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

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service) CC:DOM:FS

SUBJECT: Issuance of Timely TEFRA Notices

This Field Service Advice responds to your memorandum dated May 12, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

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ISSUE

Whether the Service may intentionally fail to issue timely notices of beginning of administrative proceeding (NBAP) so as to allow the taxpayers to elect out of TEFRA pursuant to section 6223(e).

CONCLUSION

Though issuing an untimely NBAP will allow taxpayers to elect out of TEFRA, such a procedure is contrary to the policies underlying the enactment of TEFRA and is therefore inappropriate.

FACTS

A and related entities are partnerships and limited liability companies, each of which has no greater than four partners. None of the partners are individuals, but rather, the partners are grantor trusts. Because the partnerships and LLCs have grantor trusts as their partners, they do not qualify for the small partnership exception of section 6231(a) and are thus subject to TEFRA.[1] See Primco v. Commissioner, T.C. Memo. 1997-332. In connection with a prior examination, the Service failed to issue a timely notice of beginning of administrative proceeding. In the case of the prior examination, a notice of final partnership administrative adjustment was issued less than 120 days subsequent to the issuance of a notice of beginning of administrative proceeding, thus permitting the partners to elect to have their partnership items treated as nonpartnership items. See I.R.C. § 6223(e)(3)(B). The taxpayers have indicated that they prefer not to be subject to TEFRA, and the Examination Division has inquired whether, on a continuing basis, it may intentionally issue NBAPs less than 120 days before it issues FPAAs, thus, in effect, allowing the partners to elect out of TEFRA.

LAW AND ANALYSIS

The tax treatment of partnership items "shall be determined at the partnership level." In the case of a proceeding pursuant to the TEFRA unified audit and litigation procedures of sections 6221 et seq., Congress expressly gave any partner the right to participate in the administrative proceeding. I.R.C. § 6224. In order to participate in the proceeding, the partner must be aware of the proceeding. Accordingly, section 6223(a) generally requires the Service to give partners notice of both the beginning and completion of an administrative proceeding to determine partnership items. The purpose behind this notice provision is to ensure that each partner who is entitle to notice has the opportunity to participate in the administrative proceedings.

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[1]We note that your request for advice concluded that section 6231(g) does not apply. Section 6231(g) allows the Service to reasonably rely on the face of the partnership return when determining whether TEFRA applies. Though this provision is effective for taxable years ending after August 5, 1997, existing case law arguably has reached the same conclusion. See Harrell v. Commissioner, 91 T.C. 242 (1988) and Z-Tron v. Commissioner, 91 T.C. 258 (1988) (both addressing the same share requirement). We concur that neither section 6231(g) nor the bright line test of Harrell is applicable here, because the Service has actual knowledge that the partners are grantor trusts, and thus, cannot "reasonably rely" on the face of the partnership return.

In the event the Service fails to provide proper notice of the administrative proceeding, Congress fashioned a remedy for the improper notice. If a notice of beginning of administrative proceeding (NBAP) is issued less than 120 days before the issuance of the corresponding notice of final partnership administrative adjustment (FPAA), the taxpayer's remedy is set forth in section 6223(e). Wind Energy Tech. Assoc. III v. Commissioner, 94 T.C. 787 (1990). Though the remedy varies depending upon whether the proceeding is ongoing, generally the taxpayer's choices are: to be bound by the TEFRA proceeding; to have a prior settlement entered between the Service and another partner apply to the aggrieved partner; or to have the aggrieved partner's partnership items converted to nonpartnership items. I.R.C. § 6223(e). When partnership items are converted to nonpartnership items, the Service is generally authorized to issue a notice of deficiency to the partner for any tax liability arising out of adjustments to the former partnership items. I.R.C. § 6230(a)(2)(A)(ii). Once the notice of deficiency is issued, the case is generally governed by the rules applicable to deficiency cases. Id.

As noted by the Tax Court, "Congress enacted the TEFRA provisions in order to provide consistent treatment of partnership items among all partners, and to provide judicial economy from unified audit proceedings." Doe v. Commissioner, T.C. Memo. 1993-543. Congress expressly stated that the provisions were adopted to promote "more efficient administration of the tax laws." H. Conf. Rept. No. 97-760, at 600 (1982). Furthermore, the Second Circuit has noted that TEFRA was designed to solve the problems of duplication of administrative and judicial resources and inconsistent results. Randell v. United States, 64 F.3d 101, 103 (2d Cir. 1995).

Through cooperative use of the procedures of section 6223(e), the Service and taxpayers could effectively circumvent TEFRA procedures; however, this would also serve to circumvent the benefits that were intended by TEFRA. These benefits were not intended solely for the benefit of the Service or for the benefit of the partners under examination. The benefits of TEFRA are intended to enure to the courts, as well as for the benefit of tax administration in general. By intentionally utilizing a provision in the statute to circumvent the TEFRA procedures, the Service would, in effect, be overriding an act of Congress. This is clearly contrary to Congressional intent and is therefore inappropriate.[2]

[2]We also note that issuing an untimely NBAP is contrary to the procedures set forth in the Internal Revenue Manual, which state that the "examiner is responsible for issuing the notice of beginning of proceeding to the TMP on a timely basis." IRM § 4474(3).

If you have any further questions, please call (202) 622-7940.

cc: Regional Counsel,