



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR Associate Area Counsel (Natural Resources)
CC:LM:NR:DAL:1
Attn: Silvia M. Rheinbolt

FROM: Curtis G. Wilson
Assistant Chief Counsel
CC:PA:APJP

SUBJECT: _____

This Chief Counsel Advice responds to your memorandum dated February 20, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Partnership:

Year 1:

Year 2:

Year 3:

Year 4:

ISSUES

- (1) What constitutes a valid election to use the TEFRA consolidated audit procedures;
- (2) Does answering "yes" to Form 1065, Schedule B, Question 4, constitute a valid election to become subject to the TEFRA consolidated audit procedures when no separate election has been made; and,

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- (3) If checking "Yes" to question 4, Schedule B, Form 1065, constitutes an election to be covered under the TEFRA provisions, how is that election revoked?

CONCLUSIONS

- (1) An election to be included in the TEFRA consolidated audit procedures must be made by attaching a separate statement to Form 1065 which clearly indicates that it is an election to be covered by TEFRA and is signed by all persons who were partners in the partnership for that year.
- (2) Merely answering "Yes," to question 4 of Schedule B on Form 1065 is insufficient to elect coverage under the TEFRA provisions.
- (3) Since merely checking "Yes" to the above question is insufficient to constitute an election to be covered by the TEFRA provisions, there is no election to be revoked.

FACTS

On the tax returns filed by Partnership for Year 1, Year 2, Year 3, and Year 4, Partnership checked "yes" in line (4), Schedule B of Form 1065 (entitled "Is this partnership subject to the consolidated audit procedures of I.R.C. §§ 6221 through 6233?"). You also indicate that Partnership designated a Tax Matters Partner (TMP) for the years at issue.

For all relevant years, Partnership was a limited partnership and had less than ten partners, all of which were C corporations.

Partnership alleges that when it checked the "yes" box on its Year 1 return, the partnership was comprised of only C corporation partners. Partnership did not include any separate statement electing to be covered by the unified audit procedures for any taxable year.

LAW AND ANALYSIS

The partnership provisions in Title IV of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. 97-248, established a unified audit and litigation process under sections 6221 through 6232 of the Code for determining the tax treatment of partnership items at the partnership level. For partnership tax years beginning after September 3, 1982, these TEFRA provisions effectively replace the procedures generally applicable to the determination of tax deficiencies and overpayments under sections 6211 through 6215 with special procedures applicable to the

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administrative adjustment and judicial readjustment of partnership items. See I.R.C. §§ 6221 - 6234.

The TEFRA unified audit procedures apply to any partnership that is required to file a return under section 6031(a) and which does not fall within the small partnership exception. Under section 6231(a)(1)(B), small partnerships are excepted from the TEFRA partnership provisions unless a valid election is made to be covered by the TEFRA provisions under section 6231(a)(1)(B)(ii).

Before 1997, a small partnership was a partnership in which there were ten or fewer partners, each of whom was a natural person (other than a nonresident alien) or an estate. Each partner's share of each partnership item was required to be the same as his share of every other item. Section 6231(a)(1)(B). Treas. Reg. § 301.6231(a)(1)-1T.¹

The Tax Reform Act of 1997 introduced an important change for small partnerships under section 6231 for tax years ending after August 5, 1997. Most relevant, the "10 or fewer" limitation described in section 6231(a)(1)(B)(i) is applied to the number of natural persons (other than nonresident aliens), C corporations, and estates of deceased partners that were partners at any one time during the partnership taxable year. For purposes of section 6231(a)(1)(B), a husband and wife (and their estates) are treated as one partner.

Before this change was made, Partnership could not qualify as a small partnership since all its partners were C corporations. After the law was modified, Partnership met the definition of "small partnership." The determination of whether a partnership meets the requirements for the exception for small partnerships under section 6231(a)(1)(B) is made with respect to each partnership taxable year. Treas. Reg. § 301.6231(a)(1)-1T(a)(3) (as revised by T. D. 8808, 64 FR 3839, Jan. 26, 1999).

A small partnership can elect to be subject to the TEFRA procedures by attaching a statement to the partnership return for the first taxable year for which the election is to be effective. The statement should be identified as an election under section 6231(a)(1)(B)(ii), should be signed by all persons who were partners of that partnership at any time during the partnership taxable year to which the return relates, and should be filed at the time (determined with regard to any extension of time for filing) and place prescribed for filing the partnership return.

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Under Treas. Reg. § 301.6231(a)(1)-1T, the election made by a partnership to be subject to the TEFRA procedures was effective for the partnership taxable year to which the return related and all subsequent partnership taxable years unless revoked with the consent of the Commissioner. Treas. Reg. § 301.6231(a)(1)-1T(b)(3).

Issue 1:

Treas. Reg. § 301.6231(a)(1)-1T(b)(2) provides as follows:

A partnership shall make the election...by attaching a statement to the partnership return for the first taxable year for which the election is to be effective. The statement shall be identified as an election under section 6231(a)(1)(B)(ii), shall be signed by all persons who were partners of that partnership at any time during the partnership taxable year to which the return relates, and shall be filed at the time (determined with regard to any extension of time for filing) and place prescribed for filing the partnership return.

Thus, a statement identified as an election must be attached to the partnership return, and that statement must be filed in the time and place prescribed for filing the return.

Issue 2:

The instructions for Form 1065 provide the circumstances in which a partnership should check “Yes” to Schedule B, Question 4 on Form 1065. Form 1065, Schedule B, Question 4, asks “Is this partnership subject to the consolidated audit procedures of section 6221 through 6233?...” The instructions to form 1065, however, clarify that simply checking “Yes” to Question 4 is **not** an election to become subject to the TEFRA procedures. That instruction provides that “**The partnership does not make [the small partnership election] election when it answers Yes to Question 4. The election must be made separately.**” (Emphasis added)

Thus, if Question 4, Schedule B is checked “Yes,” that alone is insufficient to constitute an election to become subject to the TEFRA procedures, within the meaning of section 6231(a)(1)(B)(ii).

Issue 3:

The taxpayer argues that checking “Yes” to Question 4 on Schedule B of Form 1065 is insufficient to elect coverage under TEFRA. We agree. The Service’s

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position is that responding affirmatively to that question does not constitute a valid election for a partnership to be included under the TEFRA unified audit procedures. As indicated earlier, a partnership can elect to be subject to the TEFRA audit procedures by attaching a separate statement to the Form 1065. Under the procedures outlined in section 6231(a)(1)(B), that statement should be identified as such, and should be signed by all persons who were partners at any time during that year. A valid election will remain in effect until the Service consents to its revocation.

In this case, Partnership did not attach a statement to any prior return indicating its wish to be covered by the TEFRA audit provisions. Accordingly, because Partnership did not elect to be subject to the TEFRA audit procedures, it need not revoke the election.

OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

CURTIS G. WILSON
Assistant Chief Counsel
Administrative Provisions
& Judicial Practice

/S/

By: _____
Susan T. Mosley
Senior Technician Reviewer
Branch 3