



August 14, 2017

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Re: Proposed Regulations Regarding the Centralized Partnership Audit Regime ([REG-136118-15](#),  
Docket ID [IRS-2017-0009](#))

Dear Messrs. Koskinen and Paul and Ms. Zuba:

The American Institute of CPAs (AICPA) offers the following comments and recommendations related to the proposed regulations regarding the Centralized Partnership Audit Regime (the “Regime”) issued June 14, 2017. The proposed regulations provide rules for partnerships subject to the Regime, including procedures for electing out of it, filing administrative adjustment requests, and determining amounts owed by the partnership or its partners based on audit adjustments from an examination of a partnership. They also address the scope of the Regime as well as provide definitions and special rules that govern its application, including the designation of a partnership representative.

The AICPA appreciates the time and effort which the United States Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) have devoted to the development of the proposed regulations. However, important sections of the proposed regulations are marked “Reserved” and are awaiting future guidance from Treasury and the IRS. We have also identified areas of the proposed regulations in need of clarification or additional explanation. In order to address these items, we provide specific recommendations and requests for clarification on certain portions of the proposed regulations. In addition, we have included general comments, concerns and recommendations regarding the implementation of the Regime by Treasury and the IRS.

These comments were developed by the AICPA Partnership Taxation Technical Resource Panel and approved by the Tax Executive Committee.

## **Background**

The proposed regulations are designed to implement section 1101 of the [Bipartisan Budget Act of 2015](#) (BBA), which was enacted into law on November 2, 2015, and amended by the [Protecting Americans From Tax Hikes Act of 2015](#). Section 1101 of the BBA repeals the current rules governing partnership audits, which generally assesses and collects tax at the partner level and replaces them with the Regime that, in general, assesses and collects tax at the partnership level. The current partnership audit and litigation rules were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The Regime and these proposed regulations generally affect partnerships for taxable years beginning after December 31, 2017.

## **Recommendations and Comments on Specific Provisions of Proposed Regulations**

### *Proposed Regulation § 301.6221(a)-1<sup>1</sup> Scope of the Partnership Procedures under Subchapter C of Chapter 63 of the Internal Revenue Code*

In general, Prop. Reg. § 301.6221(a)-1 establishes the scope of the Regime. It provides that all adjustments and items resulting from an audit of a partnership are determined at the partnership level and any related tax is assessed and collected at the partnership level.

Subsection (c)(1) allows a partnership to raise partner-level penalty defenses prior to the issuance of a notice of final partnership adjustment (FPA). The regulations are in need of clarification on the following items:

- a) Whether the provision applies to both direct and indirect partners.
- b) The method the IRS will use to identify on the FPA specifically which penalty defenses are taken into account and to which portion of the adjustments they apply.
- c) The method the IRS will use to separately identify penalty defenses taken into account relating to an adjustment item subject to modification for an amended return, tax-exempt partners or other reason.
- d) The method the IRS will use to identify and process penalty defenses taken into account if a partnership elects to “push-out” under section 6226.
- e) In examinations where a partner-level defense is raised, whether the partner involved (or their representative) may participate in discussions with the examiner.

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<sup>1</sup> All references herein to “section” or “§” are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.

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*Proposed Regulation § 301.6221(b)-1 Election Out for Certain Partnerships with 100 or Fewer Partners*

Proposed Reg. § 301.6221(b)-1 provides for circumstances whereby certain partnerships with 100 or fewer partners can elect out of the Regime as well as the steps a partnership must take to elect out.

- 1) The preamble to the proposed regulations states that “The Treasury Department and the IRS intend to continue to treat an organization that is determined to be, or claims to be, exempt from tax under section 501(a) and is classified as a corporation under section 7701(a)(3) as a C corporation for purposes of proposed §301.6221(b)-1(b)(3), consistent with Revenue Ruling 2003-69, 2003-1 C.B. 1118 (treating tax-exempt corporations as C corporations for purposes of the TEFRA small partnership exception).” However, this clarification of whether a tax-exempt entity is an eligible partner is not explicitly stated in the proposed regulations under subsection (b)(3) nor is there an example showing its application.

We recommend adding specific language incorporating Treasury’s position on this matter, along with a clarifying example to the final regulations. We are concerned that requiring taxpayers to depend solely on a revenue ruling which references the TEFRA rules, which are no longer valid, to determine whether a tax-exempt entity is an eligible partner invites confusion and potential disputes between taxpayers and the IRS.

- 2) We recommend adding a definition or an example clearly stating the meaning and application of the phrase in subsection (b)(3)(ii)(E) which states that “a nominee or other similar person that holds an interest on behalf of another person” does not qualify as an eligible partner. This phrase does not appear elsewhere in the Internal Revenue Code (IRC) or regulations and therefore its meaning is unclear.
- 3) Subsection (b)(3)(ii) provides a list of entities that are not considered eligible partners for the election out of the Regime. This list includes trusts and “a disregarded entity described in Prop. Reg. § 301.7701-2(c)(2)(i).”

We recommended that the IRS exercise their authority under section 6221(b)(2)(C) to expand the list of eligible partners to include:

- a) Single Member LLCs (SMLLC) treated as disregarded entities owned by an eligible partner described in section 6221(b)(1)(C);
- b) Trusts, within the meaning of section 7701;
- c) Individual Retirement Accounts (IRAs);

- d) Qualified pension, profit-sharing and stock bonus plans described in section 401(a); and
- e) Tax-exempt organizations described in section 501(c), including tax-exempt entities organized either as a charitable trust or a nonprofit corporation.

The inclusion of the entity types listed above to the definition of eligible partners would not impose any significant additional administrative burdens upon the IRS or its ability to properly audit partnerships and their partners. Also, extending the list of eligible partners should not unduly impact the ability of the IRS to assess and collect any additional taxes due resulting from an examination.

Additionally, the IRS has requested feedback on how the failure to include an entity as an eligible partner could increase the burdens the IRS might face. We identify a SMLLC treated as a disregarded entity owned by an eligible partner described in section 6221(b)(1)(C) as an example of such a situation. Failure to include the SMLLC as an eligible partner may result in many taxpayers choosing to transfer partnership shares from SMLLCs, either to themselves as individual partners or to a subchapter S corporation partner in order to permit the partnership to elect out of the Regime. This action would have no effect on the ultimate tax liabilities of these taxpayers, but would generate unnecessary filings, along with additional work and expense for the IRS, taxpayers and their tax professionals.

We recommend that all of the additional eligible types of partners identified above, with the exception of trusts, are counted as receiving a single statement under section 6221(b)(1)(B). In the case of trusts, we recommend that the IRS use rules similar to those proposed for S corporations in subsection (b)(2)(ii) and subsection (b)(3)(i).

- 4) Subsection (c)(2) requires a partnership making an election out of the Regime to provide the IRS with certain information regarding “each person who was a partner **at any time** during the taxable year” (emphasis added). For any partner that is an S corporation, similar information is required for “each shareholder of the S corporation.” It is unclear if this requirement for information on S corporation shareholders applies to shareholders as of a specific date or any person who was shareholder during the S Corporation’s taxable year (which may differ from the partnership’s taxable year).

We recommend that the final regulations requiring the disclosure of information on the shareholders of an S corporation partner include language similar to subsection (b)(2)(ii) which takes “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.”

- 5) Subsection (c)(2) requires an “affirmative statement that the partner is an eligible partner under paragraph (b)(3) of this section” for each partner of the electing partnership.

We suggest this statement appear at the bottom of an IRS developed form or return attachment which a partnership will use to provide the required information. Additionally, we suggest that the signature of any person eligible to sign the affected Form 1065, *U.S. Return of Partnership Income*, below such statement is sufficient affirmation for partners listed.

- 6) Subsection (c)(3) requires notification to each partner of the election out of the Regime within 30 days of making the election. Presumably, no notification is required to the shareholders of any partner which is an S corporation. We recommend that the final regulations include a clarifying statement to that effect.

We recommend that the IRS add a checkbox to Schedule K-1 (Form 1065), *Partner’s Share of Income, Deductions, Credits, etc.* indicating that the partnership has elected out of the Regime, similar to the existing checkboxes for a Final or Amended Schedule K-1. A partnership is required to provide a Schedule K-1 to its partners on or before the required filing date of the partnership return. As the election is made on a timely filed return, Schedule K-1 is required to reach the partners within the mandated 30-day period of this subsection. There is no need to create or require an additional form or statement for this purpose.

- 7) Subsection (e)(2) indicates that the IRS will notify the partnership in writing if they determine that the election is invalid.

We recommend that the final regulations provide a limited timeframe for when the IRS is allowed to determine that the election is invalid. The proposed regulations do not contain a limitation on the time period in which the IRS must make such a determination. Therefore, the IRS could determine that the election is invalid at any time the statute of limitations for examination of the return remains open. This extended timeframe will impose unnecessary uncertainty on an electing partnership and its partners. A reasonable time limitation, perhaps 180 days from the later of the return’s original due date or actual filing date (provided the return was timely filed under a valid extension), on this determination is fair and equitable.

#### *Proposed Regulation § 301.6223-1 Partnership Representative*

Proposed Reg. § 301.6223-1 provides rules regarding the requirement of a partnership to designate a partnership representative who replaces the existing tax matters partner (TMP) required under the TEFRA rules. It also establishes rules for the termination and replacement of a partnership representative.

- 1) Subsection (a) states that “A partnership subject to subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) for a partnership taxable year must designate a partnership representative for the partnership taxable year in accordance with this section.” However, Prop. Reg. § 301.6221(b)-1 allows certain partnerships to opt out, stating specifically that “The provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) do not apply for any partnership taxable year for which an eligible partnership under paragraph (b) of this section makes a valid election in accordance with paragraph (c) of this section.”

We recommend that the final regulations clarify if a partnership making a valid election to opt out is required to appoint a partnership representative.

It is our interpretation of the language in the proposed regulations that a partnership making a valid election to opt out is not required to appoint a partnership representative. However, we think that it is in the best interest of a partnership to have a partnership representative. If the IRS should subsequently determine that the election to opt out was invalid, it would benefit both the partnership and the IRS to have a partnership representative. Also, various sections of the proposed regulations state that an upper-tier partnership, which is itself a partner in an audited partnership, is subject to any provisions which apply generally to partners of the audited partnership. To assure that an upper-tier partnership will have the ability to push-out any adjustment to its own partners, the designation of a partnership representative at the time of filing their original return is warranted.

- 2) Subsection (b)(3) contains proposed regulations regarding the appointment of a person who is not an individual to serve as the partnership representative, identified as an “entity partnership representative.” In situations where a partnership selects an “entity partnership representative,” the proposed regulations also require the partnership to appoint a specific person, known as the “designated individual,” as the sole individual who may act on behalf of the “entity partnership representative.” We think that the requirement to also designate a specific individual prior to the issuance of a notice of administrative proceeding is contrary to Congressional intent. The statute states that the partnership representative is “a partner (or other person)...” Neither the statute nor the *General Explanation Of Tax Legislation Enacted in 2015* (“Blue Book”)<sup>2</sup> requires that such person is an individual. If an entity that meets the requirements of subsections (b)(2) and (b)(4) is designated as the partnership representative, the appointment of a specific individual to act on their behalf should take place only upon issuance of a notice of administrative proceeding or with the filing of a valid administrative adjustment request (AAR) in accordance with section 6227.
- 3) We recommend that once an entity is properly appointed as the partnership representative, that entity (and not the partnership) should specify the identity of the “designated individual.” The requirement that the partnership appoint the “designated individual” for

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<sup>2</sup> [JCS-1-16](#).

an “entity partnership representative” eliminates the purpose of having an entity designated as the partnership representative. In Example 3 of Prop. Reg. § 301.6223-2(d), a situation is described where the designated individual appointed by the partnership is “unaffiliated with” nor “an officer, director or employee” of the entity partnership representative. We question why the partnership in that situation would not have merely selected that individual as the partnership representative, rather than identifying an entity with no power or authority over the individual.

- 4) Subsection (d) describes the procedures for the resignation of a partnership representative or designated individual. Subsection (d)(2) sets the time for resignation to coincide with the filing of an AAR or the receipt of a notice of administrative proceeding from the IRS.

We recommend allowing the partnership representative or designated individual to resign at any time. A previously designated partnership representative may discontinue their business relationship with the partnership, no longer qualify as an eligible person or have another reason for resigning. A designated individual may have also left the employ of the entity partnership representative. Preventing a resignation from occurring until an examination has begun imposes an undue burden on the taxpayer and the person serving as the partnership representative. Also, the notice of administrative proceeding could reach a person no longer connected to partnership, or fail to reach them.

The IRS has indicated their concern with the administrative burden of having to track changes in the partnership representative. However, the IRS has a proven and effective system for tracking Power of Attorney (POA) status based on taxpayer, year and type of return. A modification or adaptation of the POA system should accommodate the required tracking. Also, subsection (a) requires that “a partnership representative must update the partnership representative’s contact information when such information changes.” Therefore, it appears that the IRS will require and anticipates processing updates to their database of partnership representatives at any time.

- 5) Subsection (d) also permits a resigning partnership representative or designated individual to appoint their own successor.

We oppose this provision because the resignation will often take place as the result of a dispute or disagreement between the partnership and the individual. Under the regulations as written, if a partnership representative resigns upon receipt of a notice of administrative proceeding and appoints a successor, the partnership is represented by that successor (who they may have had no input in selecting) who will act on their behalf and have the power to make binding decisions during an IRS examination.

We recommend that upon resignation of a partnership representative, including an entity partnership representative, the IRS should allow the partnership 30 days to appoint a new partnership representative. In the case of the resignation of the designated individual for

an entity partnership representative, the IRS should allow the entity 30 days to designate a new individual. If the entity fails to do so, the provisions of subsection (f) regarding the designation of a partnership representative by the IRS shall take effect.

- 6) Subsection (e) describes the procedures for a partnership to revoke their designation of a partnership representative and designate a successor.

We recommend allowing a partnership to revoke the designation of their partnership representative at any time, provided that they simultaneously appoint a new partnership representative. Similar to our comments regarding the procedures for the partnership representative's resignation, we disagree with limiting the ability of a partnership to revoke their designation only upon receipt of a notice of administrative adjustment or the filing of a valid AAR.

- 7) If the IRS maintains the proposed limitations on when a partnership representative may resign or have their designation revoked, we recommend delaying the timeframe that time sensitive actions or required responses are due to the IRS until the successor designation takes effect (currently 30 days in proposed regulations). The outgoing partnership representative, who potentially has an adversarial relationship with the partnership, can still bind the partnership during the 30-day period and therefore, it is inappropriate for them to take any action or provide responses to the IRS on behalf of the partnership.
- 8) Subsection (e)(3)(iii)(A)(2) requires that the notification of revocation provided to the IRS includes a certification that a copy of the revocation was provided to the partnership representative whose designation is revoked. Failure to provide a copy of the revocation will render it invalid. We suggest that the final regulations provide clarification of the following issues:
  - a) How a partnership should make this certification when the revocation relates to a partnership representative who is now deceased or, in the case of an entity, no longer exists.
  - b) In situations where the partnership is no longer in contact with the representative, we suggest a clarification that the notice sent to the last known address is sufficient.
  - c) The specific requirements and/or exclusions related to the method of delivery used by a partnership to provide this notice, such as proof of delivery or electronic delivery.



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*Proposed Regulation § 301.6223-2 Binding Effect of Actions of the Partnership and Partnership Representative*

Proposed Reg. § 301.6223-2 provides for the binding effect of the actions of the partnership and partnership representative.

- 1) Subsection (b) states that termination of a partnership representative's designation does not invalidate actions taken prior to the effective date of the termination. However, a resignation or revocation of such designation does not take effect until 30 days after receipt by the IRS.

We recommend prohibiting a partnership representative or designated individual who has resigned or had their designation revoked from making decisions or taking any action binding the partnership once the IRS receives proper notice of the resignation or revocation. We are concerned, particularly in the case of a revocation, that a partnership representative could deliberately take actions during the 30-day period with the intent to inflict economic harm on the partnership.

- 2) Subsection (c) states that "Except for a partner that is the partnership representative or the designated individual, no partner, or any other person, may participate in an examination or other proceeding involving the partnership under subchapter C of chapter 63 without the permission of the IRS." We suggest that the final regulations provide clarification related to this statement with respect to the following situations:
  - a) If the partnership representative may engage, using a standard POA designation, a tax professional authorized to practice before the IRS under Circular 230<sup>3</sup> to act on their behalf during the examination.
  - b) If a person holding a properly executed POA from the partnership for the tax year in question can take part in meetings or calls concerning the examination.
  - c) If a person holding a properly executed POA from the partnership for the tax year in question will receive copies of correspondence related to the examination, assessment or collection.

*Proposed Regulation § 301.6225-1 Partnership Adjustment by the Internal Revenue Service*

Proposed Reg. § 301.6225-1 describes the rules and processes regarding the treatment of partnership adjustments.

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<sup>3</sup> [https://www.irs.gov/pub/irs-utl/revised\\_circular\\_230\\_6\\_-\\_2014.pdf](https://www.irs.gov/pub/irs-utl/revised_circular_230_6_-_2014.pdf).

- 1) Subsection (a)(1) provides that “the adjustments that result in the imputed underpayment are taken into account by the partnership in accordance with §6241-4.”

We agree that the imputed underpayment is properly treated as a section 705(a)(2)(B) item. However, we suggest that the final regulations clarify that the adjustments are treated as income items described in section 705(a)(1)(B).

- 2) Subsection (d) discusses subgrouping of partnership adjustments based on “preferences, limitations, restrictions, and conventions, such as source, character, holding period, or restrictions under the Internal Revenue Code (Code) applicable to such items.”

We recommend that the final regulations include examples showing the application of this subgrouping provision for various types of preferences, limitations, restrictions and conventions. The lack of an example in the proposed regulations which shows the application of a limitation (e.g., those related to section 469, investment interest expense, and charitable contributions) creates difficulty in determining how or when the IRS would apply partner-level limitations at the partnership level.

- 3) In Example 3 of subsection (f), the \$125 decrease in long-term capital gain does not result in an imputed underpayment and is not taken into account. The statute and regulations indicate that the partnership would take that adjustment into account during the adjustment year under the provisions of Prop. Reg. § 301.6225-3.

We suggest adding a statement to the example outlining that the \$125 decrease is reported on the adjustment year tax return as a decrease to the long-term capital gain separately stated item as outlined in Prop. Reg. § 301.6225-3(b)(2).

- 4) In Example 4 of subsection (f), the \$25 increase in the deduction for 2020 does not result in an imputed underpayment and is not taken into account. The statute and regulations provide that the partnership would take that adjustment into account during the adjustment year under the provisions of Prop. Reg. § 301.6225-3. We suggest adding a clarifying statement to Example 4 highlighting this effect.

*Proposed Regulation § 301.6225-2 Modification of Imputed Underpayment*

Proposed Reg. § 301.6225-2 sets forth modification procedures in the case of an imputed underpayment based on adjustments resulting from an examination.

- 1) Subsection (b)(3)(iv) describes the rules for requesting a rate modification based on the type of partner allocated an adjustment or character of the adjusted income in cases where a special allocation may apply. The requirement to determine the partner’s distributive share based on a hypothetical sale of all partnership assets at fair market value (FMV) as of the close of the reviewed year is administratively burdensome and difficult to apply

many years after the calculation date. The statutory language appears to mandate such an approach. However, FMV is undefined in both the statute and the proposed regulations and therefore, will generate significant disputes between the IRS and partnerships.

We suggest that in order to simplify the administration of this provision, the IRS should define FMV, solely for purposes of this provision, as a more easily determined amount, such as using section 704(b) basis. Alternatively, the IRS has exercised their authority to calculate multiple imputed underpayments via various groupings and subgroupings. Accordingly, we recommend that the IRS permit a partnership to request that the adjustment items which are subject to a special allocation are placed into a separate subgrouping rather than require the FMV calculation. In this manner, the adjustment is allocated solely to the affected partners in the appropriate manner and the request for modification is considered separately from requests related to other portions of the adjustments.

We also request that the final regulations clarify that if the IRS requires a partnership to make the deemed sale calculation envisioned in the proposed regulations, such action is not considered a revaluation for purposes of section 704.

- 2) Subsection (c)(3) sets forth the timing rules for requesting a modification of the imputed underpayment. Subsection (d) describes the types of modifications available and the basic requirements for each type.

We suggest that the final regulations provide clarification of the following areas not addressed in the proposed regulations:

- a) Provide a specified timeframe in which the IRS must respond to a request for modification.
- b) Provide that if there is a pending request for modification at the expiration of the 270-day period, the IRS will automatically agree to an extension of that period until at least 30 days after they provide their response.
- c) Provide a specified timeframe for a partnership to respond to an IRS request for additional information during their review of a modification request. We suggest a minimum of 60 days. This issue is particularly significant if the request occurs near the expiration of the 270-day period.
- d) Provide an allowance for the following fact pattern in the final regulations. The approval of a modification based on an amended return requires payment of all “tax, penalties, additions to tax, and interest due.” However, the taxpayer filing an amended return may incorrectly calculate the interest amount due and subsequently receive an additional assessment from the IRS. If the amended return and payment

is made close to the end of the 270-day period, this unintentional payment shortfall may result in an inadvertent denial of the modification request.

- e) Provide clarification that the restriction in subsection (d)(2)(vii) on additional amended returns relates to only those items related to a partnership adjustment.
- f) Provide clarification on whether a tax-exempt partner, as defined in subsection (d)(3)(ii), involved in a reallocation adjustment must file an amended return to satisfy the requirements for approval of a modification request. We recommend that the IRS add either an explicit statement to subsection (d)(2)(vi) or an example indicating that such a filing is not necessary provided the IRS is satisfied that the relevant partner (for modification of the reallocation) qualifies as a tax-exempt entity.
- g) Provide clarification that if the IRS denies a modification based on a partner's filing of an amended return and payment of tax, that the partner can file a request for refund. If the partner is not entitled to a refund, then the IRS will unfairly receive payment twice for the same adjustment. This scenario could also occur with denial of a modification based upon a closing agreement.
- h) Provide clarification on the availability and timeframe for a partnership's appeal rights to a denial of a requested modification.

*Proposed Regulation § 301.6225-3 Treatment of Partnership Adjustments that do not Result in an Imputed Underpayment*

We recommend that Treasury and the IRS provide examples in the final regulations which demonstrate the proper application of subsection (b)(4) concerning reallocation adjustments of partnership items.

*Proposed Regulation § 301.6225-4 Adjustments to Partners' Outside Bases and Capital Accounts and a Partnership's Basis and Book Value in Property – [Reserved]*

This section of the proposed regulations is marked “[Reserved].” The preamble requested recommendations for proposed guidance in this area. Accordingly, our proposals are as follows:

- 1) With respect to the treatment of adjustments resulting in an imputed underpayment for purposes of the calculation of a partner's capital account and basis, we recommend that a partnership allocate adjustments as items of sections 705(a)(1)(B) or (2)(B) in accordance with the partnership agreement of the reviewed year and that the adjustments are subject to the existing “substantial economic effect” rules under section 704.

We also present the following recommendations with respect to that portion of the adjustment allocated to a reviewed year partner that is no longer a partner in the adjustment year:

- a) If the successor adjustment year partner received its interest from the reviewed year partner in a nonrecognition transaction, the successor partner should receive the same treatment as the reviewed year partner would have received with respect to all treatments of the adjustments.
  - b) If the successor adjustment year partner received its interest from the reviewed year partner in a taxable transaction, the successor partner should receive the same treatment as the reviewed year partner would have received with respect to all treatments of the adjustments. In addition, the successor adjustment year partner should have the ability to use the adjustment amounts to determine whether and how it affects the section 743(b) adjustment such partner computed at the time it received the partnership interest (if it had a section 743(b) adjustment), and then to update the changes affecting its section 743(b) adjustment.
  - c) If the reviewed year partner was redeemed out of the partnership and is no longer a partner in the adjustment year, the adjustment is allocated between the adjustment year partners of the partnership as a section 734(b) adjustment.
- 2) The following examples and Appendix 1 demonstrate the application of our recommendations.

**Example 1:** A, B, and C are equal partners in ABC, LLC. ABC is classified as a partnership for United States (U.S.) federal income tax purposes. A, B, and C originally contributed \$1,000 cash to ABC. ABC reported taxable income of \$1,200 in year 1, \$2,100 in year 2, and \$3,000 in year 3. In year 4, an examination under the Regime of ABC's year 1 tax return resulted in an imputed underpayment arising from an adjustment to reduce depreciation expense in year 1 by \$600. The \$600 depreciation should have been taken as a deduction as follows: \$300 in year 2 and \$300 in year 3. On January 1, year 3, C transferred its entire interest in ABC to XYZ, LLC, which was treated as a contribution under section 721.

The \$600 adjustment to depreciation is taken into account by A, B, and C in year 1 (reviewed year). Each partner's capital account and basis is increased by \$200 in year 1.

**Example 2:** The facts are the same as in Example 1, except that on January 1, year 3, C sells its entire interest in ABC to D, an unrelated party, for \$3,000 at a time when ABC's balance sheet is as follows:

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	Tax <u>(as originally reported)</u>	Tax <u>(as adjusted)</u>	<u>FMV</u>
Cash	3,000	3,000	3,000
Depreciable Asset	<u>3,300</u>	<u>3,600</u>	<u>6,000</u>
Total Assets	6,300	6,600	9,000
Liabilities	-	-	-
Capital:			
A	2,100	2,200	3,000
B	2,100	2,200	3,000
C	<u>2,100</u>	<u>2,200</u>	<u>3,000</u>
Total Liabilities & Capital	6,300	6,600	9,000

Assume that Depreciable Asset has a recovery period of 5 years and a straight-line depreciation method is used. ABC included a section 754 election in its originally filed year 3 tax return and reflected a basis adjustment under section 743(b) to D of \$900. D's section 743(b) basis adjustment is properly reflected as \$800 due to the adjustment of its share of basis in the Depreciable Asset from year 1 (reviewed year) and year 2 (intervening year). D would update its section 743(b) adjustment and also any depreciation affected by the revision to the basis adjustment.

As in Example 1, C's section 704(b) capital account should transfer to D.

**Example 3:** The facts are the same as in Example 1, except that on January 1, year 3, ABC redeems C's entire interest for \$3,000. A and B should take their share of the underlying adjustment into account and adjust their basis and capital accounts in year 1. Since C is no longer a partner of ABC in the adjustment year, the adjustment year partners are allocated C's share (\$200) of the underlying adjustment based on their allocations provided for in ABC's partnership agreement in effect for the adjustment year. Thus, A and B would each increase their basis and capital accounts by \$100 in the adjustment year.

Proposed Regulation § 301.6226-1 Election for an Alternative to the Payment of the Imputed Underpayment

Proposed Reg. § 301.6226-1 provides that a partnership can elect to have its reviewed year partners (rather than the partnership) take into account any adjustments made by the IRS during an examination and pay any taxes due resulting from the adjustments. It also describes procedures that the partnership should follow in order to have a valid election.

It appears that the failure to exercise reasonable diligence in determining the correct address to use in providing statements to a reviewed year partner makes the election invalid. We suggest that the

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final regulations provide clarification on whether or not a failure under this provision related to a single partner would make the entire election invalid or only the election for that portion of the adjustments allocable to that specific partner.

*Proposed Regulation § 301.6226-3 Adjustments Taken into Account by Partners*

Proposed Reg. § 301.6226-3 provides that a reviewed year partner who receives the applicable statement from the IRS must pay the additional tax resulting from adjustments related to the examination that are detailed in the statement. It also discusses the determination of the aggregate adjustment amounts, corrections, payment of a safe harbor amount as well as interest on the adjustment.

- 1) We think that Example 4 under this section is incorrect. The example indicates that a capital gain of \$40 million was originally allocated entirely to partner E. On examination, it was determined that the gain should have been allocated equally to partners E, F, G and H. The FPA shows a \$30 million reduction in capital gains for partner E. However, the example also provides that “The statement for E reflects a partnership adjustment of a reduction of **\$10 million** of capital gain for 2020. The statement also reflects that E’s safe harbor amount, as determined under §301.6226-2(g), is \$0 (<**\$10 million**> multiplied by 40 percent but not less than zero). **F elects to pay the safe harbor amount, which is zero.**” (emphasis added).

The statement for E should reflect a reduction of \$30 million of capital gain and a safe harbor calculation of “<\$30 million> multiplied by 40 percent but not less than zero.” In addition, the last sentence should read “**E** elects to pay the safe harbor amount, which is zero” instead of “**F** elects to pay the safe harbor amount, which is zero.”

- 2) We request that Treasury and the IRS add examples to the final regulations showing their proposed treatment of the following situations:
  - a) The IRS approves a modification based on a partner’s filing of amended returns. Subsequently, the partnership challenges the adjustment in Tax Court and the amount of the adjustment is reduced.
  - b) The IRS approves a modification based on a partner’s status as a tax-exempt entity. The IRS imposes a 20% accuracy-related penalty on the partnership. We ask that the example shows how the amount of the penalty is calculated after allowance for the modification and how the penalty is allocated among all partners, including the tax-exempt entity.
- 3) We request that Treasury and the IRS add examples to the final regulations showing the proper application of partner and partnership level tax attributes to the calculation of additional tax due for the intervening years.

*Proposed Regulation § 301.6226-3(e) Adjustments Taken into Account by Partners - Pass-through Partners – [Reserved]*

Proposed Reg. § 301.6226-3(e) is marked “[Reserved].” We recommend that the IRS establish procedures under Prop. Reg. § 301.6226-3(e) to allow for the push-out of audit adjustments through a tiered partnership structure. In the following numbered points, we describe a proposed general framework for implementing such an approach. This approach, and likely this approach only, could allow the partners of an audited partnership to ultimately pay the appropriate amount of tax. In general, we discourage establishing any limitations on tiers, dollar amounts, number of partners, or other attributes because those limitations may result in the partners paying inappropriate amounts of tax. Our proposed framework would result in a system that is administrable for the IRS and taxpayers while allowing for maximum flexibility for each partner to pay their appropriate share of taxes on any adjustments from an audited partnership. The proposed framework could also enable the IRS to fully collect the appropriate amount of tax on an adjustment without the inefficiencies experienced with the current TEFRA system.

- 1) We suggest that following receipt of the FPA, the audited partnership is required to complete a Partnership Adjustment Report (PAR). If the audited partnership elects to push-out any of the adjustment to its partners under section 6226, the PAR is due within 60 days after the date all of the partnership adjustments to which the PAR relates are finally determined. The PAR, designed to mimic a Schedule K, *Partners’ Distributive Share Items* of Form 1065, would show the total adjustments resulting from the audit. Further, the PAR would include columns showing the amounts modified or paid under section 6225 and the amounts pushed-out to partners under section 6226. By requiring reconciliation of the total adjustments pursuant to the FPA to the adjustments accounted for under section 6225 or 6226, the PAR will enable to the IRS to quickly view that all audit adjustments are accounted for under the rules of the Regime. An “Adjustment K-1” attached to the PAR filed with the IRS and issued to the relevant partners should detail any adjustment amounts pushed-out under section 6226. This system is consistent with the current Form 1065 and Schedule K-1 filing process and will have a minimal learning curve for all parties. After filing the PAR and Adjustment K-1s, the audit is completed with respect to the audited partnership and the process would enter the collection phase. No actions by a partner of the audited partnership shall cause the re-opening of the audit or any further liability to the partnership or its other partners.

Upon receipt of an Adjustment K-1 from an audited partnership, a partnership-partner will need to file its own PAR indicating the total amount shown on the Adjustment K-1 received, any amounts modified or paid under section 6225, and any amounts further pushed-out under section 6226. The PAR and related Adjustment K-1s are due (i.e., required mailing date) to the IRS and affected partners within 60 days of the date shown on the Adjustment K-1 received from the audited partnership.



We recommend that the IRS issue an assessment of tax in an amount equal to the safe harbor payment as calculated under the proposed regulations if a partner does not file its PAR with the IRS within the required timeframe. For purposes of this calculation and assessment only, any partner which is not an individual should have the safe harbor amount applied as if they were an individual subject to chapter 1 tax.

If an upper-tier partnership receives an Adjustment K-1 and further pushes-out the adjustment under section 6226, they will provide Adjustment K-1s to their partners and the same process will continue up the chain of ownership. We recommend that an S corporation which receives an Adjustment K-1 follow the procedures of those used by a partnership under section 6226 to report the properly allocable portion of the adjustment to the IRS and its owners.

- 2) We recommend that all PARs and Adjustment K-1s are due no later than the extended due date of the audited partnership's tax return for the taxable year in which the FPA is issued. While this suggestion might have the effect of limiting the number of tiers through which an adjustment is ultimately pushed-out, we recommend placing this overall time limit on the process rather than establishing a maximum allowable number of tiers.
- 3) In order to facilitate the collection and tracking of PARs and Adjustment K-1s, the AICPA proposes the creation of a special processing unit (SPU) within the IRS. This centralized collection point will allow for the most efficient tracking of adjustments through a tiered partnership structure. Further, we recommend that each audit is assigned a control number which is indicated on any PAR or Adjustment K-1 filed with respect to that audit.
- 4) We recommend that the IRS establish procedures for electronic submission of Adjustment K-1s to partners, similar to existing rules for original Schedules K-1. It is critical that any Adjustment K-1 is issued and received by the partners as expeditiously as possible, particularly in tiered partnership structures. Permitting electronic submission of Adjustment K-1s to the partners will greatly aid in that process and help ensure the IRS collects the appropriate amount of tax as efficiently as possible.

*Proposed Regulation § 301.6226-4 Adjustments to Partners' Outside Bases and Capital Accounts and a Partnership's Basis and Book Value in Property – [Reserved]*

Proposed Reg. § 301.6226-4 is marked “[Reserved].” We recommend that rules similar to those we proposed under section 6225 above are applied to calculate these adjustments as well.

*Proposed Regulation § 301.6227-1 Administrative Adjustment Request by Partnership*

- 1) Subsection (c) requires that the partnership representative must sign an AAR. Any change of partnership representative made in connection with the filing of an AAR does not take effect until 30 days after receipt by the IRS.

We oppose this provision and recommend that Treasury and the IRS remove this requirement from the proposed regulations. We recommend allowing any person authorized to sign the original Form 1065 to sign an AAR. There could exist circumstances where complying with the proposed requirement for a signature by the partnership representative is difficult, if not impossible. The following are examples of such situations:

- a) When the existing partnership representative is deceased or otherwise unavailable to sign the AAR.
  - b) Where the partnership is revoking an existing partnership representative designation and appointing a successor as part of the AAR and the existing representative refuses to sign it.
- 2) We suggest that the final regulations address how a partnership, which has made a valid election out of the Regime under Prop. Reg. § 301.6221(b)-1, should report changes to its original return. Clarification is needed as to whether the partnership is required to file an AAR, may continue to follow the current amended return procedures or will follow another procedure which the IRS intends to establish.

*Proposed Regulation § 301.6241-3 Treatment where a Partnership Ceases to Exist*

Subsection (b) indicates that if the IRS determines that a partnership has ceased to exist they will notify the partnership and the former partners. We think that the IRS should also inform the partnership representative and, when applicable, the “designated individual.”

*Proposed Regulation § 301.6241-4 Payments Nondeductible*

Proposed Reg. § 301.6241-4 states that payments made by a partnership under subchapter C of chapter 63 of the IRC are nondeductible, including any imputed underpayment. We recommend modification of this section to address the treatment of the adjustment that resulted in the imputed underpayment.

Under Prop. Reg. § 301.6225-1(a), a “partnership’s expenditure for the imputed underpayment and the adjustments that result in the imputed underpayment are taken into account by the partnership in accordance with §301.6241-4.” Subsection (a) addresses the nondeductible expense for “the imputed underpayment, interest, penalties, additions to tax or additional amounts with respect to an imputed underpayment” and treats it as an expenditure described in section 705(a)(2)(B). However, this section does not address the treatment of the underlying adjustments that resulted in the imputed underpayment, which likely are taken into account under section 705(a)(1)(B).

### **General Recommendations and Comments**

- 1) There is no reference in either the preamble or the proposed regulations related to an audited partnership's right to challenge various determinations under the Regime with the IRS Office of Appeals (Appeals). We recommend that the final regulations provide an explicit right to challenge via the Appeals process, the following actions or determinations by the IRS:
  - a) A determination by the IRS that an election to opt out under section 6221 is invalid.
  - b) A denial by the IRS of a requested modification to an imputed underpayment amount.
  - c) A denial by the IRS of a partner-level defense raised by the partnership prior to issuance of a FPA.
  - d) The underlying adjustments to the partnership's return appearing on a Notice of Proposed Partnership Adjustment (NOPPA).
  - e) A determination by the IRS that a partnership has ceased to exist under section 6241.
- 2) We suggest allowing a partnership the right to appeal the determinations under sections 6221 and 6241 above within 60 days of receipt of the determination.
- 3) We recommend that the IRS establish a single unified appeals process for a partnership to challenge both the underlying adjustments and any denial of requested modifications. If a partnership has submitted no requests for modification of the imputed underpayment, then its right to challenge the underlying adjustments with Appeals shall expire upon the conclusion of the 270-day period following the mailing of a NOPPA (including any extensions of that period agreed to by the IRS). If a partnership has filed a request for modification, then its right to challenge the underlying adjustments and any denial of the requested modification shall expire on the later of the conclusion of the 270-day period following the mailing of a NOPPA (including any extensions of that period agreed to by the IRS) or 45 days after the IRS has either accepted or denied all properly submitted requests for modification of the imputed underpayment amount.
- 4) We request that the IRS not have the ability to issue an FPA until at least 30 days after a final decision is made on all issues and determinations challenged by a partnership with Appeals.
- 5) We request further clarification on statements in the preamble regarding the ability of the IRS to "separately examine the partnership or its partners outside the centralized

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partnership audit regime for purposes of determining and assessing” taxes imposed by chapter 2 (Tax on Self-Employment Income) and chapter 2A (Unearned Income Medicare Contribution). Specifically, clarification is needed on whether a taxpayer filing an amended return or requesting a closing agreement under section 6225 for purposes of a modification to the imputed underpayment is required to take into account and pay any additional taxes due under Chapters 2 and 2A.

In addition, clarification is also needed relating to taxpayers paying tax on their allocated share of an adjustment under the procedures of section 6226. We request clarification of whether a taxpayer must calculate and pay any additional taxes due under Chapters 2 and 2A when reporting a “pushed-out” adjustment, particularly when the taxpayer elects to pay the safe harbor amount. We also request guidance as to what circumstance the IRS envisions auditing individual partners on this issue following conclusion of a partnership level audit under the Regime.

- 6) If a partnership challenges an adjustment, either via Appeals or in a court proceeding, and the amount of the adjustment is reduced, it is unclear how a taxpayer who has filed an amended return or executed a closing agreement under section 6225 would receive the benefit of the reduced tax liability of the revised adjustment amount. We recommend that the IRS clarify the procedure that will allow the taxpayer to request a refund of the amount overpaid.

\* \* \* \* \*

The AICPA is the world’s largest member association representing the accounting profession, with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please feel free to contact me at (408) 924-3508 or [Annette.Nellen@sjsu.edu](mailto:Annette.Nellen@sjsu.edu); Michael Greenwald, Chair, AICPA Partnership Taxation Technical Resource Panel, at (212) 842-7513 or [MGreenwald@friedmanllp.com](mailto:MGreenwald@friedmanllp.com); or Jonathan Horn, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204 or [Jonathan.Horn@aicpa-cima.com](mailto:Jonathan.Horn@aicpa-cima.com).

Respectfully submitted,



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cc: Ms. Rochelle Hodes, Attorney-Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
Mr. Brendan O'Dell, Attorney-Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
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## Appendix 1

EXAMPLE 1															
Nonrecognition transfer															
	Total			A			B			C			XYZ		
	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)
Year 1:															
Contribution	3,000	3,000	3,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000			
Profit/Loss Allocation	1,200	1,200	1,200	400	400	400	400	400	400	400	400	400			
Distribution	-	-	-												
Balance - 12/31/Year 1	4,200	4,200	4,200	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	-	-	-
Adjustment to Basis and Capital Account	600	600	600	200	200	200	200	200	200	200	200	200			
Balance - 12/31/Year 1 (Adjusted)	4,800	4,800	4,800	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	-	-	-
Year 2:															
Contribution	-	-	-												
Profit/Loss Allocation	2,100	2,100	2,100	700	700	700	700	700	700	700	700	700			
Distribution	-	-	-												
Balance - 12/31/Year 2	6,900	6,900	6,900	2,300	2,300	2,300	2,300	2,300	2,300	2,300	2,300	2,300	-	-	-
Intervening Year Adjustment	(300)	(300)	(300)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)			
Balance - 12/31/Year 2 (Adjusted)	6,600	6,600	6,600	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200	-	-	-
Year 3:															
Transfer from C to XYZ	-	-	-							(2,200)	(2,200)	(2,200)	2,200	2,200	2,200
Contribution	3,000	3,000	3,000	1,000	1,000	1,000	1,000	1,000	1,000				1,000	1,000	1,000
Profit/Loss Allocation	-	-	-												
Distribution	-	-	-												
Balance - 12/31/Year 3	9,600	9,600	9,600	3,200	3,200	3,200	3,200	3,200	3,200	-	-	-	3,200	3,200	3,200
Intervening Year Adjustment	(300)	(300)	(300)	(100)	(100)	(100)	(100)	(100)	(100)				(100)	(100)	(100)
Balance - 12/31/Year 3 (Adjusted)	9,300	9,300	9,300	3,100	3,100	3,100	3,100	3,100	3,100	-	-	-	3,100	3,100	3,100

<b>EXAMPLE 2</b>															
Recognition transfer															
	Total			A			B			C			XYZ		
	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)
Year 1:															
Contribution	3,000	3,000	3,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000			
Profit/Loss Allocation	1,200	1,200	1,200	400	400	400	400	400	400	400	400	400			
Distribution	-	-	-												
Balance - 12/31/Year 1	4,200	4,200	4,200	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	-	-	-
Adjustment to Basis and Capital Account	600	600	600	200	200	200	200	200	200	200	200	200			
Balance - 12/31/Year 1 (Adjusted)	4,800	4,800	4,800	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	1,600	-	-	-
Year 2:															
Contribution	-	-	-												
Profit/Loss Allocation	2,100	2,100	2,100	700	700	700	700	700	700	700	700	700			
Distribution	-	-	-												
Balance - 12/31/Year 2	6,900	6,900	6,900	2,300	2,300	2,300	2,300	2,300	2,300	2,300	2,300	2,300	-	-	-
Intervening Year Adjustment	(300)	(300)	(300)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)			
Balance - 12/31/Year 2 (Adjusted)	6,600	6,600	6,600	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200	-	-	-
Year 3:															
Transfer from C to XYZ	800	-	-							(2,200)	(2,200)	(2,200)	3,000	2,200	2,200
Contribution	3,000	3,000	3,000	1,000	1,000	1,000	1,000	1,000	1,000				1,000	1,000	1,000
Profit/Loss Allocation	-	-	-												
Distribution	-	-	-												
Depreciation from section 743(b) adjustment													(180)		
Balance - 12/31/Year 3	10,400	9,600	9,600	3,200	3,200	3,200	3,200	3,200	3,200	-	-	-	3,820	3,200	3,200
Intervening Year Adjustment	(300)	(300)	(300)	(100)	(100)	(100)	(100)	(100)	(100)				(100)	(100)	(100)
Revision to section 743(b) depreciation to D													20		
Balance - 12/31/Year 3 (Adjusted)	10,100	9,300	9,300	3,100	3,100	3,100	3,100	3,100	3,100	-	-	-	3,740	3,100	3,100

EXAMPLE 3												
Nonrecognition transfer												
	Total			A			B			C		
	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)	Outside Tax	Inside Tax	704(b)
Year 1:												
Contribution	3,000	3,000	3,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Profit/Loss Allocation	1,200	1,200	1,200	400	400	400	400	400	400	400	400	400
Distribution	-	-	-									
Balance - 12/31/Year 1	4,200	4,200	4,200	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400	1,400
Adjustment to Basis and Capital Account	400	400	400	200	200	200	200	200	200			
Balance - 12/31/Year 1 (Adjusted)	4,600	4,600	4,600	1,600	1,600	1,600	1,600	1,600	1,600	1,400	1,400	1,400
Year 2:												
Contribution	-	-	-									
Profit/Loss Allocation	2,100	2,100	2,100	700	700	700	700	700	700	700	700	700
Distribution	-	-	-									
Balance - 12/31/Year 2	6,700	6,700	6,700	2,300	2,300	2,300	2,300	2,300	2,300	2,100	2,100	2,100
Intervening Year Adjustment	(200)	(200)	(200)	(100)	(100)	(100)	(100)	(100)	(100)			
Balance - 12/31/Year 2 (Adjusted)	6,500	6,500	6,500	2,200	2,200	2,200	2,200	2,200	2,200	2,100	2,100	2,100
Year 3:												
Liquidating distribution to C	(3,000)	(3,000)	(3,000)							(3,000)	(3,000)	(3,000)
Adjustment under 1.704-1(b)(2)(iv)(m) re: section 734(b)	-	900	900								900	900
Section 734(b) adjustment	900	-	-							900		
Contribution	2,000	2,000	2,000	1,000	1,000	1,000	1,000	1,000	1,000			
Profit/Loss Allocation	-	-	-									
Distribution	-	-	-									
Balance - 12/31/Year 3	6,400	6,400	6,400	3,200	3,200	3,200	3,200	3,200	3,200	-	-	-
Adj to Basis and Cap Acct related to C's share of adj	200	200	200	100	100	100	100	100	100			
Intervening Year Adjustment	(200)	(200)	(200)	(100)	(100)	(100)	(100)	(100)	(100)			
Balance - 12/31/Year 3 (Adjusted)	6,400	6,400	6,400	3,200	3,200	3,200	3,200	3,200	3,200	-	-	-