the NHS which do not conform to the minimum criteria as set forth in the standards, policies, and standard specifications for:

(A) Experimental features on projects; and

(B) Projects where conditions warrant that exceptions be made.

(ii) The determination to approve a project design that does not conform to the minimum criteria is to be made only after due consideration is given to all project conditions such as maximum service and safety benefits for the dollar invested, compatibility with adjacent sections of roadway and the probable time before reconstruction of the section due to increased traffic demands or changed conditions.

(2) *Programmatic exception.* Approval within the delegated authority provided by FHWA Order M1100.1A may be given, on a programmatic basis, a more recent edition of any standard or specification incorporated by reference under § 625.4(d).

■ 4. Amend § 625.4 by;

■ a. Revising paragraphs (a)(1) and (3) and (b)(7);

■ b. Adding paragraph (b)(9);

■ c. Removing paragraph (c)(2) and redesignating paragraph (c)(3) as paragraph (c)(2);

■ d. Revising the last sentence in the paragraph (d) introductory text and paragraph (d)(1)(i);

■ e. Revising paragraphs (d)(1)(vi)(E) and (F) and adding paragraph (d)(1)(vi)(G);

■ f. Revising paragraphs (d)(1)(vii);

■ g. Revising paragraph (viii)(A) and adding paragraphs (d)(1)(viii)(B) and (C);

■ h. Revising paragraphs (d)(1)(ix)(A) and (B) and adding paragraphs (d)(1)(ix)(C) and (D);

■ i. Removing paragraph (d)(1)(x); and

■ j. Redesignating paragraph (d)(2)(i) as paragraph (d)(2)(ii), and adding new paragraph (d)(2)(i).

The revisions and additions read as follows:

§ 625.4 Standards, policies, and standard specifications.

(a) * * *

(1) A Policy on Geometric Design of Highways and Streets, AASHTO (paragraph (d) of this section).

* * * * *

(3) The geometric design standards for resurfacing, restoration, and rehabilitation (RRR) projects on NHS highways shall be the procedures or the design criteria established for individual projects, groups of projects, or all RRR projects in a State, and as approved by FHWA. The RRR design standards shall reflect the consideration of the traffic, safety, economic, physical, community, and environmental needs of the projects. If a State does not adopt design procedures or criteria for RRR projects as approved by FHWA, the standards listed in paragraphs (a)(1) and (2) of this section shall apply.

* * * * *

(b) * * *

(7) AASHTO Standard Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, (paragraph (d) of this section); or AASHTO LRFD Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals (paragraph (d) of this section).

* * * * *

(9) AWS D1.1/D1.1M Structural Welding Code—Steel (paragraph (d) of this section).

* * * * *

(d) * * * For information on the availability of this material at NARA, email *fedreg.legal@nara.gov* or go to *www.archives.gov/federal-register/cfr/ibr-locations.html.*

(1) * * *

(i) A Policy on Geometric Design of Highways and Streets, 7th Edition, 2018.

* * * * *

(vi) * * *

(E) Interim Revisions, 2014,

(F) Interim Revisions, 2015, and

(G) Interim Revisions, 2018.

(vii) AASHTO/AWS D1.5M/D1.5: 2015–AMD1, Bridge Welding Code, Amendment: Second Printing December 12, 2016.

(viii) * * *

(A) AASHTO LTS–6–I1, 2015 Interim Revisions to Standard Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2014,

(B) AASHTO LTS–6–I2–OL, 2019 Interim Revisions to Standard Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2018, and

(C) AASHTO LTS–6–I3–OL, 2020 Interim Revisions to Standard Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2019.

(ix) * * *

(A) AASHTO LRFDLTS–1–I1–OL, 2017 Interim Revisions to LRFD Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2016,

(B) AASHTO LRFDLTS–1–I2–OL, 2018 Interim Revisions to LRFD Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2017,

(C) AASHTO LRFDLTS–1–I3–OL, 2019 Interim Revisions to LRFD Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2018, and

(D) AASHTO LRFDLTS–1–I4–OL, 2020 Interim Revisions to LRFD Specifications for Structural Supports for Highway Signs, Luminaires, and Traffic Signals, copyright 2019.

(2) * * *

(i) D1.1/D1.1M:2015 Structural Welding Code—Steel, Second printing, copyright 2016, and

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[FR Doc. 2020–25679 Filed 11–23–20; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG–123652–18]

RIN 1545–BP01

Treatment of Special Enforcement Matters

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations to except certain partnership-related items from the centralized partnership audit regime that was created by the Bipartisan Budget Act of 2015, and sets forth alternative rules that will apply. The centralized partnership audit regime does not apply to a partnership-related item if the item involves a special enforcement matter described in these regulations. Additionally, these regulations propose changes to the regulations to account for changes to the Internal Revenue Code (Code). Finally, these proposed regulations also make related and clarifying amendments to the final regulations under the centralized partnership audit regime. The proposed regulations would affect partnerships and partners to whom special enforcement matters apply.

DATES: Written or electronic comments must be received by January 25, 2021.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–123652–18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket. Send paper submissions to: CC:PA:LPD:PR (REG–123652–18), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jennifer M. Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317–6834; and concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317–5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) regarding special enforcement matters under section 6241(11) of the Code and the collection of amounts due under the centralized partnership audit regime pursuant to section 6241(7) of the Code. Section 6241(11) was enacted by section 206 of the Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115–141 (TTCA). This document also contains several proposed amendments to the final regulations on the centralized partnership audit regime published in TD 9844 (84 FR 6468) on February 27, 2019.

Section 1101(a) of the Bipartisan Budget Act of 2015, Public Law 114–74 (BBA) amended chapter 63 of the Code (chapter 63) by removing former subchapter C of chapter 63 effective for partnership taxable years beginning after December 31, 2017. Former subchapter C of chapter 63 contained the unified partnership audit and litigation rules enacted by the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (TEFRA) that were commonly referred to as the TEFRA partnership procedures or simply, TEFRA. Section 1101(b) of the BBA removed subchapter D of chapter 63 and amended chapter 1 of the Code (chapter 1) by removing part IV of subchapter K of chapter 1, rules applicable to electing large partnerships, effective for partnership taxable years beginning after December 31, 2017. Section 1101(c) of the BBA replaced the TEFRA partnership procedures and the rules applicable to electing large partnerships with a centralized partnership audit regime that determines adjustments and, in general, determines, assesses, and collects tax at the partnership level. Section 1101(g) of the BBA set forth the effective dates for these statutory amendments, which are effective generally for returns filed for partnership taxable years beginning after December 31, 2017. On December 18, 2015, section 1101 of the BBA was amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113 (PATH Act). The amendments under the PATH Act are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

Enacted on March 23, 2018, the TTCA made a number of technical corrections to the centralized partnership audit regime, including adding sections 6241(11) (regarding the treatment of special enforcement matters) and 6232(f) (regarding the collection of the imputed underpayment and other amounts due from partners of the partnership in the event the amounts are not paid by the partnership) to the Code. The amendments to subchapter C of chapter 63 included in the TTCA are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

On January 2, 2018, the Treasury Department and the IRS published in the **Federal Register** (82 FR 28398) final regulations under section 6221(b) providing rules for electing out of the centralized partnership audit regime (TD 9829).

On August 9, 2018, the Treasury Department and the IRS published in the **Federal Register** (83 FR 39331) final regulations under section 6223 providing rules relating to partnership representatives and final regulations under § 301.9100–22 providing rules for electing into the centralized partnership audit regime for taxable years beginning on or after November 2, 2015, and before January 1, 2018. Corresponding temporary regulations under § 301.9100–22T were also withdrawn (TD 9839).

On February 27, 2019, the Treasury Department and the IRS published in the **Federal Register** (84 FR 6468) final regulations implementing sections 6221(a), 6222, and 6225 through 6241 of the centralized partnership audit regime (TD 9844).

Under section 6241(11), in the case of partnership-related items involving special enforcement matters, the Secretary of the Treasury or his delegate (Secretary) may prescribe regulations providing that the centralized partnership audit regime (or any portion thereof) does not apply to such items and that such items are subject to special rules as the Secretary determines to be necessary for the effective and efficient enforcement of the Code. For purposes of section 6241(11), the term ''special enforcement matters'' means: (1) Failure to comply with the requirements of section 6226(b)(4)(A)(ii) (regarding the requirement for a partnership-partner or S corporation partner to furnish statements or compute and pay an imputed underpayment); (2) assessments under section 6851 (relating to termination assessments of income tax) or section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes); (3) criminal investigations; (4) indirect methods of proof of income; (5) foreign partners or partnerships; and (6) other matters that the Secretary determines by regulation present special enforcement considerations.

Explanation of Provisions

On January 14, 2019, the IRS published in the Internal Revenue Bulletin Notice 2019–06, 2019–03 IRB 353 (Notice 2019–06), informing taxpayers that the Treasury Department and the IRS intended to propose regulations addressing two special enforcement matters under section 6241(11). These regulations propose the rules addressed in Notice 2019–06 and several other rules regarding special enforcement matters under section 6241(11).

These regulations also propose several changes to regulations finalized in TD 9844 to provide clarity regarding certain provisions. Changes are required to the regulations finalized in TD 9844 to address the treatment of chapter 1 taxes, penalties, additions to tax, additional amounts, and any imputed underpayments previously reported by the partnership adjusted as part of an examination under the centralized partnership audit regime to correspond to the addition of proposed § 301.6241–7(g), which is discussed in part 5.F of this Explanations of Provisions. Additional edits are proposed to modify the rules implementing section 6241(7) regarding the treatment of adjustments when a partnership ceases to exist to account for the addition of section 6232(f) to the Code. Finally, minor clarifying edits are proposed.

In addition to the changes listed above, certain regulations have been reordered or renumbered, typographical errors have been corrected, and nonsubstantive editorial changes have been made.

1. Election Out of the Centralized Partnership Audit Regime

Certain partnerships may elect out of the centralized partnership audit regime under section 6221(b). Section 301.6221(b)–1 provides the rules for electing out of the centralized partnership audit regime, including determining whether a partnership is eligible to elect out of the centralized partnership audit regime. A partnership is eligible to make an election out if it has 100 or fewer partners for the taxable year, each partner in the partnership is an eligible partner, the election is timely made in the manner prescribed by the Secretary, and the partnership notifies its partners of the election in the manner prescribed by the Secretary. Section 301.6221(b)–1(b)(2)(i) generally provides that a partnership has 100 or fewer partners if the partnership is required to furnish 100 or fewer statements under section 6031(b) for the taxable year. As part of determining whether a partnership has 100 or fewer partners, section 6221(b)(2)(A) and § 301.6221(b)–1(b)(2)(ii) require a partnership with a partner that is an S corporation (as defined in section 1361(a)(1)) to take into account each statement required to be furnished by the S corporation to its shareholders under section 6037(b) for the taxable year of the S corporation ending with or within the partnership's taxable year.

Eligible partners are those persons prescribed in section 6221(b)(1)(C) and § 301.6221(b)–1(b)(3)(i). Under § 301.6221(b)–1(b)(3)(ii)(D) a partner is not an eligible partner if the partner is a ''disregarded entity described in § 301.7701–2(c)(2)(i).'' Proposed § 301.6221(b)–1(b)(3)(ii)(D) changes ''disregarded entity described in § 301.7701–2(c)(2)(i)'' to ''a wholly-owned entity disregarded as separate from its owner for Federal income tax purposes'' and would include, for example, a qualified REIT subsidiary (as defined in section 856(i)(2)) or grantor trust. This change is made to be consistent with the description of a disregarded entity used elsewhere in the regulations under the centralized partnership audit regime. *See, e.g.,* §§ 301.6225–2; 301.6226–3; 301.6241–1.

The proposed regulations also add § 301.6221(b)–1(b)(3)(ii)(G), which addresses partnerships with qualified subchapter S subsidiaries (QSubs) as partners to remove any ambiguity regarding whether a partnership with a QSub as a partner can elect out of the centralized partnership audit regime. A QSub is defined in section 1361(b)(3)(B) as any domestic corporation that is not an ineligible corporation (as defined in section 1361(b)(2)) if 100 percent of the stock of such corporation is held by an S corporation and the S corporation elects to treat such corporation as a QSub. *See* § 1.1361–4(a)(1). However, section 1361(b)(3)(A) provides that, ''[e]xcept as provided in regulations prescribed by the Secretary, for purposes of *this title*'' (that is, the Code): (i) A corporation that is a QSub is not treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit, of a QSub are treated as assets, liabilities, and such items (as the case may be) of its parent S corporation. Further, section 1361(b)(3)(E) provides that, except to the extent provided by the Secretary, the rules of section 1361(b)(3) do not apply with respect to the provisions of part III of subchapter A of chapter 61 of the Code (relating to information reporting). That is, a QSub is treated as a separate corporation for information reporting purposes. *See* § 1.1361–4(a)(9). Section 6031(b), one of the provisions of part III of subchapter A of chapter 61, provides that each partnership required to file a return must furnish to each person who is a partner or who holds an interest in the partnership as a nominee for another person at any time during a partnership taxable year a copy of the information required to be shown on the return as may be required by regulations. Thus, if a QSub is treated as a partner in a partnership, then under section 6031(b) the partnership is required to furnish a statement containing its return information to the QSub.

Notice 2019–06 states that partnership structures with QSubs as partners present special enforcement concerns because allowing a partnership with a QSub partner to elect out of the centralized partnership audit regime would enable a partnership to elect out in situations where there are over 100 ultimate taxpayers. If a partnership elects out of the centralized partnership audit regime, any adjustments must be made in examinations of the ultimate taxpayers who own interests in the partnership. To limit the number of examinations the IRS must conduct, Congress determined that only partnerships with 100 or fewer partners could elect out of the centralized partnership audit regime. Section 6221(b). In addition, under section 6221(b), partnerships with partners that are flow-through entities, except for partners that are S corporations, are ineligible to elect out of the centralized partnership audit regime. For partnerships with S corporation partners, the shareholders of the S corporation partner are counted in determining if the partnership has 100 or fewer partners. Section 6221(b)(2)(A). Accordingly, if such partnerships elect out of the centralized partnership audit regime, this will generally result in there being less than 101 ultimate taxpayers to potentially examine. However, as described above, if partnerships with QSubs as partners are eligible to elect out, this may result in the IRS having to examine more than 100 ultimate taxpayers for a particular partnership.

For example, in contrast to S corporations, if a QSub was an eligible partner for purposes of section 6221, because a QSub is not an S corporation, the special rules for S corporations under section 6221(b)(2)(A) and § 301.6221(b)–1(b)(2)(ii) would not apply to a QSub partner. These special rules require the partnership to count the number of statements required to be furnished by the S corporation partner in determining if the partnership has 100 or fewer partners for the taxable year. Therefore, in a situation where a partnership that has a QSub as a partner and 99 other individual partners for purposes of section 6031(b), the stock of the S corporation that wholly owned the stock of the QSub could be owned by well over 100 ultimate taxpayers who satisfy the requirements of section 1361(b)(1)(A) (limiting the number of shareholders of an S corporation to 100) by reason of section 1361(c)(1) (treating members of a family as one shareholder for purposes of section 1361(b)(1)(A)). Allowing such a partnership to elect out of the centralized partnership regime would clearly frustrate the efficiencies the regime was intended to create.

To avoid this result and the attendant special enforcement concerns, Notice 2019–06 states that the Treasury Department and the IRS intend to propose regulations under section 6241(11)(B)(vi) providing that the ability to elect out of the centralized partnership audit regime under section 6221(b) generally does not apply to a partnership with a QSub as a partner. Notice 2019–06 states that the proposed regulations would apply a rule similar to the rules for S corporations under section 6221(b)(2)(A), which would require an S corporation holding the QSub stock to disclose the name and taxpayer identification number of each person with respect to whom the S corporation is required to furnish a statement under section 6037(b) for the taxable year of the S corporation ending with or within the partnership taxable year. Such statements are treated as if they were furnished by the partnership. *See* section 6221(b)(2)(A)(ii). Therefore, under Notice 2019–06, each statement furnished by the partnership to the S corporation, and by the S corporation to its shareholders, would be included in determining if the partnership has 100 or fewer partners for the taxable year for purposes of the election out of the centralized partnership audit regime.

In determining whether a QSub is an eligible partner under section 6221(b), Notice 2019–06 cites to section 1361(a)(2), which provides that a corporation, other than an S corporation (as defined in section 1361(b)(1)), is a C corporation. Comments to the centralized partnership audit regime and Notice 2019–06 revealed a lack of consensus regarding how section 1361 should be interpreted.

A comment relating to rules for electing out of the centralized partnership audit regime requested guidance confirming that a partner's status as a QSub does not prevent a partnership from electing out of the centralized partnership audit regime based on the belief that current law under section 1361 treats a QSub as an eligible partner (that is, a C corporation) and so requires this result. Further, the comment stated that a QSub is not a disregarded entity as described in § 301.7701–2(c)(2)(i) and even if a QSub is ignored for most Federal tax purposes, such treatment is afforded by section 1361(b)(3)(A)(i) and not § 301.7701–2(c)(2)(i). Section 301.7701–2(c)(2)(i) provides that a business entity that has a single owner and is not a ''per se'' corporation under § 301.7701–2(b) is disregarded as an entity separate from its owner. Thus, the comment concluded that a QSub could never be the type of disregarded entity that Treasury regulations identify as an ineligible partner.

In contrast, another comment in response to Notice 2019–06 stated that Notice 2019–06 incorrectly states that, because a QSub is not an S corporation, it is a C corporation and therefore, an eligible partner under section 6221(b). The comment provided the rationale that, when a corporation makes a QSub election, it is treated under section 1361(b)(3)(A) as if it liquidated into its parent S corporation and accordingly, no longer exists, for purposes of the Code, as a separate entity for Federal tax purposes (even though for state law purposes, such as limited liability, it still exists). Therefore, the comment stated that a QSub is not a partner under section 6221(b) and concluded that the parent S corporation is treated as the partner and that the S corporation, not the QSub, should provide its shareholder information to the partnership under section 6221(b)(2) for purposes of determining whether the partnership may elect out of the centralized partnership audit regime.

Although Notice 2019–06 states that the proposed regulations would have applied a rule similar to the rules for S corporations under section 6221(b)(2)(A) to partnerships with a QSub as a partner, the Treasury Department and the IRS have reconsidered that approach. Under § 301.6221(b)–1(b)(3)(ii), partnerships that have disregarded entities as partners may not elect out of the centralized partnership audit regime. QSubs are treated similarly to disregarded entities for most purposes under the Code in that both QSubs and disregarded entities do not file income tax returns but instead report their items of income and loss on the returns of the person who wholly owns the entity. Thus, as described earlier in this part and in Notice 2019–06, the Treasury Department and the IRS have determined that partnership structures with QSubs as partners present special enforcement concerns because allowing a partnership with a QSub partner to elect out of the centralized partnership audit regime would enable a partnership to elect out in situations where there are over 100 ultimate taxpayers, thereby frustrating the efficiencies the regime was intended to create. To make clear to taxpayers that a QSub cannot be used to facilitate the election out of the centralized partnership audit regime by a partnership with greater than 100 ultimate taxpayers, the Treasury Department and the IRS have determined it is necessary for the proposed regulations to address such a special enforcement concern by treating QSubs as ineligible partners for purposes of section 6221. Accordingly, proposed § 301.6221(b)–1(b)(3)(ii)(G) provides that a QSub is not an eligible partner for purposes of making an election out of the centralized partnership audit regime under section 6221(b). Therefore, if a QSub is a partner in a partnership and required to be furnished a statement by the partnership under section 6031(b), that partnership will not be eligible to make an election under section 6221(b) to elect out of the centralized partnership audit regime.

2. Imputed Underpayments, Chapter 1 Taxes, Penalties, Additions to Tax, and Additional Amounts

If the IRS adjusts a partnership's chapter 1 taxes, penalties, additions to tax, or similar amounts utilizing the centralized partnership audit regime, there must be a mechanism for including these amounts in the imputed underpayment and accounting for these amounts if the partnership elects to push out the adjustments under section 6226. In addition, there must also be a mechanism to account for any adjustments to a previously determined imputed underpayment. Accordingly, these proposed rules apply to the calculation of the imputed underpayment during an IRS examination and to adjustments to the imputed underpayment as calculated by the partnership. For example, the rules apply to the filing of an administrative adjustment request (AAR) when the partnership-partner computes and pays an imputed underpayment. For proposed changes related to § 301.6241–3, see part 4, Cease to Exist.

A. Inclusion of Adjustments to an Imputed Underpayment and the Partnership's Chapter 1 Taxes, Penalties, Additions to Tax, or Additional Amounts in an Imputed Underpayment

Section 301.6225–1 provides rules for how to calculate the imputed underpayment. First, all adjustments are placed into groups of similar adjustment types and netted appropriately, resulting in net positive or negative adjustments (as described in § 301.6225–1(e)(4)(i)). Most net positive adjustments to items of income, gain, loss, and deduction are then added together to create a total netted partnership adjustment and a tax rate is then applied. That amount is then increased or decreased by any adjustments to credits. Credits are not included in earlier steps of the imputed underpayment calculation because credits generally adjust a taxpayer's amount of tax owed on a dollar-for-dollar basis after a tax rate has been applied. If adjustments to credits were taken into account as part of the total netted partnership adjustment before the tax rate was applied, the value of the credits would be reduced by the tax rate applied and, because of that reduction, would no longer operate as an increase or decrease in tax on a dollar-for-dollar basis.

Proposed § 301.6225–1 modifies the final regulations under § 301.6225–1 to provide a mechanism for including the partnership's chapter 1 taxes, penalties, additions to tax, or additional amounts, as well as any adjustment to a previously determined imputed underpayment (chapter 1 liabilities), in the calculation of the imputed underpayment. Under proposed § 301.6225–1(c)(3), any adjustments to the partnership's chapter 1 liabilities will be placed in the credit grouping and treated similarly to credit adjustments for purposes of calculating the imputed underpayment. Adjustments to these amounts are placed into the credit grouping because, similar to credits, they change the amount the partnership owes on a dollar-per-dollar basis. Multiplying these adjustments to chapter 1 liabilities by a tax rate after the amount has been calculated would be inappropriate because, like credits, these amounts increase or decrease the amount owed on a dollar-per-dollar basis. If these chapter 1 liabilities were included with the other partnership adjustments, they would be multiplied by a tax rate, which would inappropriately reduce the amount of the partnership's chapter 1 liabilities. Thus, treating adjustments to chapter 1 liabilities similarly to credit adjustments allows for appropriate increases or decreases to the imputed underpayment.

The proposed addition to § 301.6225–1(d)(2)(ii) provides that a decrease in a chapter 1 liability is treated as a negative adjustment. Because § 301.6225–1(d)(2)(iii) provides that a positive adjustment is any adjustment that is not a negative adjustment as defined in § 301.6225–1(d)(2)(ii), the proposed addition to the definition of a negative adjustment has the result of making an increase in a chapter 1 liability a positive adjustment. Because § 301.6225–1(e)(4) defines net positive adjustments and net negative adjustments with respect to the definitions of positive and negative adjustments, the proposed addition to § 301.6225–1(d)(2)(ii) affects those definitions as well.

In general, net positive adjustments are used to calculate the imputed underpayment, and net negative adjustments are adjustments that do not result in an imputed underpayment as described in § 301.6225–1(f). An exception to that rule is the treatment of credit adjustments. Both net positive and net negative adjustments to credits may be included in the calculation of the imputed underpayment to increase or decrease the imputed underpayment amount after the tax rate is applied to other adjustments. *See* § 301.6225–1(b)(1)(v) and (e)(3)(ii). If a net negative adjustment applied to the imputed underpayment reduces the amount of the imputed underpayment to zero or below zero, the imputed underpayment adjustments are treated as adjustments that do not result in an imputed underpayment under § 301.6225–1(f)(1)(ii). These adjustments would then be taken into account by the partnership on the adjustment year return pursuant to § 301.6225–3 or by the reviewed year partners pursuant to § 301.6226–3.

This rule does not operate well, however, when the adjustment that has reduced the imputed underpayment below zero is a net negative adjustment to chapter 1 liabilities because the chapter 1 liabilities at issue are adjustments to the liability of the partnership, not the partners, and they are thus neither properly allocated to the partners after they are reported on the partnership's next filed return nor properly pushed out to the partners under section 6226. These amounts could be used to offset another chapter 1 liability of the partnership, but partnerships may not have those types of items on their returns each year because partnerships are often not liable for tax under chapter 1. Treating these amounts similarly to other adjustments could result in an amount reported on the partnership's return that would not result in an overpayment to the partnership and for which there may not be an item to offset in the adjustment year. Accordingly, for partnerships to take advantage of a net negative adjustment to these chapter 1 liabilities, a special rule is required.

The proposed addition to § 301.6225–1(e)(3)(ii), along with proposed § 301.6225–1(f)(1)(ii) and (f)(3), provides two special rules for the treatment of a net negative adjustment to chapter 1 liabilities. Under the first rule, a net negative adjustment to a credit is normally treated as an adjustment that does not result in an imputed underpayment under § 301.6225–1(f)(1)(i), unless the IRS makes a determination to have it offset the imputed underpayment. The proposed addition to § 301.6225–1(e)(3)(ii) states that a net negative adjustment to one of the chapter 1 liabilities is not an adjustment described in § 301.6225–1(f).

The second rule creates an exception to § 301.6225–1(f)(1)(ii), which provides that if the calculation of the imputed underpayment under § 301.6225–1(b)(1) results in a number that is zero or less than zero, the partnership adjustments associated with that calculation are treated as adjustments that do not result in an imputed underpayment. Proposed § 301.6225–1(f)(3) provides a new method for calculating the imputed underpayment if the imputed underpayment calculation results in zero or less than zero and includes a net negative adjustment to one of the chapter 1 liabilities at issue. This new calculation provides that the imputed underpayment be recalculated using all partnership adjustments under § 301.6225–1(b)(1) except for the net negative adjustments to the chapter 1 liabilities. Once that calculation is complete, if the imputed underpayment is a number greater than zero, the imputed underpayment may be reduced, but not below zero, using the net negative adjustment to the chapter 1 liabilities at issue. If this happens, the adjustments that went into the calculation are not adjustments that do not result in an imputed underpayment because the partnership has effectively paid the imputed underpayment calculated on these adjustments through the application of the net negative adjustment to chapter 1 liabilities (or a portion thereof). Any remaining portion of the net negative adjustment to chapter 1 liabilities is not an adjustment that does not result in an imputed underpayment. If, however, the imputed underpayment is already zero or less than zero, the net negative adjustments to the chapter 1 liabilities are not added back to the imputed underpayment calculation, and the net negative adjustments to the chapter 1 liabilities are not treated as adjustments that do not result in an imputed underpayment.

If there is an additional amount of the net negative adjustment to chapter 1 liabilities that was not included in the imputed underpayment calculation (that is, there was excess after the imputed underpayment was reduced to zero or if the imputed underpayment was zero or less than zero regardless of the net negative adjustment to chapter 1 liabilities), the partnership may be able to recoup that amount to offset a prior payment. For instance, if the adjustment related to an amount previously paid by the partnership, the partnership may file a claim for refund of the amount in accordance with section 6511. Alternatively, if the amount has not been previously paid by the partnership, the remaining net negative adjustment to a chapter 1 liability will reduce the amount of chapter 1 tax, penalty, additional amount, addition to tax, or imputed underpayment owed by the partnership.

B. Exception to the Section 6226 Push Out Election

Proposed § 301.6226–2(g)(4) provides that a partnership that makes an election under section 6226 (sometimes called a ''push out election'') must pay any chapter 1 taxes, penalties, additions to tax, and additional amounts or the amount of any adjustment to an imputed underpayment at the time statements are furnished to its partners in accordance with § 301.6226–2. Because these amounts are the partnership's liability, partnerships are not permitted to push out any adjustments to these items when making the push out election.

3. Adjustments to Items That Are Not Items of Income, Gain, Loss, Deduction, or Credit

The final regulations implementing section 6225 do not expressly explain how adjustments to items that are not items of income, gain, loss, deduction, or credit (collectively referred to as ''non-income items'') are taken into account (1) in the calculation of the imputed underpayment; (2) as adjustments that do not result in an imputed underpayment; or (3) if the partnership elects to push out the adjustments to its reviewed year partners. Examples of non-income items include the partnership's assets, liabilities, and capital accounts. Accordingly, amendments are proposed to the final regulations to clarify the treatment of adjustments to non-income items.

Under section 6241(2)(A) and § 301.6241–1(a)(6)(i), a partnership adjustment is any adjustment to a partnership-related item. Under section 6241(2)(B) and § 301.6241–1(a)(6)(ii), a partnership-related item is any item or amount that is relevant in determining the chapter 1 liability of any person that is reflected, or required to be reflected, on the partnership's return under section 6031 for the taxable year or required to be maintained in the partnership's books and records, any partner's distributive share of such items, and the imputed underpayment. Accordingly, adjustments to non-income items that meet this definition are partnership-related items. *See, e.g.,* § 301.6241–1(a)(6)(ii)(C)–(E). Under § 301.6225–1(a)(1), all partnership adjustments, including adjustments to non-income items, are taken into account in determining whether the adjustments result in an imputed underpayment.

In some cases, adjustments to non-income items will be related to adjustments to items of income, gain, loss, deduction, or credit (for example, if an item was expensed that was required to be capitalized). Under § 301.6225–1(b)(4), the IRS may treat an adjustment as zero solely for purposes of calculating an imputed underpayment if that adjustment is reflected in one or more partnership adjustments. Accordingly, the IRS could, if appropriate, treat an adjustment to a non-income item as zero solely for purposes of calculating the imputed underpayment if the effect of the adjustment is already reflected in an adjustment to an item of income, gain, loss, deduction, or credit. However, § 301.6225–1(b)(4) only provides this authority to the IRS. Accordingly, an addition is proposed to § 301.6225–1(b)(4) to provide that, generally, an adjustment to a non-income item that is related to, or results from, an adjustment to an item of income, gain, loss, deduction, or credit is treated as zero as part of the calculation of an imputed underpayment unless the IRS determines that the adjustment should be included in the imputed underpayment. This proposed addition not only clarifies the rule in § 301.6225–1(b)(4) but also extends the rule in § 301.6225–1(b)(4) to persons other than the IRS. Consequently, when filing an AAR a partnership may treat an adjustment to a non-income item as zero if the adjustment is related to, and the effect is reflected in, an adjustment to an item of income, gain, loss, deduction, or credit unless the IRS subsequently determines, in an examination of the AAR, that both adjustments should be included in the calculation of the imputed underpayment.

As discussed in part 2.A of this Explanation of Provisions, § 301.6225–1(d)(2)(iii)(A) defines a ''positive adjustment'' as any adjustment that is not a negative adjustment. An adjustment to a non-income item, by definition, is not an adjustment to an item of income, gain, loss, deduction, credit, or chapter 1 liability, therefore, and is a positive adjustment. However, as with any other adjustment, an adjustment to a non-income item may be an adjustment that does not result in an imputed underpayment, as defined in § 301.6225–1(f), if the adjustment is included in a calculation that results in an amount that is zero or less than zero.

Proposed § 301.6225–3(b)(8) clarifies the rules for taking into account adjustments to non-income items if they are adjustments that do not result in an imputed underpayment. Under proposed § 301.6225–3(b)(8), a partnership takes into account adjustments to non-income items in the adjustment year by adjusting the item on its adjustment year return to be consistent with the adjustment (for example, in amount, character, or classification). However, this only applies to the extent the item would appear on the adjustment year return without regard to the adjustment. If the item already appears on the partnership's adjustment year return as a non-income item or the item appeared as a non-income item on any return of the partnership for a taxable year between the reviewed year and the adjustment year, the partnership does not create a new item on the partnership's adjustment year return. For example, if the adjustment results in the addition of a liability in the reviewed year but the partnership had reported the liability on its return for the year immediately following the reviewed year and the liability was paid off prior to the adjustment year, then the adjustment to the liability does not create a new liability in the adjustment year and the adjustment is disregarded when the partnership takes into account the adjustments that did not result in an imputed underpayment on its adjustment year return. Accordingly, the partnership takes into account the adjustment to the non-income item by, for example, changing the character or amount of the item on the adjustment year return consistent with the adjustment to the non-income item. Proposed § 301.6225–3(d)(3) provides an example of the application of this rule.

4. Cease To Exist

Section 6241(7) provides that if a partnership ceases to exist prior to the partnership adjustments taking effect, the adjustments are taken into account by the former partners of the partnership. To utilize the provisions of section 6241(7) the partnership must first have ceased to exist, as defined in proposed § 301.6241–3(b), prior to the adjustments taking effect. In addition to the provisions of section 6241(7), if a partnership has ceased to exist, section 6232(f) provides rules that allow the IRS to assess a former partner for that partner's proportionate share of any amounts owed by the partnership under the centralized partnership audit regime.

A. When Partnership Adjustments Take Effect

Section 301.6241–3(c) provides that the partnership adjustments take effect when there is full payment of the tax and other amounts owed as a result of the partnership adjustments. If the partnership ceases to exist prior to the amounts due being fully paid, the former partners must take into account the adjustments. This interpretation could potentially preclude the use of section 6232(f) because if there is an amount due from the partnership any determination that a partnership has ceased to exist will trigger the rules under section 6241(7) as it would occur prior to the adjustments taking effect (*i.e.,* full payment).

Section 6232(f) expressly provides for rules that govern the use of section 6232(f) in situations when a partnership has ceased to exist. Accordingly, it would be inconsistent with the intent of Congress to define when the adjustments take effect in a way that precludes the use of section 6232(f) when a partnership has ceased to exist. Therefore, proposed § 301.6241–3 amends § 301.6241–3(b) to provide that a partnership adjustment takes effect when the adjustments become finally determined as described in § 301.6226–2(b)(1); when the partnership and IRS enter into a settlement agreement regarding the adjustment; or, for adjustments reflected in an AAR, when the AAR is filed. After this amendment, the rules under section 6241(7) would apply prior to the adjustments taking effect and the rules under section 6232(f) would apply once the adjustments have taken effect.

As a result of this change, the proposed regulations contain additional conforming changes to other provisions in § 301.6241–3. Proposed § 301.6241–3(b)(1)(ii) was modified to provide that a partnership ceases to exist if the IRS determines that the partnership does not have the ability to pay in full any amount that the partnership may become liable for under the centralized partnership audit regime. Previously, § 301.6241–3(b)(1)(ii) provided that the partnership ceases to exist if the IRS determines that the partnership does not have the ability to pay any amounts due under the centralized partnership audit regime. As proposed § 301.6241–3 only applies prior to the adjustments becoming finally determined, the partnership would not have an amount due under the centralized partnership audit regime at that time. Because the partnership would not have an amount due, § 301.6241–3 is incompatible with section 6232(f). Accordingly, proposed § 301.6241–3 reconciles section 6232(f) with section 6241(7) in a way that gives meaning to both sections.

Additionally, proposed § 301.6241–3 would remove § 301.6241–3(b)(2). Section 301.6241–3(b)(2) provides situations for when the IRS will not determine that a partnership ceases to exist. Under § 301.6241–3(b)(2), the IRS would not make such determination if the partnership has a valid election under section 6226 in effect, if a pass-through partner receives a statement under section 6226 and furnishes statements to its partners, or if the partnership has not paid any amount due under the centralized partnership audit regime, but was able to pay such amount. As all these exceptions cover situations where the partnership adjustments have already been finally determined, this provision is no longer necessary. Similarly, § 301.6241–3(c)(2) regarding partial payments by the partnership is also proposed to be removed because it is impossible to have an amount due until after the adjustments become finally determined. Accordingly, after the changes introduced by proposed § 301.6241–3, there would be nothing upon which to make a partial payment before the adjustments take effect.

Finally, § 301.6241–3(e)(2)(ii) is proposed to be modified to provide that statements under § 301.6241–3 must be furnished to the former partners and filed with the IRS no later than 60 days after the later of the date the IRS notifies the partnership that it has ceased to exist or the date the adjustments take effect, as described in § 301.6241–3(c). Section 301.6241–3(e)(2)(ii) provides that statements must be furnished no later than 30 days after the date the IRS notifies the partnership that the partnership has ceased to exist. Now, with the proposed change to when adjustments take effect, the IRS may determine that a partnership has ceased to exist prior to the date the adjustments become finally determined. To prevent confusion, statements should not be issued until the adjustments become final. Section 301.6241–3(e)(2)(ii) is proposed to be adjusted accordingly. The proposed change from 30 days to 60 days for furnishing statements is intended to conform the rules for statements in § 301.6241–3 with those in § 301.6226–2.

B. Former Partners

As described previously, if a partnership ceases to exist prior to the adjustments taking effect, the former partners of the partnership must take the adjustments into account. Section 301.6241–3(d) defines former partners as the partners from the adjustment year of the partnership or, if there were no adjustment year partners, the partners from the partnership taxable year for which a final partnership return is filed. Proposed § 301.6241–3(d) modifies the definition of former partners to be partners of the partnership during the last taxable year for which a partnership return or AAR was filed or the most recent persons determined to be the partners of the partnership in a final determination (for example, final court decision, defaulted notice of final partnership adjustment (FPA), or settlement agreement). As discussed previously, proposed § 301.6241–3 applies prior to the adjustments taking effect. Because the adjustment year does not exist until the adjustments become final, proposed § 301.6241–3 would not apply after that point. Accordingly, the definition of former partners is modified to reflect the partners that are the partners of the partnership before the partnership adjustments take effect.

Finally, the examples under § 301.6241–3(f) are modified to reflect the changes to § 301.6241–3 previously described in this Explanation of Provisions.

5. Miscellaneous Amendments to Regulations Finalized in TD 9844

In addition to the amendments described above, two other miscellaneous clarifications to the regulations finalized in TD 9844 are being proposed in these regulations.

First, under § 301.6225–2(d)(2)(vi)(A), as part of a request for modification of an imputed underpayment a pass-through partner may file an amended return, take into account its share of the partnership adjustments, and determine and pay an amount calculated in the same manner as the amount computed under § 301.6226–3(e)(4)(iii). In calculating the amount due under § 301.6225–2(d)(2)(vi)(A), a pass-through partner may, as described in § 301.6225–2(d)(2)(vi)(B), take into account any modifications approved with respect to its direct and indirect partners. Under § 301.6226–3(e)(4)(iii), a pass-through partner calculates an imputed underpayment on its allocable share of the adjustments, taking into account any modifications approved with respect to its direct and indirect partners. Accordingly, § 301.6225–2(d)(2)(vi)(B) is redundant in that, under § 301.6225–2(d)(2)(vi)(A), a pass-through partner computes the amount due by reference to § 301.6226–3(e)(4)(iii), which also allows a pass-through partner to take into account modifications approved with respect to its direct and indirect owners when computing its amount due. Therefore, the proposed regulations propose to remove § 301.6225–2(d)(2)(vi)(B) as in the final regulations and replace it as described below. Also, additional language is added to the end of § 301.6225–2(d)(2)(vi)(A) by the proposed regulations to clarify the reference to § 301.6226–3(e)(4)(iii) for the needs of a partnership-partner pursuing modification under section 6225.

Section 301.6225–2(d)(2)(vi)(A) is silent as to how the pass-through partner would take into account any adjustments that do not result in an imputed underpayment. Under § 301.6226–3(e)(4)(v), a pass-through partner who pays an imputed underpayment takes into account any adjustments that did not result in an imputed underpayment in accordance with § 301.6225–3 in the taxable year of the pass-through partner that includes the date the imputed underpayment is paid. Under § 301.6226–3(e)(4)(v), if there are only adjustments that do not result in an imputed underpayment, the pass-through partner takes into account those adjustments in the taxable year of the pass-through partner that includes the date the statement under section 6226 is furnished to that pass-through partner.

The Treasury Department and the IRS have determined that a pass-through partner that pays an amount as part of an amended return submitted for purposes of modifying an imputed underpayment should take into account any adjustments that do not result in an imputed underpayment in the taxable year the amount is paid by the pass-through partner. However, unlike under § 301.6226–3(e)(4)(v), a pass-through partner should not be able to take adjustments that do not result in an imputed underpayment into account as part of a request for modification unless the partnership pays an amount on the corresponding adjustments that resulted in an imputed underpayment. If there are solely adjustments that do not result in an imputed underpayment, those adjustments should be subject to modification by the ultimate taxpayers who reported the original amounts and not by any new partners of the pass-through partner. Accordingly, proposed § 301.6225–3(d)(2)(vi)(B) provides that a pass-through partner that is paying an amount as part of an amended return filed during modification takes into account any adjustments that do not result in an imputed underpayment in the taxable year of the pass-through partner that includes the date the payment is made. This provision, however, does not apply if no payment is made by the partnership because no payment is required.

Finally, under § 301.6225–3(b)(1), a partnership adjustment that does not result in an imputed underpayment is taken into account as a reduction in non-separately stated income or as an increase in non-separately stated loss for the adjustment year. However, not all adjustments that do not result in an imputed underpayment are negative adjustments. For example, adjustments may not result in an imputed underpayment because, after the application of adjustments to credits, the imputed underpayment is zero or less than zero. In those cases, it would be inappropriate for a positive adjustment to reduce non-separately stated income or increase non-separately stated loss. Accordingly, the proposed change to § 301.6225–3(b)(1) clarifies that adjustments that do not result in an imputed underpayment, except as provided in § 301.6225–3(b)(2) through (7), can increase or decrease non-separately stated income or loss, as appropriate, depending on whether the adjustment is to an item of income or loss.

6. Special Enforcement Matters

Proposed § 301.6241–7(a) provides the general rule that the partnership-related items described in proposed § 301.6241–7 involve special enforcement matters.

A. Partnership-Related Item Components of Non-Partnership-Related Items

Section 6221(a) requires that any adjustment to a partnership-related item must be determined at the partnership level under the centralized partnership audit regime, except to the extent otherwise provided in subchapter C of chapter 63. Section 6241(2)(B) defines a partnership-related item as any item or amount with respect to the partnership which is relevant in determining the tax liability of any person under chapter 1, including any distributive share of such an item or amount.

Generally, adjusting partnership-related items in a centralized proceeding at the partnership level is the most efficient way to determine adjustments to partnership-related items. Under the centralized partnership audit procedures, the IRS can then efficiently assess and collect any tax associated with the adjustments. Requiring the IRS to adjust certain partnership-related items at the partnership level in a centralized proceeding, however, would interfere with the efficient enforcement of the Code. These circumstances present special enforcement considerations.

Specifically, the Treasury Department and the IRS have determined that special enforcement considerations are presented where the partnership's treatment of a partnership-related item on its return or in its books and records is based in whole, or in part, on information provided by a person other than the partnership. In these circumstances, it is more efficient for the IRS and the partner if the IRS makes an adjustment to a partnership-related item during an examination of the partner rather than opening a separate examination of the partnership to first adjust the partnership-related item at issue in the examination of the partner. It also is likely that the partnership is not in the best position to substantiate the information upon which the partnership's treatment of that partnership-related item is based and may not have detailed or adequate records regarding the information. In situations in which the number of partners potentially impacted by an adjustment is limited, adjusting the partnership-related items in direct examinations of those partners does not raise inefficiency or inconsistency concerns that the centralized partnership audit regime is designed to alleviate. As a result, it may be a more efficient use of both IRS and taxpayer resources to examine and adjust that partnership-related item in an examination of the person who provided this information. The IRS anticipates making these adjustments in cases in which the adjustments are likely only relevant to a single partner or a small group of partners and are unlikely to involve items that are allocable to all partners generally or that impact the partnership as a whole.

For example, if a partner contributes a non-depreciable asset to a partnership in exchange for a partnership interest, any issues regarding the basis in the asset may be more easily identified in an examination of the partner who contributes the asset than in an examination of the partnership. Because the asset is not depreciable the partnership does not take any depreciation deductions with respect to the asset. Proper deductions are likely to be the focus of an examination of the partnership, but the basis of the asset is not until the partnership disposes of the asset. In contrast, the contribution of the asset itself is a partnership-related item, and the basis of the asset that is contributed is taken into account in determining the partner's basis in the partnership interest (not a partnership-related item). The partner's basis in the partnership interest may affect the ability of the partner to claim a distributive share of deductions or losses or the computation of gain or loss the partner would recognize on the sale of the partnership interest, items that are commonly reviewed in an examination of a partner. These types of partnership-related items are therefore more likely to be identified during examinations of a single partner or a small group of partners, not during an examination of the partnership alone.

The ability to adjust certain partnership-related items at the partner level under these circumstances should be beneficial to partnerships and partners, as well as the IRS. For partnerships, this special rule alleviates the need to open an examination of the partnership under the centralized partnership audit procedures solely to adjust the partnership-related items based on information provided by the partner who is already independently under examination. This relieves the partnership from having to expend resources during an examination for items related primarily to the partner who provided the information.

This rule allows those partners whose non-partnership-related items are being adjusted during an examination of their return to more fully control and participate in any adjustments or determinations that need to be made to partnership-related items that underlie or affect the non-partnership-related item that is being adjusted. Further, after adjustments to certain partnership-related items impacting a single partner or a small group of partners are made there are cases in which it may not be necessary to adjust any other partnership-related item of the partnership, and an examination at the partnership level would be unnecessary. Adjusting these partnership-related items (or portions thereof) outside of subchapter C of chapter 63 also allows the IRS to effectively and efficiently focus on a single partner or a small group of partners with respect to a limited set of partnership-related items without unduly burdening the partnership.

Therefore, under proposed § 301.6241–7(b), the IRS may determine that subchapter C of chapter 63 does not apply to an adjustment or determination of a partnership-related item if an adjustment or determination of that partnership-related item is part of, or underlies, an adjustment to a non-partnership-related item during an examination of a person other than the partnership. However, this rule only applies if the treatment of the partnership-related item on the return of the partnership (or in its books and records) is based in whole or in part on information provided by the person under examination. Accordingly, if the IRS determines that subchapter C of chapter 63 (of a portion thereof) does not apply, the IRS may adjust, or make determinations regarding, partnership-related items that underlie, or are part of adjustments or determinations regarding a non-partnership-related item of the person under examination. Proposed § 301.6241–7(b)(2) provides an example that illustrates this provision.

B. Termination and Jeopardy Assessments

Section 6241(11)(B)(ii) provides that assessments under section 6851 (relating to termination assessments of income tax) or section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes) are special enforcement matters. Consequently, the Secretary may prescribe rules under which subchapter C of chapter 63 (or a portion thereof) does not apply to partnership-related items allocable to a partner or indirect partner subject to a termination or jeopardy assessment and those partnership-related items are subject to special rules as is necessary for the effective and efficient enforcement of the Code. Section 6241(11)(A).

In termination and jeopardy assessment situations, the IRS makes an immediate assessment against a taxpayer to collect tax where the collection of tax is in jeopardy. In these special circumstances, the IRS needs to be able to make a full assessment of any amounts determined to be owed or risk being unable to collect tax in the future.

To address this special enforcement matter, proposed § 301.6241–7(c) provides that for any taxable year of a partner or indirect partner for which an assessment of income tax under section 6851 or section 6861 is made, the IRS may adjust any partnership-related item with respect to such partner or indirect partner as part of making that assessment without regard to subchapter C of chapter 63. When making a termination or jeopardy assessment against a partner or indirect partner, the IRS will be able to protect the government's interest quickly with respect to a particular partner or indirect partner without having to conduct a proceeding under subchapter C of chapter 63 at the partnership level.

C. Criminal Investigations

Section 6241(11)(B)(iii) provides that criminal investigations constitute a special enforcement matter. As such, the Secretary may prescribe rules under which subchapter C of chapter 63 (or a portion thereof) does not apply to partnership-related items with respect to a taxpayer subject to criminal investigation and these partnership-related items are subject to special rules as is necessary for the effective and efficient enforcement of the Code. Section 6241(11)(A). The IRS needs to preserve flexibility in addressing potential adjustments so as to not interfere with criminal investigations.

To address this special enforcement matter, proposed § 301.6241–7(d) provides that the IRS may adjust any partnership-related item with respect to any partner or indirect partner for any taxable year of a partner or indirect partner for which the partner or indirect partner is under criminal investigation without regard to subchapter C of chapter 63.

D. Indirect Methods of Proof

Section 6241(11)(B)(iv) provides that indirect methods of proof of income constitute a special enforcement matter. As such, the Secretary may prescribe rules under which subchapter C of chapter 63 (or a portion thereof) does not apply to partnership-related items with respect to a taxpayer whose income is subject to an indirect method of proof and these partnership-related items are subject to special rules as is necessary for the effective and efficient enforcement of the Code. Section 6241(11)(A).

When using an indirect method of proving a person's income, the IRS may not be able to determine whether the income is derived from partnership-related items of a partnership subject to the centralized partnership audit regime. Accordingly, the IRS must be able to determine a person's income without determining whether any of the income identified using an indirect method of proof are partnership-related items that must be adjusted under the centralized partnership audit regime. Requiring the IRS to determine what amount of income identified using an indirect method of proof is attributable to a partnership-related item would frustrate the administration of the Code by making it nearly impossible to utilize an indirect method of proof because the source of the specific income is generally not readily apparent when an indirect method of proof is being utilized.

To address this special enforcement matter, proposed § 301.6241–7(e)(1) provides that the IRS may adjust any partnership-related item as part of a determination of any deficiency (or portion thereof) of the partner or indirect partner that is based on an indirect method of proof without regard to subchapter C of chapter 63.

E. Controlled Partnerships and the Partner's Period of Limitations

Under section 6221, any adjustments to partnership-related items must be made at the partnership level. Section 6235 sets the period of limitations in which those adjustments to partnership-related items must be made. Although the items of a partnership are reported on the partnership's return, a partnership itself does not pay income tax. *See* section 701. The true tax impact and completeness of the partnership's reporting may not be apparent except by reviewing the partners' returns that report the partnership-related items. Additionally, in allocating resources and determining whether to open an examination, the IRS may identify issues either by reviewing the partners' returns or the partnership's return. Certain partnership issues may only become apparent at a future date or during an examination of a partner, which can frustrate the IRS's ability to allocate resources and examine taxpayers timely, especially in situations where the partnership structure includes many related and controlled entities.

Many partnerships, through many related and controlled entities, are ultimately controlled by a single or small number of individuals. The ultimate tax impact of the partnership's reporting would not be evident until the items were traced through a network of entities until they reach the single, or small group, of ultimate taxpayers. Many of these structures are examined as a group or as part of an examination of the controlling individual. In these situations, the existence of the partnership or the ultimate tax impact may not be known until the period of limitations on making adjustments to the partnership has expired, even though the controlling taxpayer may still be under examination. In those cases, the most efficient way to examine the partnership's reporting might be as part of a consolidated examination or during the examination of the controlling individual. In these cases, all of the related and controlled entities and their transactions can be considered together, benefiting both the IRS and the taxpayer by eliminating the need for separate examinations. These situations also present special enforcement considerations.

Specifically, the Treasury Department and the IRS have determined that special enforcement considerations are presented when the period of limitations on making adjustments to the partnership has expired for a taxable year but a controlling partner's period of limitations on assessment of chapter 1 tax has not expired or where the partner has voluntarily agreed to extend the period of limitation. When examining a partner that has control of a partnership through multiple tiered entities it may not be evident that an adjustment to an item on the controlling partner's return requires an adjustment to a partnership-related item until the controlling partner's interest is finally traced to a partnership. It may not be possible for this tracing to be completed before the period of limitations to make adjustments to the partnership has expired. In these circumstances, it is necessary for the effective and efficient enforcement of the Code to make adjustments or determinations regarding partnership-related items at the partner level during an examination of the controlling partner who has an open period to assess chapter 1 tax with respect to that item or amount. The same principles apply with respect to a partner who has consented to extend the period of limitations.

Under proposed § 301.6241–7(f), the IRS may only make adjustments or determinations as to partnership-related items without regard to subchapter C of chapter 63 if the partner has control of the partnership or if the partner has voluntarily agreed to extend his or her period of limitations on making assessments under section 6501. The extension agreement must expressly provide that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

To determine if a direct or indirect partner has control of the partnership, proposed § 301.6241–7(f)(1) incorporates the rules under sections 267(b) and 707(b). Accordingly, a direct or indirect partner will be deemed to be in control of the partnership if the partner is related to the partnership under sections 267(b) or 707(b).

F. Penalties and Taxes Imposed on the Partnership Under Chapter 1

Except as otherwise provided under subchapter C of section 63, under section 6221(a), adjustments to partnership-related items and the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to partnership-related items must be determined at the partnership level. To be a partnership-related item, the item must be relevant in determining the tax liability of any person under chapter 1. Section 6241(2)(B)(i); § 301.6241–1(a)(6)(iv). A tax, penalty, addition to tax, or additional amount that is imposed on, and which is the liability of, the partnership under chapter 1 could qualify as a partnership-related item that would need to be adjusted under the centralized partnership audit regime.

The purpose of the centralized partnership audit regime is to create a centralized and efficient means of examining partnerships instead of examining partners. This purpose would not be served if these chapter 1 taxes and penalties were adjusted in an examination under this regime because these taxes and penalties are imposed on the partnership itself and are not the liability of the partners. As a liability of the partnership, these chapter 1 penalties and taxes are incompatible with the centralized partnership audit regime, which is designed to approximate the chapter 1 liability on the adjustments that would have been owed by the partners, not the partnership. On the other hand, when a liability is owed by the partnership itself, the partnership's exact liability should be determined and paid by that partnership. As such, the centralized partnership audit regime is generally not compatible with chapter 1 penalties and taxes imposed on partnerships. However, there could be situations where an adjustment to a chapter 1 tax or penalty owed by the partnership would be more appropriately adjusted at the partnership level, such as when the adjustment relates to, or results from, other adjustments being made at the partnership level. Accordingly, for the reasons stated above, the Treasury Department and the IRS have determined that special enforcement considerations are presented where a tax, penalty, addition to tax, or additional amount is imposed on, and is the liability of, a partnership under chapter 1.

Therefore, under proposed § 301.6241–7(g), the IRS may determine that the centralized partnership audit regime does not apply to any taxes, penalties, additions to tax, or additional amounts imposed on a partnership under chapter 1 and to any determination made to determine whether the partnership meets the requirements for the tax or penalty, addition to tax, or additional amount. Accordingly, these taxes and penalties may be determined outside the centralized partnership audit regime in the same manner as they would be determined and imposed for entities not subject to the centralized partnership audit regime, such as corporations. Additionally, if the IRS is determining any chapter 1 tax or penalty imposed on the partnership outside of the centralized partnership audit regime, the IRS may also adjust any partnership-related item, outside of the centralized partnership audit regime, as part of any determination necessary to determine the amount and applicability of the chapter 1 tax or penalty. This rule does not apply to determinations surrounding the actual payment of the chapter 1 tax or penalty, such as whether the payment is deductible and any determinations regarding how the payment must be allocated amongst the partners. For the rules for when a chapter 1 tax or penalty is determined under the centralized partnership audit regime, see part 2 of this Explanation of Provisions.

G. Determining That Subchapter C of Chapter 63 Does Not Apply

Proposed § 301.6241–7(h)(1) provides that if the IRS determines that all or some of the rules under the centralized partnership audit regime do not apply to a partnership-related item (or portion thereof) under the rules described in paragraphs (b) (partnership-related items underlying adjustments to non-partnership-related items), (c) (termination and jeopardy assessments), (d) (criminal investigations), (e) (indirect methods of proof of income), (f) (controlled partnerships and extensions of the partner's period of limitations), or (g) (penalties and taxes imposed on the partnership under chapter 1), then the IRS will notify, in writing, the taxpayer to whom the adjustments are being made. The Treasury Department and the IRS request comments on the timing of notices to be provided under proposed § 301.6241–7(h)(1) including comments regarding whether the timing should be different based on the specific provision that is applicable.

Proposed § 301.6241–7(h)(2) provides that any final decision with respect to any partnership-related item adjusted outside of the centralized partnership audit regime is not binding on the partnership, any partner, or any indirect partner that is not a party to the proceeding because there is no provision which would make them liable for any adjustments in a proceeding to which they are not a party.

H. Coordination With Adjustments Made at the Partnership Level

If the IRS makes adjustments to partnership-related items in an examination of a person other than the partnership and adjustments are made to the same partnership-related items in an examination of the partnership, there is a potential for the same adjustments to be subject to tax at both the partner and partnership level. Proposed § 301.6241–7(i) sets forth a rule that would prevent taxing the same partnership-related item twice. Under this rule, if a deficiency is calculated or an adjustment is proposed by the IRS that includes amounts based on adjustments to partnership-related items and the person can establish that specific amounts included within the deficiency or adjustment were previously taxed to the partner in one of two sets of circumstances, the amounts will not be included in the deficiency or adjustment.

First, the partner or indirect partner can exclude amounts previously taken into account by the partner or indirect partner under the centralized partnership audit regime. For example, the partner could demonstrate that the amounts were taken into account through an amended return modification, the alternative to amended return modification, or through a push out election.

Second, a partner can exclude amounts included in an imputed underpayment that was paid by a partnership (or pass-through partner) in which the partner was a reviewed year partner or indirect partner. The amounts included as part of an imputed underpayment may only be excluded from the deficiency or adjustment if the amount included in the imputed underpayment exceeds the amount reported by the partnership to the partner (for example, on a Schedule K–1 or statement under section 6227) or is otherwise included in the deficiency or adjustment determined by the IRS (for example, as part of the deficiency based on a means other than an indirect method of proof). In other words, a partner may only exclude amounts included in an imputed underpayment paid by a partnership if the partner was taxed on the original amounts reported by the partnership to the partner. This puts the partner in parity with other partners in the partnership that are not subject to a special rule. Those partners are required to report consistently with the statements furnished by the partnership to the partner and are not taxed on any additional amounts included in an imputed underpayment paid by a partnership.

I. Applicability Dates

If this proposed rule is finalized, the revisions to the regulations finalized in TD 9829 and TD 9844 will be applicable on November 20, 2020.

Proposed § 301.6241–7(j) provides the applicability dates for the rules contained in proposed § 301.6241–7. Proposed § 301.6241–7(j) provides that, except for the rules contained in proposed § 301.6241–7(b) (partnership-related items that underlie non-partnership-related items), the rules contained in proposed § 301.6241–7 apply to partnership taxable years ending after November 20, 2020, or any examination or investigation beginning after [DATE THE FINAL RULE IS FILED FOR PUBLIC INSPECTION AT THE OFFICE OF THE FEDERAL REGISTER]. Proposed § 301.6241–7(j) provides that the rules contained in proposed § 301.6241–7(b) apply to partnership taxable years beginning after December 20, 2018, or to any examinations or investigations beginning after [DATE THE FINAL RULE IS FILED FOR PUBLIC INSPECTION AT THE OFFICE OF THE FEDERAL REGISTER].

Section 7805(b)(7) permits the Secretary to allow taxpayers to elect to apply a regulation retroactively. Accordingly, proposed § 301.6241–7(j) contains a provision that provides that, notwithstanding the applicability dates provided in proposed § 301.6241–7(j), the IRS and a partner may agree to apply any provision of proposed § 301.6241–7 to any taxable year of a partner that corresponds to a partnership taxable year that is subject to the centralized partnership audit regime.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) it is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities.

The proposed rules directly affect any partnership subject to the centralized partnership audit regime under subchapter C of chapter 63. As all partnerships are subject to the centralized partnership audit regime unless they make a valid election out of the regime, the proposed rules are expected to affect a substantial number of small entities. However, the IRS has determined that the economic impact on small entities affected by the proposed rule would not be significant.

The proposed rules under § 301.6241–7 implement section 6241(11) and allow the IRS, for partnership-related items that involve special enforcement matters, to provide that the centralized partnership audit regime (or a portion thereof) does not apply to such partnership-related items and that such items are subject to special rules as is necessary for the efficient and effective enforcement of the Code. As such, except for one circumstance, the proposed rules provide for certain situations where partnership-related items may be adjusted outside of the centralized partnership audit regime. In all but one of these situations, if the rules in proposed § 301.6241–7 were utilized, then the adjustments would be made to partners of the partnership, rather than the partnership itself and, thus, utilizing the proposed rules would not have an impact on small entities. Additionally, many small entities may be eligible to elect out of the centralized partnership audit regime under section 6221(b). Accordingly, if a small entity is eligible to elect out, they may choose to elect out of the regime at which point the rules contained in proposed

§ 301.6241–7 would be inapplicable to those entities.

Finally, the proposed rules under § 301.6241–7 address the process for conducting an examination and do not have a significant economic impact on small entities as the rules do not affect entities' substantive tax, such as the requirement to include items in income or the deductibility of items. The proposed rules promulgated under other Code sections simply clarify sections of regulations previously published. Accordingly, any significant economic impact on small entities will result from the application of the substantive tax provisions and will not be as a result of the procedural rules contained in proposed § 301.6241–7.

The Secretary hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. The Treasury Department and the IRS invite comment from members of the public about potential impacts on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for the Office of 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 amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the ADDRESSES section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020–4, 2020–17 I.R.B 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal author of these proposed regulations is Jennifer M. Black of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in the development of the proposed regulations.

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

■ **Par. 1.** The authority citation for part 301 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

Section 301.6221(b)–1 also issued under sections 6221 and 6241.

* * * * *

Section 301.6241–7 also issued under section 6241.

* * * * *

■ **Par. 2.** Section 301.6221(b)–1 is amended by revising paragraphs (b)(3)(ii)(D) and (F), adding paragraph (b)(3)(ii)(G), and adding a sentence to the end of paragraph (f) to read as follows:

§ 301.6221 (b)–1 Election out for certain partnerships with 100 or fewer partners.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(D) A wholly owned entity disregarded as separate from its owner for Federal income tax purposes,

* * * * *

(F) Any person who holds an interest in the partnership on behalf of another person, or

(G) A qualified subchapter S subsidiary, as defined in section 1361(b)(3)(B).

* * * * *

(f) * * * Notwithstanding the preceding sentence, paragraph (b)(3)(ii)(D), (F), and (G) of this section are applicable on November 20, 2020.

§ 301.6223–1 [Amended]

■ **Par. 3.** Section 301.6223–1 is amended by removing ''B'' and ''B's'' and adding ''PR'' and ''PR's'' in its place, respectively, wherever either appears in Examples 1 and 2 in paragraph (e)(8).

■ **Par. 4.** Section 301.6225–1 is amended:

■ 1. By revising the paragraph (b)(3) subject heading;

■ 2. By adding a sentence to the end of paragraph (b)(4);

■ 3. By adding a sentence to the end of paragraph (c)(3);

■ 4. By revising paragraph (d)(2)(ii);

■ 5. By removing reserved paragraph (d)(3)(iii)(C);

■ 6. By adding a sentence to the end of paragraph (e)(3)(ii);

■ 7. By revising paragraph (f)(1)(ii);

■ 8. By adding paragraph (f)(3);

■ 9. By adding paragraphs (h)(13) and (14); and

■ 10. By adding a sentence to the end of paragraph (i)(1).

The revisions and additions read as follows:

§ 301.6225–1 Partnership adjustment by the Internal Revenue Service.

* * * * *

(b) * * *

(3) *Adjustments to items for which tax has been collected under chapters 3 and 4 of the Internal Revenue Code (Code).* * * *

(4) * * * If an adjustment to an item of income, gain, loss, deduction, or credit is related to, or results from, an adjustment to an item that is not an item of income, gain, loss, deduction, or credit, the adjustment to the item that is not an item of income, gain, loss, deduction, or credit will generally be treated as zero solely for purposes of calculating the imputed underpayment unless the IRS determines that the adjustment should be included in the imputed underpayment.

* * * * *

(c) * * *

(3) * * * Each adjustment to any tax, penalty, addition to tax, or additional amount for the taxable year for which the partnership is liable under chapter 1 of the Code (chapter 1) and each adjustment to an imputed underpayment calculated by the partnership is placed in the credit grouping.

* * * * *

(d) * * *

(2) * * *

(ii) *Negative adjustment.* A *negative adjustment* is any adjustment that is a decrease in an item of income; a partnership adjustment treated under paragraph (d)(2)(i) of this section as a decrease in an item of income; an increase in an item of credit; a decrease in an item of tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1; or a decrease to an imputed underpayment calculated by the partnership for the taxable year.

* * * * *

(e) * * *

(3) * * *

(ii) * * * A net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year is not an adjustment described in paragraph (f) of this section.

* * * * *

(f) * * *

(1) * * *

(ii) The calculation under paragraph (b)(1) of this section results in an amount that is zero or less than zero, unless paragraph (f)(3) of this section applies.

* * * * *

(3) *Exception to treatment as an adjustment that does not result in an imputed underpayment*—(i) *Application of this paragraph (f)(3).* If the calculation under paragraph (b)(1) of this section results in an amount that is zero or less than zero due to the inclusion of a net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year, this paragraph (f)(3) applies, and paragraph (f)(1) of this section does not apply except as provided in paragraph (f)(3)(ii)(C) of this section.

(ii) *Recalculation if paragraph (f)(3) of this section applies*—(A) *In general.* If this paragraph (f)(3) applies, the imputed underpayment is recalculated under paragraph (b)(1) of this section without regard to a net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year. The net negative adjustment that was excluded from the imputed underpayment recalculation is then treated in one of two ways under paragraphs (f)(3)(ii)(B) and (C) of this section depending on the results of the recalculation.

(B) *Recalculation is greater than zero.* If the result of the recalculation under paragraph (f)(3)(ii) of this section is greater than zero, the IRS may apply the portion of the net negative adjustment(s) that was excluded from the recalculation to reduce the imputed underpayment to zero, but not below zero. In this case, the imputed underpayment is zero but the adjustments included in the recalculation and the remaining net negative adjustment(s) excluded from the recalculation under paragraph (f)(3)(ii)(A) of this section are not adjustments that do not result in an imputed underpayment subject to treatment as described in paragraph (f)(2) of this section. See paragraph (h)(13) of this section (*Example 13*).

(C) *Recalculation is zero or less than zero.* If the result of the recalculation under paragraph (f)(3)(ii) of this section is zero or less than zero, the adjustments included in the recalculation are treated as adjustments that do not result in an imputed underpayment under paragraph (f)(1)(ii) of this section. The net negative adjustment(s) that was excluded from the recalculation is not an adjustment that does not result in an imputed underpayment subject to treatment as described in paragraph (f)(2) of this section. See paragraph (h)(14) of this section (*Example 14*).

* * * * *

(h) * * *

(13) *Example 13.* The IRS initiates an administrative proceeding with respect to Partnership's 2019 partnership return and makes adjustments as follows: Net positive adjustment of $100 ordinary income, net negative adjustment of $20 in credits, and a net negative adjustment of $25 to a chapter 1 tax liability of the partnership. The IRS determines that the net negative adjustment in credits should be taken into account in the calculation of the imputed underpayment in accordance with paragraph (b)(1)(v) of this section. Pursuant to paragraph (b)(1) of this section, the $100 net positive adjustment to ordinary income is multiplied by 40 percent (highest tax rate in effect), which results in $40. The adjustments in the credits grouping are then applied, which include the adjustment to credits and the adjustment to the chapter 1 tax liability. Applying the credits results in an amount less than zero as described in paragraph (f)(3)(i) of this section ($40 − $20 − $25 = −$5). Pursuant to paragraph (f)(3)(ii) of this section, the imputed underpayment is recalculated without regard to the adjustment to the chapter 1 tax liability, resulting in a recalculation amount greater than zero as described in paragraph (f)(3)(ii)(B) of this section ($40 − $20 = $20). Pursuant to paragraph (f)(3)(ii)(B) of this section, the IRS may apply a portion of the adjustment to chapter 1 tax liability to reduce the recalculation to zero but not below zero. In this case, the recalculation amount would be reduced to zero using $20 of the $25 adjustment to chapter 1 tax liability. Because the imputed underpayment was reduced to zero, pursuant to paragraph (f)(3)(ii)(B), the adjustments that went into the recalculation are not adjustments that do not result in an imputed underpayment. These adjustments are the $100 adjustment to ordinary income and the $20 adjustment to credits. The remaining $5 adjustment to the chapter 1 tax liability of the partnership is an adjustment that is treated as described in paragraph (e)(3)(ii) of this section and is therefore not taken into account on the partnership's adjustment year return.

(14) *Example 14.* The facts are the same as in paragraph (h)(13) of this section (*Example 13*), but the negative adjustment to credits is $50 instead of $20. Applying the credits results in an amount less than zero as described in paragraph (f)(3)(i) of this section ($40 − $50 − $25 = −$35). Pursuant to paragraph (f)(3)(ii) of this section, the imputed underpayment is recalculated without regard to the adjustment to the chapter 1 tax liability, resulting in a recalculation amount less than zero as described in paragraph (f)(3)(ii)(C) of this section ($40 − $50 = −$10). Pursuant to paragraph (f)(3)(ii)(C) of this section, the partnership adjustments resulting in the −$10 recalculation amount are adjustments that do not result in an imputed underpayment treated in accordance with paragraph (f)(1)(ii) of this section, and the $25 adjustment to chapter 1 tax liability is not treated as such an adjustment and is therefore not taken into account on the partnership's adjustment year return.

(i) * * *

(1) * * * Notwithstanding the preceding sentence, paragraphs (b)(4), (c)(3), (d)(2)(ii), (d)(3)(iii)(C), (e)(3)(ii), (e)(3)(iii)(B), (f)(1)(ii), (f)(3), and (h)(13) and (14) of this section are applicable on November 20, 2020.

■ **Par. 5.** Section 301.6225–2 is amended:

■ 1. In paragraph (d)(2)(vi)(A), by removing the period and the end of the paragraph and adding in its place '', by treating any approved modifications and partnership adjustments allocable to the pass-through partner as items reflected on the statement furnished to the pass-through partner.'';

■ 2. By revising paragraph (d)(2)(vi)(B); and

■ 3. By adding a sentence to the end of the paragraph (g)(1).

The additions and revisions read as follows:

§ 301.6225–2 Modification of imputed underpayment.

* * * * *

(d) * * *

(2) * * *

(vi) * * *

(B) *Adjustments that do not result in an imputed underpayment.* If a pass-through partner takes into account its share of the adjustments by paying an amount described in paragraph (d)(2)(vi)(A) of this section and there are any adjustments that do not result in an imputed underpayment (as defined in § 301.6225–1(f)), those adjustments 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 described in paragraph (d)(2)(iv)(A) of this section is paid. This paragraph does not apply if, after making the calculation described in paragraph (d)(2)(iv)(A) of this section, no amount exists and therefore no payment is required under paragraph (d)(2)(iv)(A) of this section.

* * * * *

(g) * * *

(1) * * * Notwithstanding the preceding sentence, paragraph (d)(2)(vi)(B) of this section is applicable on November 20, 2020.

■ **Par. 6.** Section 301.6225–3 is amended:

■ 1. In paragraph (b)(1) by removing ''a reduction in non-separately stated income or as an increase in non-separately stated loss'' and adding in its place ''part of non-separately stated income or loss'';

■ 2. By adding paragraphs (b)(8) and (d)(3); and

■ 3. By adding a sentence to the end of paragraph (e)(1).

The additions read as follows:

§ 301.6225–3 Treatment of partnership adjustments that do not result in an imputed underpayment.

* * * * *

(b) * * *

(8) *Adjustments to items that are not items of income, gain, loss, deduction, or credit.* The partnership takes into account an adjustment that does not result in an imputed underpayment that resulted from an adjustment to an item that is not an item of income, gain, loss, deduction, or credit by adjusting the item on its adjustment year return but only to the extent the item would appear on the adjustment year return without regard to the adjustment. If the item is already reflected on the partnership's adjustment year return as an item that is not an item of income, gain, loss, deduction, or credit, or in any year between the reviewed year and the adjustment year, a partnership should not create a new item in the amount of the adjustment on the partnership's adjustment year return.

* * * * *

(d) * * *

(3) *Example 3.* On its partnership return for the 2020 taxable year, Partnership placed Asset into service, reporting that Asset, a non-depreciable asset, had a basis of $100. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS determines that Asset has a basis of $90 instead of $100. The IRS also determines that Partnership has a negative adjustment to credits of $4. There are no other adjustments for the 2020 partnership taxable year. Under paragraph (d)(2) of this section, the adjustment to the basis of an asset is not an adjustment to an item of income. Therefore, the $10 adjustment to the basis of Asset is treated as a $10 positive adjustment. The IRS determines that the net negative adjustment to credits should be taken into account as part of the calculation of the imputed underpayment. The total netted partnership adjustment is $10, which, after applying the highest rate and decreasing the product by the $4 adjustment to credits results in an imputed underpayment of $0. Accordingly, both adjustments are adjustments that do not result in an imputed underpayment under paragraph (f) of this section. The adjustment year is 2022 and Partnership still owns Asset. Under paragraph (b)(8) of this section, the partnership takes into account the $10 adjustment to Asset on its 2022 return by reducing its basis in Asset by $10.

(e) * * *

(1) * * * Notwithstanding the preceding sentence, paragraphs (b)(8) and (d)(3) of this section are applicable on November 20, 2020.

* * * * *

■ **Par. 7.** Section 301.6226–2 is amended by removing ''Internal Revenue'' from the paragraph (g)(3) subject heading, adding paragraph (g)(4), and adding a sentence to the end of paragraph (h)(1).

The additions read as follows:

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

* * * * *

(g) * * *

(4) *Liability for chapter 1 taxes and penalties.* A partnership that makes an election under § 301.6226–1 with respect to an imputed underpayment must pay any taxes, penalties, additions to tax, additional amounts, or the amount of any adjustments to any imputed underpayment calculated by the partnership that is determined under subchapter C of chapter 63 for which the partnership is liable under chapter 1 of the Code or subchapter C of chapter 63 at the time the partnership furnishes statements to its partners in accordance with paragraph (b) of this section. Any adjustments to such items are not included in the statements the partnership furnishes to its partners or files with the IRS under this section.

(h) * * *

(1) * * * Notwithstanding the prior sentence, paragraph (c)(1) of this section is applicable on November 20, 2020.

* * * * *

■ **Par. 8.** Section 301.6241–3 is amended:

■ 1. By revising paragraph (b)(1)(ii);

■ 2. By removing paragraph (b)(2);

■ 3. By redesignating paragraphs (b)(3) and (4) as paragraphs (b)(2) and (3) respectively; and

■ 4. By revising paragraphs (c), (d), (e)(2)(ii), (f)(1) and (2), and (g).

The revisions read as follows:

§ 301.6241–3 Treatment where a partnership ceases to exist.

* * * * *

(b) * * *

(1) * * *

(ii) The partnership does not have the ability to pay, in full, any amount that may be due under the provisions of subchapter C of chapter 63 for which the partnership is or may become liable. For purposes of this section, a partnership does not have the ability to pay if the IRS determines that the partnership is currently not collectible based on the information the IRS has at the time of such determination.

* * * * *

(c) *Partnership adjustment takes effect.* For purposes of this section, a partnership adjustment under subchapter C of chapter 63 takes effect when the adjustment becomes finally determined as described in § 301.6226–2(b)(1); when the partnership and the IRS enter into a settlement agreement regarding the adjustment; or, for adjustments appearing on an administrative adjustment request (AAR), when the request is filed.

(d) *Former partners*—(1) *In general.* Except as described in paragraph (d)(2) of this section, the term *former partners* means the partners of the partnership during the last taxable year for which a partnership return under section 6031 or AAR was filed for such partnership or the most recent persons determined to be partners of the partnership in a final determination (for example, a defaulted notice of final partnership adjustment, final court decision, or settlement agreement) binding upon the partnership.

(2) *Partnership-partner ceases to exist.* If any former partner is a partnership-partner that the IRS has determined ceased to exist, the former partners for purposes of this section are the partners of such partnership-partner during the last partnership taxable year for which a partnership return of the partnership-partner under section 6031 or AAR was filed or the most recent persons determined to be partners of the partnership-partner in a final determination (for example, a defaulted notice of final partnership adjustment, final court decision, or settlement agreement) binding upon the partnership-partner.

(e) * * *

(2) * * *

(ii) The partnership must furnish statements to the former partners and file the statements with the IRS no later than 60 days after the later of the date of the notification to the partnership that the IRS has determined that the partnership has ceased to exist or the date the adjustment takes effect, as described in paragraph (c) of this section.

* * * * *

(f) * * *

(1) *Example 1.* The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of Partnership. During 2023, in accordance with section 6235(b), Partnership extends the period of limitations on adjustments under section 6235(a) until December 31, 2025. However, on July 31, 2024, Partnership terminates within the meaning of section 708(b)(1). Based on the prior termination under section 708(b)(1), the IRS determines that Partnership ceased to exist, as defined in paragraph (b) of this section, on September 16, 2024. On February 1, 2025, the IRS mails Partnership a notice of final partnership adjustment (FPA) that determines partnership adjustments that result in a single imputed underpayment. Partnership does not timely file a petition under section 6234 and does not make a valid election under section 6226. Partnership files its final return of partnership income on October 15, 2024 listing A and B, both individuals, as the partners for its final taxable year ending July 31, 2024. Accordingly, under paragraph (d)(1) of this section, A and B are former partners. Therefore, A and B are required to take their share of the partnership adjustments determined in the FPA into account under paragraph (e) of this section.

(2) *Example 2.* The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of P, a partnership. G, a partnership that has an election under section 6221(b) in effect for the 2020 taxable year, is a partner of P during 2020 and for every year thereafter. On February 3, 2025, the IRS mails P an FPA that determines partnership adjustments that result in a single imputed underpayment. P does not timely file a petition under section 6234 and does not make a timely election under section 6226. On March 21, 2025, the IRS determines that P has ceased to exist because P did not make an election under section 6226, P is currently not collectible, and the IRS does not expect P will be able to pay any imputed underpayment. G terminated under section 708(b)(1) on December 31, 2024. On March 3, 2025, the IRS determines that G ceased to exist in 2024 for purposes of this section in accordance with paragraph (b) of this section. J and K, individuals, were the only partners of G during 2024. Therefore, under paragraph (d)(2) of this section, J and K, the partners of G during G's 2024 partnership taxable year, are the former partners of G for purposes of this section. Therefore, J and K are required to take into account their share of the adjustments contained in the statement furnished by P to G in accordance with paragraph (e) of this section.

(g) *Applicability date.* This section applies to any determinations made after November 20, 2020.

■ **Par. 9.** Section 301.6241–7 is added to read as follows:

§ 301.6241–7 Treatment of special enforcement matters.

(a) *Items that involve special enforcement matters.* In accordance with section 6241(11)(B) of the Internal Revenue Code (Code), the partnership-related items (as defined in § 301.6241–1(a)(6)(ii)) described in this section have been determined to involve special enforcement matters.

(b) *Partnership-related items underlying non-partnership-related items*—(1) *In general.* The Internal Revenue Service (IRS) may determine that the rules of subchapter C of chapter 63 of the Code (subchapter C of chapter 63) do not apply to an adjustment to a partnership-related item of a partnership if—

(i) An examination is being conducted of a person other than the partnership;

(ii) A partnership-related item is adjusted, or a determination regarding a partnership-related item is made, as part of, or underlying, an adjustment to a non-partnership-related item of the person whose return is being examined; and

(iii) The treatment of the partnership-related item on the return of the partnership under section 6031(b) or in the partnership's books and records is based in whole or in part on information provided by the person whose return is being examined.

(2) *Example.* The following example illustrates the provisions of paragraph (b) of this section. For purposes of this example, the partnership has no liabilities, is subject to subchapter C of chapter 63, and the partnership and partner each has a calendar year taxable year. On June 1, 2018, A acquires an interest in Partnership by contributing Asset to Partnership in a section 721 contribution (Contribution). Partnership claims a basis in Asset of $50 under section 723 equal to A's purported adjusted basis in Asset as of June 1, 2018, based on information A provided to Partnership. There is no activity in Partnership that gives rise to any other partnership-related items between June 1, 2018 and June 2, 2019. On June 2, 2019, A sells A's interest in Partnership to B for $100 in cash and reports a gain of $50 based on A's purported adjusted basis in Partnership of $50 under section 722 (reflecting solely A's purported adjusted basis in Asset immediately prior to the Contribution). The IRS opens an examination of A and determines that A's adjusted basis in Asset immediately prior to the Contribution should have been $30 instead of the $50 claimed by A. As a result, A's basis in Asset immediately prior to the Contribution is reduced from $50 to $30 and A's adjusted basis in A's interest in Partnership under section 722 is reduced from $50 to $30. Because A's adjusted basis in A's interest in Partnership is reduced to $30, the total gain from the sale of A's interest in Partnership is increased to $70 ($50 as originally reported plus $20 as adjusted by the IRS). The amount of Partnership's adjusted basis in Asset, which is the property transferred by A in the Contribution, is based on information provided by A to Partnership; the adjustment to A's pre-

Contribution adjusted basis in Asset, which is a non-partnership-related item, results in an adjustment to the adjusted basis of the property (that is, Asset) transferred to Partnership in the Contribution, which is a partnership-related item; and the Contribution underlies the adjustment to A's basis in A's interest Partnership, which is a non-partnership-related item. As a result, the IRS may determine that the rules of subchapter C of chapter 63 do not apply to the Contribution and may adjust, during an examination of A, the Contribution as it relates to the adjusted basis in Asset transferred in the Contribution.

(c) *Termination and jeopardy assessment.* For any taxable year of a partner or indirect partner for which an assessment of income tax under section 6851 or section 6861 is made, the IRS may adjust any partnership-related item with respect to such partner or indirect partner as part of making an assessment of income tax under section 6851 or section 6861 without regard to subchapter C of chapter 63.

(d) *Criminal investigations.* For any taxable year of a partner or indirect partner for which the partner or indirect partner is under criminal investigation, the IRS may adjust any partnership-related item with respect to such partner or indirect partner without regard to subchapter C of chapter 63.

(e) *Indirect methods of proof of income.* The IRS may adjust any partnership-related item as part of a determination of any deficiency (or portion thereof) of the partner or indirect partner that is based on an indirect method of proof of income without regard to subchapter C of chapter 63.

(f) *Controlled partnerships and extensions of the partner's period of limitations.* If the period of limitations under section 6235 on making partnership adjustments has expired for a taxable year, the IRS may adjust any partnership-related item that relates to any item or amount for which the partner's period of limitations on assessment of tax imposed by chapter 1 of the Code (chapter 1) has not expired for the taxable year of the partner or indirect partner, without regard to subchapter C of chapter 63 if—

(1) The direct or indirect partner is deemed to have control of a partnership if such partner is related to the partnership under sections 267(b) or 707(b); or

(2) Under section 6501(c)(4), the direct or indirect partner agrees, in writing, to extend the partner's section 6501 period of limitations on assessment for the taxable year but only if the agreement expressly provides that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

(g) *Penalties and taxes imposed on the partnership under chapter 1.* The IRS may adjust any tax, penalties, additions to tax, or additional amounts imposed on, and which are the liability of, the partnership under chapter 1 without regard to subchapter C of chapter 63. The IRS may also adjust any partnership-related item, without regard to subchapter C of chapter 63, as part of any determinations made to determine the amount and applicability of the tax, penalty, addition to tax, or additional amount being determined without regard to subchapter C of chapter 63. Any determinations under this paragraph (g) will be treated as a determination under a chapter of the Code other than chapter 1 for purposes of § 301.6241–6.

(h) *Determination that subchapter C of chapter 63 does not apply*—(1) *Notification.* If the IRS determines, in accordance with paragraph (b), (c), (d), (e), (f), or (g) of this section, that some or all of the rules under subchapter C of chapter 63 do not apply to any partnership-related item (or portion thereof), then the IRS will notify, in writing, the taxpayer to whom the adjustments are being made.

(2) *Effect on adjustments made under subchapter C of chapter 63.* Any final decision with respect to any partnership-related item adjusted in a proceeding not under subchapter C of chapter 63 is not binding on any person that is not a party to the proceeding.

(i) *Coordination with adjustments made at the partnership level.* This section will not apply to the extent the partner can demonstrate adjustments to partnership-related items included in the deficiency or an adjustment by the IRS were—

(1) Previously taken into account under subchapter C of chapter 63 by the person being examined; or

(2) Included in an imputed underpayment paid by a partnership (or pass-through partner) for any taxable year in which the partner was a reviewed year partner or indirect partner but only if the amount included in the deficiency or adjustment exceeds the amount reported by the partnership to the partner that was either reported by the partner or indirect partner or is otherwise included in the deficiency or adjustment determined by the IRS.

(j) *Applicability date*—(1) *In general.* Except for paragraph (b) of this section, this section applies to partnership taxable years ending after November 20, 2020, or any examination or investigation begun after November 20, 2020. Notwithstanding the preceding sentence, any provision of this section except for paragraph (b) of this section may apply to any taxable year of a partner that relates to a partnership taxable year subject to subchapter C of chapter 63 that ended before November 20, 2020, upon agreement between the partner under examination and the IRS.

(2) *Partnership-related items underlying non-partnership-related items.* Paragraph (b) of this section applies to partnership taxable years beginning after December 20, 2018, or any examination or investigation begun after November 20, 2020. Notwithstanding the preceding sentence, paragraph (b) of this section may apply to any taxable year of a partner that relates to a partnership taxable year subject to subchapter C of chapter 63 that ended before December 20, 2018, upon agreement between the partner under examination and the IRS.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

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FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 73

[MB Docket No. 20–299; FCC 20–146; FRS 17240]

Sponsorship Identification Requirements for Foreign Government-Provided Programming

AGENCY: Federal Communications Commission.

ACTION: Proposed rule.

SUMMARY: In this document, the Commission seeks comment on rules proposing to require specific disclosure requirements for broadcast programming that is paid for, or provided by a foreign government or its representative.

DATES: Comments due on or before December 24, 2020; reply comments due on or before January 25, 2021.

FOR FURTHER INFORMATION CONTACT: Radhika Karmarkar, Media Bureau, Industry Analysis Division, *Radhika.Karmarkar@fcc.gov,* (202) 418–1523.

SUPPLEMENTARY INFORMATION: This is a summary of the Commission's Notice of Proposed Rulemaking (*NPRM*), FCC 20–146, in MB Docket No. 20–299, adopted on October 16, 2020, and released on