

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

(a) In general. Partnership adjustments (as defined in § 301.6241-1(a)(6)) that do not result in an imputed underpayment (as described in § 301.6225-1(f)) are taken into account by a partnership in the adjustment year (as defined in § 301.6241-1(a)(1)) in accordance with paragraph (b) of this section.

(b) Treatment of adjustments by the partnership -

(1) In general. Except as described in paragraphs (b)(2) through (7) of this section, 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 depending on whether the adjustment is to a partnership-related item that is an item of income or loss.

(2) Separately stated items. In the case of a partnership adjustment to partnership-related item that is required to be separately stated under section 702, the adjustment is taken into account by the partnership in the adjustment year as a reduction in such separately stated item or as an increase in such separately stated item depending on whether the adjustment is a reduction or an increase to the separately stated item.

(3) Credits. In the case of an adjustment to a partnership-related item that is reported or could be reported by a partnership as a credit on the partnership's return for the reviewed year (as defined in § 301.6241-1(a)(8)), the adjustment is taken into account by the partnership in the adjustment year as a separately stated item.

(4) Reallocation adjustments. A partnership adjustment that reallocates a partnership-related item to or from a particular partner or partners that also does not result in an imputed underpayment pursuant to § 301.6225-1(f) is taken into account by the partnership in the adjustment year as a separately stated item or a non-separately stated item, as required by section 702. Except as provided in forms, instructions, and other guidance prescribed by the Internal Revenue Service (IRS), the portion of an adjustment allocated under this paragraph (b)(4) is allocated to adjustment year partners (as defined in § 301.6241-1(a)(2)) who are also reviewed year partners (as defined in § 301.6241-1(a)(9)) with respect to whom the amount was reallocated.

(5) Adjustments taken into account by partners as part of the modification process. If, as part of modification under § 301.6225-2, a relevant partner (as defined in § 301.6225-2(a)) takes into account a partnership adjustment that does not result in an imputed underpayment, and the IRS approves the modification, such partnership adjustment is not taken into account by the partnership in the adjustment year in accordance with § 301.6225-1(a).

(6) Effect of election under section 6226. If a partnership makes a valid election under § 301.6226-1 with respect to an imputed underpayment, a partnership adjustment that does not result in an imputed underpayment and that is associated with such imputed underpayment as

described in § 301.6225-1(g) is taken into account by the reviewed year partners in accordance with § 301.6226-3 and is not taken into account under this section.

(7) Adjustments taken into account previously by partners. If, prior to the mailing of a notice of administrative proceeding by the IRS or the filing of an administrative adjustment request by the partnership, a partner has previously taken into account an adjustment that does not result in an imputed underpayment that would have been taken into account under this section, such partnership adjustment is not taken into account by such partner.

(c) Treatment of adjustment year partners. The rules under subchapter K of chapter 1 of the Internal Revenue Code with respect to the treatment of partners apply in the case of adjustments taken into account by the partnership under this section.

(d) Examples. The following examples illustrate the rules of this section. For purposes of these examples, unless otherwise provided, each partnership is subject to the provisions of subchapter C of chapter 63 of the Internal Revenue Code, each partnership and its relevant partners are calendar year taxpayers, all relevant partners are U.S. persons (unless otherwise stated), the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods, and no partnership requests modification.

(1) Example 1. For all of Partnership's 2019, 2020, and 2021 partnership taxable years, Partnership has two equal partners, A and B. The IRS initiates an administrative proceeding with respect to Partnership's 2019 partnership taxable year. The IRS mails a notice of proposed partnership adjustment (NOPPA) to Partnership for the 2019 partnership taxable year proposing a recharacterization adjustment, changing a \$100 ordinary loss to a \$100 long term capital loss. Under § 301.6225-1, this recharacterization adjustment results in two adjustments: A \$100 increase to ordinary income (positive adjustment) and a -\$100 decrease in long term capital gain (negative adjustment). Under § 301.6225-1(b), the \$100 positive adjustment is the total netted partnership adjustment, which is multiplied by the highest rate of 40 percent, resulting in a \$40 imputed underpayment. Under § 301.6225-1(f), the -\$100 negative adjustment is an adjustment that does not result in an imputed underpayment and is taken into account in accordance with this section. On March 1, 2021, the IRS mails a notice of final partnership adjustment (FPA), and because Partnership does not file a petition for readjustment with respect to the FPA, the adjustments are finally determined in 2021, and the adjustment year is determined to be 2021 pursuant to § 301.6241-1(a)(1). Pursuant to paragraph (a) of this section, Partnership takes into account the -\$100 adjustment that does not result in an imputed underpayment on its 2021 partnership return. In addition to the -\$100 adjustment to partnership's 2019 taxable year taken into account under this section, Partnership has an additional \$300 in long term capital gain reportable in its 2021 taxable year. The -\$100 negative adjustment and the \$300 long term capital gain are Partnership's only long term capital gains and losses for its 2021 taxable year. Because the -\$100 net negative adjustment is an adjustment to long term capital gain, which is a separately stated item under section 702(a)(2), the -\$100 negative adjustment must be taken into account in accordance with paragraph (b)(2)

of this section. Partnership includes both the -\$100 negative adjustment and the \$300 in long term capital gain as separately stated items on its 2021 tax return.

(2) Example 2. The facts are the same as in Example 1 in paragraph (d)(1) of this section, except that the IRS proposes a reallocation adjustment instead of a recharacterization adjustment. The IRS determines that the -\$100 ordinary loss that the Partnership allocated equally to A and B should instead all be allocated all to A. The IRS mails a NOPPA for the 2019 partnership taxable year proposing a reallocation adjustment resulting in a \$50 increase in ordinary loss allocated to A (negative adjustment) and a \$50 decrease in ordinary loss allocated to B (positive adjustment). Because the adjustments are the result of a reallocation, they are placed in separate subgroupings pursuant to § 301.6225-1(d). Because the adjustments are in different subgroupings, the adjustments are not netted under § 301.6225-1(e), resulting in a net negative adjustment of -\$50 allocated to A and a net positive adjustment of \$50 to B. Pursuant to § 301.6225-1(b), the total netted partnership adjustment includes the \$50 net positive adjustment, and the imputed underpayment is \$20 (\$50 total netted partnership adjustment × 40 percent). Pursuant to § 301.6225-1(f), the -\$50 net negative adjustment is an adjustment that does not result in an imputed underpayment and is taken into account in accordance with this section. On March 1, 2021, the IRS mails an FPA, and because Partnership does not file a petition for readjustment with respect to the FPA, the adjustments are finally determined in 2021, and the adjustment year is determined to be 2021 pursuant to § 301.6241-1(a)(1). Pursuant to paragraph (a) of this section, Partnership takes into account the -\$50 adjustment that does not result in an imputed underpayment on its 2021 partnership return. In addition to the -\$50 net negative adjustment to partnership's 2019 taxable year taken into account under this section, Partnership also has an additional \$300 in ordinary income reportable in its 2021 taxable year unrelated to the administrative proceeding with respect to Partnership's 2019 partnership taxable year. Because the -\$50 net negative adjustment is due to a reallocation, the adjustment must be taken into account under paragraph (b)(4) of this section. Because the net negative adjustment was determined to have been entirely allocable to A, and because A was a reviewed year partner and is also an adjustment year partner, the net negative adjustment is taken into account by Partnership by allocating the entire adjustment to A on its 2021 tax return. The -\$50 negative adjustment does not reduce the \$300 in ordinary income.

(e) Applicability date -

(1) In general. Except as provided in paragraph (e)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017, and ending after August 12, 2018.

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

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