain (the adjustment to which the 40-percent penalty relates) and the adjustments to ordinary income and credits (the adjustments to which the 20-percent penalty relates) are grouped separately. In accordance with paragraph (c)(2)(ii)(D) of this section, because there are no partnership adjustments with respect to which no penalties have been imposed, the \$50 reduction in ordinary income (the negative adjustment) is allocated to the grouping of adjustments with respect to which the 20-percent penalty is imposed. The amount described under paragraph (c)(2)(ii)(B) of this section with respect to the 20-percent penalty grouping is \$30 $((\$100 \times 40 \text{ percent}) - (\$50 \times 40 \text{ percent}) + 10)$. Therefore, the portion of the imputed underpayment to which the 20 percent accuracy-related penalty applies is \$30 and the penalty is \$6 $(\$30 \times 20 \text{ percent})$. The portion of the imputed underpayment to which the 40-percent gross valuation misstatement penalty applies is \$120 $(\$300 \times 40 \text{ percent})$, and the penalty is \$48 $(\$120 \times 40 \text{ percent})$. The accuracy-related penalty under section 6662(a) is \$54.

Example 5. Modification with respect to tax-exempt partner. The IRS initiates an administrative proceeding with respect to Partnership's 2019 taxable year. Partnership has four equal partners during its 2019 taxable year: two partners are partnerships, A and B; one partner is a tax-exempt entity, C; and the fourth partner is an individual, D. The IRS timely mails a notice of proposed partnership adjustment (NOPPA) to Partnership for its 2019 taxable year proposing a single partnership adjustment increasing Partnership's ordinary income by \$400,000. The \$400,000 increase in income is due to negligence or disregard of rules or regulations under section 6662(c). A 20-percent accuracy-related penalty under section 6662(a) and (c) applies to the portion of the imputed underpayment attributable to the negligence or disregard of the rules or regulations. In the NOPPA, the IRS determines an imputed underpayment of \$160,000 ($\$400,000 \times 40$ percent); the portion of the imputed underpayment to which the 20-percent penalty applies is \$32,000 ($\$160,000 \times 20$ percent). Partnership requests modification under §301.6225-2(d)(3) (regarding tax-exempt partners) with respect to the amount of additional income allocated to C, and the IRS approves the request. After modification of the imputed underpayment, the imputed underpayment is \$120,000 ($(\$400,000 - \$100,000) \times 40$ percent), and the penalty is \$24,000 ($\$120,000 \times 20$ percent).

Example 6. Amended return modification. The facts are the same as in Example 5 of this paragraph (c)(3), except in addition to the modification with respect to C's tax-exempt status, Partnership requests a modification under §301.6225-2(d)(2) (regarding amended returns) with respect to the \$100,000 of additional income allocated to D. In accordance with the rules under §301.6225-2(d)(2), D files an amended return for D's 2019 taxable year taking into account \$100,000 of additional ordinary income. In addition, in accordance with §301.6225-2(d)(2)(viii), D takes into account on D's return the 20-percent accuracy-related penalty for negligence or disregard of rules or regulations that relates to the ordinary income adjustment. D's tax attributes for other taxable years are not affected. The IRS approves the modification. As a result, Partnership's total netted partnership adjustment under §301.6225-1(c)(3) is \$200,000 ($\$400,000$ less $\$100,000$ allocable to C and $\$100,000$ taken into account by D). The imputed underpayment, after modification, is \$80,000 ($\$200,000 \times 40$ percent), and the penalty is \$16,000 ($\$80,000 \times 20$ percent).

(d) Applicability date--(1) In general. Except as provided in paragraph (d)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Par. 11. Section 301.6233(b)-1 is added to read as follows:

§301.6233(b)-1 Interest and penalties with respect to the adjustment year return.

(a) Interest and penalties with respect to failure to pay imputed underpayment on the date prescribed. In the case of any failure to pay an imputed underpayment on the date prescribed for such payment (as described in §301.6232-1(b)), a partnership is liable for —

- (1) Interest as determined under paragraph (c) of this section; and
- (2) Any penalty, addition to tax, or additional amount as determined under paragraph (d) of this section.

(b) Imputed underpayments to which this section applies. This section applies to the portion of an imputed underpayment determined by the IRS under section 6225(a)(1), or an imputed underpayment resulting from adjustments requested by a partnership in an administrative adjustment request under section 6227, that is not paid by the date prescribed for payment under §301.6232-1(b).

(c) Interest. Interest determined under this paragraph (c) is the interest that would be imposed under chapter 67 of the Internal Revenue Code (Code) by treating any unpaid amount of the imputed underpayment as an underpayment of tax imposed for the adjustment year (as defined in §301.6241-1(a)(1)). The interest under this paragraph (c) begins on the date prescribed for payment (as described in §301.6232-1(b)) and ends on the date payment of the imputed underpayment is made.

(d) Penalties. If a partnership fails to pay an imputed underpayment by the date prescribed for payment (as described in §301.6232-1(b)), section 6651(a)(2) applies to such failure, and any unpaid amount of the imputed underpayment is treated as if it

were an underpayment of tax for purposes of part II of subchapter A of chapter 68 of the Code. For purposes of this section, the penalty under 6651(a)(2) is applied by treating the unpaid amount of the imputed underpayment as the unpaid amount shown as tax on a return required under subchapter A of chapter 61 of the Code.

(e) Applicability date--(1) In general. Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Par. 12. Section 301.6234-1 is added to read as follows:

§301.6234-1 Judicial review of partnership adjustment.

(a) In general. Within 90 days after the date on which a notice of a final partnership adjustment (FPA) with respect to any partnership taxable year is mailed under section 6231(a)(3), a partnership may file a petition for a readjustment of any partnership adjustment (as defined in §301.6241-1(a)(6)) reflected in the FPA for such taxable year (without regard to whether an election under section 6226 has been made with respect to any imputed underpayment reflected in such FPA) with--

(1) The Tax Court;

(2) The district court of the United States for the district in which the partnership's principal place of business is located; or

(3) The Court of Federal Claims.

(b) Jurisdictional requirement for bringing action in district court or Court of Federal Claims. A petition for readjustment under this section with respect to any partnership adjustment may be filed in a district court of the United States or the Court of Federal Claims only if the partnership filing the petition deposits with the Internal Revenue Service (IRS), on or before the date the petition is filed, the amount of any imputed underpayment resulting from the partnership adjustment.

(c) Treatment of deposit as payment of tax. Any amount deposited in accordance with paragraph (b) of this section, while deposited, will not be treated as a payment of tax for purposes of the Internal Revenue Code (Code). Notwithstanding the preceding sentence, an amount deposited in accordance with paragraph (b) of this section will be treated as a payment of tax for purposes of chapter 67 of the Code (relating to interest). Interest will be allowed and paid in accordance with section 6611.

(d) Effect of decision dismissing action. If an action brought under this section is dismissed other than by reason of a rescission of the FPA under section 6231(c) and §301.6231-1(g), the decision of the court dismissing the action is considered as its decision that the FPA is correct.

(e) Amount deposited may be applied against assessment. If the limitations on assessment under section 6232(b) and §301.6232-1(c) no longer apply with respect to an imputed underpayment for which a deposit under paragraph (b) of this section was made, the IRS may apply the amount deposited against any such imputed underpayment that is assessed.

(f) Applicability date--(1) In general. Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Par. 13. Section 301.6235-1 is added to read as follows:

§301.6235-1 Period of limitations on making adjustments.

(a) In general. Except as provided in section 6235(c) and (d) and paragraph (b) of this section (regarding extensions), no partnership adjustment (as defined in §301.6241-1(a)(6)) for any partnership taxable year may be made after the later of the date that is ---

(1) 3 years after the latest of—

(i) The date on which the partnership return for such taxable year was filed;
(ii) The return due date (as defined in section 6241(3)) for the taxable year; or
(iii) The date on which the partnership filed an administrative adjustment request with respect to such taxable year under section 6227; or

(2) The date described in paragraph (b) of this section with respect to a request for modification; or

(3) The date described in paragraph (c) of this section with respect to a notice of proposed partnership adjustment.

(b) Modification requested under section 6225(c)--(1) In general. For purposes of paragraph (a)(2) of this section, in the case of any request for modification of any

imputed underpayment under section 6225(c), the date by which the Internal Revenue Service (IRS) may make a partnership adjustment is the date that is 270 days (plus the number of days of an extension of the modification period (as described in §301.6225-2(c)(3)(i)) agreed to by the IRS under section 6225(c)(7) and §301.6225-2(c)(3)(ii)) after the date on which everything required to be submitted to the IRS pursuant to section 6225(c) is so submitted.

(2) Date on which everything is required to be submitted--(i) In general. For purposes of paragraph (b)(1) of this section, the date on which everything required to be submitted to the IRS pursuant to section 6225(c) is so submitted is the earlier of—

(A) The date the modification period ends (including extensions) as described in §301.6225-2(c)(3)(i) and (ii); or

(B) The date the modification period expires as a result of a waiver of the prohibition on mailing a notice of final partnership adjustment (FPA) under §301.6231-1(b)(2). See §301.6225-2(c)(3)(iii).

(ii) Incomplete submission has no effect. A determination by the IRS that the information submitted as part of a request for modification is incomplete has no effect on the applicability of paragraph (b)(2) of this section.

(c) Notice of proposed partnership adjustment. For purposes of paragraph (a)(3) of this section, the date by which the IRS may make a partnership adjustment is the date that is 330 days (plus the number of days of an extension of the modification period (as described in §301.6225-2(c)(3)(i)) agreed to by the IRS under section 6225(c)(7) and §301.6225-2(c)(3)(ii)) after the date the last notice of proposed

partnership adjustment (NOPPA) is mailed under section 6231(a)(2), regardless of whether modification is requested by the partnership under section 6225(c).

(d) Extension by agreement. The periods described in paragraphs (a), (b), and (c) of this section (including any extension of those periods pursuant to this paragraph (d)) may be extended by an agreement, in writing, entered into by the partnership and the IRS before the expiration of such period.

(e) Examples. The following examples illustrate the rules of this section. For purposes of these examples, each partnership has a calendar taxable year.

Example 1. Partnership timely files its partnership return for the 2020 taxable year on March 1, 2021. On September 1, 2023, Partnership files an administrative adjustment request (AAR) under section 6227 with respect to its 2020 taxable year. As of September 1, 2023, the IRS has not initiated an administrative proceeding under subchapter C of chapter 63 of the Internal Revenue Code with respect to Partnership's 2020 taxable year. Therefore, as of September 1, 2023, under paragraph (a)(1) of this section, the period for making partnership adjustments with respect to Partnership's 2020 taxable year expires on September 1, 2026.

Example 2. Partnership timely files its partnership return for the 2020 taxable year on the due date, March 15, 2021. On February 1, 2023, the IRS mails to Partnership and the partnership representative of Partnership (PR) a notice of administrative proceeding under section 6231(a)(1) with respect to Partnership's 2020 taxable year. Assuming no AAR has been filed with respect to Partnership's 2020 taxable year and the IRS has not yet mailed a NOPPA under section 6231(a)(2) with respect to Partnership's 2020 taxable year, the period for making partnership adjustments for Partnership's 2020 taxable year expires on the date determined under paragraph (a)(1) of this section, March 15, 2024.

Example 3. The facts are the same as in Example 2 of this paragraph (e), except that on June 1, 2023, pursuant to §301.6235-1(d), PR signs an agreement extending the period for making partnership adjustments under section 6235(a)(1) for Partnership's 2020 taxable year to December 31, 2025. In addition, on June 2, 2025, the IRS mails to Partnership and PR a timely NOPPA under section 6231(a)(2). Pursuant to §301.6225-2(c)(3)(i), the modification period expires on February 27, 2026 (270 days after June 2, 2025, the date the NOPPA is mailed), but PR does not submit a request for modification on or before this date. Under paragraph (c) of this section, the date for purposes of paragraph (a)(3) of this section is April 28, 2026, the date that is 330 days from the mailing of the NOPPA. Because April 28, 2026 is later than the date under paragraph (a)(1) of this section (December 31, 2025, as extended under

paragraph (d) of this section), and because no modification was requested, paragraph (a)(2) of this section is not applicable, April 28, 2026 is the date on which the period for making partnership adjustments expires under section 6235.

Example 4. The facts are the same as in Example 3 of this paragraph (e), except that PR notifies the IRS that Partnership will be requesting modification. On January 5, 2026, PR and the IRS agree to extend the modification period pursuant to section 6225(c)(7) and §301.6225-2(c)(3)(ii) for 45 days—from February 27, 2026 to April 13, 2026. PR submits the request for modification to the IRS on April 13, 2026. Therefore, the date determined under paragraph (b) of this section is February 22, 2027, which is 270 days after the date everything required to be submitted was so submitted pursuant to paragraph (b)(2) of this section plus the additional 45-day extension of the modification period agreed to by PR and the IRS. Because February 22, 2027 is later than the date under paragraph (a)(1) of this section (December 31, 2025, as extended under paragraph (d) of this section) and the date under paragraph (a)(3) of this section (June 12, 2026, which is 330 days from the date the NOPPA was mailed plus the 45-day extension under section 6225(c)(7)), February 22, 2027 is the date on which the period for making partnership adjustments expires under section 6235.

Example 5. The facts are the same as in Example 4 of this paragraph (e), except that PR does not request an extension of the modification period. On February 1, 2026, PR submits a request for modification and PR, and the IRS agree in writing to waive the prohibition on mailing an FPA pursuant to §301.6231-1(b)(2). Pursuant to §301.6225-2(c)(3)(iii), the modification period expires as of February 1, 2026, rather than February 27, 2026. Accordingly, under paragraph (b)(2) of this section, the date on which everything required to be submitted pursuant to section 6225(c) is so submitted is February 1, 2026, and the 270-day period described in paragraph (b)(1) of this section begins to run on that date. Therefore, the date for purposes of paragraph (a)(2) of this section is October 29, 2026, which is 270 days after February 1, 2026, the date on which everything required to be submitted under section 6225(c) is so submitted. Because October 29, 2026 is later than the date under paragraph (a)(1) of this section (December 31, 2025, as extended under paragraph (d) of this section) and the date under paragraph (a)(3) of this section (April 28, 2026), October 29, 2026 is the date on which the period for making partnership adjustments expires under section 6235.

Example 6. The facts are the same as in Example 5 of this paragraph (e), except PR completes its submission of information to support a request for modification on July 1, 2025, but does not execute a waiver pursuant to §301.6231-1(b)(2). Therefore, pursuant to paragraph (b)(2) of this section, February 26, 2026, the date the modification period expires, is the date on which everything required to be submitted pursuant to section 6225(c) is so submitted. As a result, the 270-day period described in paragraph (b)(1) of this section expires on November 23, 2026. Because November 23, 2026 is later than the date under paragraph (a)(1) of this section (December 31, 2025, as extended under paragraph (d) of this section) and the date under paragraph (a)(3) of this section (April 28, 2026), November 23, 2026 is the date on which the period for making partnership adjustments expires under section 6235.

(f) Applicability date--(1) In general. Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) Election under §301.9100-22T in effect. This section applies to any partnership taxable year beginning after November 2, 2015 and before January 1, 2018 for which a valid election under §301.9100-22T is in effect.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.