Class E airspace designations are published in paragraph 6002, and 6005, respectively, of FAA Order 7400.11B, dated August 3, 2017 and effective September 15, 2017, which is incorporated by reference in 14 CFR 71.1. The Class E airspace designation listed in this document will be published subsequently in the Order.

Regulatory Notices and Analyses

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current, is non-controversial and unlikely to result in adverse or negative comments. It, therefore: (1) Is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule, when promulgated, would not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Environmental Review

This proposal will be subject to an environmental analysis in accordance with FAA Order 1050.1F, ''Environmental Impacts: Policies and Procedures'' prior to any FAA final regulatory action.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—DESIGNATION OF CLASS A, B, C, D, AND E AIRSPACE AREAS; AIR TRAFFIC SERVICE ROUTES; AND REPORTING POINTS

■ 1. The authority citation for 14 CFR part 71 continues to read as follows:

Authority: 49 U.S.C. 106(f), 106(g); 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

■ 2. The incorporation by reference in 14 CFR 71.1 of FAA Order 7400.11B, Airspace Designations and Reporting Points, dated August 3, 2017, and effective September 15, 2017, is amended as follows:

Paragraph 5000 Class D Airspace.

* * * * *

AWP CA D Atwater, CA [Amended]

Castle Airport, CA
(Lat. 37°22′50″ N, long. 120°34′06″ W)

That airspace extending upward from the surface up to but not including 2,000 feet MSL within a 4.6-mile radius of Castle Airport beginning at the 297° bearing from the airport clockwise to the 164° bearing, thence to the point of beginning. This Class D airspace area is effective during the specific dates and times established in advance by a Notice to Airmen. The effective date and time will thereafter be continuously published in the Chart Supplement.

Paragraph 6005 Class E Airspace Areas Extending Upward From 700 Feet or More Above the Surface of the Earth

* * * * *

AWP CA E5 Atwater, CA [Amended]

Castle Airport, CA
(Lat. 37°22′50″ N, long. 120°34′06″ W)

That airspace extending upward from 700 feet above the surface within a 7.2-mile radius of Castle Airport.

Issued in Seattle, Washington, on January 11, 2018.

Shawn M. Kozica,

Manager, Operations Support Group, Western Service Center.

[FR Doc. 2018–02012 Filed 2–1–18; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG–118067–17]

RIN 1545–BO00

Centralized Partnership Audit Regime: Adjusting Tax Attributes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations implementing section 1101 of the Bipartisan Budget Act of 2015, which was enacted into law on November 2, 2015. The Bipartisan Budge Act repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, determines, assesses and collects tax at the partnership level. These proposed regulations provide rules addressing how partnerships and their partners adjust tax attributes to take into account partnership adjustments under the centralized partnership audit regime.

DATES: Written or electronic comments and requests for a public hearing must be received by May 3, 2018.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–118067–17), Room 5207, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG–118067–17), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (REG–118067–17).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Allison R. Carmody or Meghan M. Howard of the Office of Associate Chief Counsel (Passthroughs and Special Industries), (202) 317–5279; concerning the submission of comments, Regina L. Johnson, (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations that supplement the regulations proposed in the notice of proposed rulemaking (REG–136118–15) published in the **Federal Register** on June 14, 2017 (82 FR 27334) (the ''June 14 NPRM'') and amend the Income Tax Regulations (26 CFR part 1) under Subpart—Partners and Partnerships and the Procedure and Administration Regulations (26 CFR part 301) under Subpart—Tax Treatment of Partnership Items to implement the centralized partnership audit regime. Furthermore, certain provisions of the June 14 NPRM are being amended.

1. The New Centralized Partnership Audit Regime

For information relating to (1) the new centralized partnership audit regime enacted by the Bipartisan Budget Act (BBA), Public Law 114–74 (129 Stat. 58 (2015)) (as amended by the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114–113 (129 Stat. 2242 (2015))); (2) Notice 2016–23 (2016–13 I.R.B. 490 (March 28, 2016)), which requested comments on the new partnership audit regime enacted by the BBA; and (3) the temporary regulations (TD 9780, 81 FR 51795 (August 5, 2016)) and a notice of proposed rulemaking (REG–105005–16, 81 FR 51835 (August 5, 2016)), which provided the time, form, and manner for

a partnership to make an election into the centralized partnership audit regime for a partnership taxable year beginning before the general effective date of the regime, see the Background section of the June 14 NPRM.

2. Proposed Regulations Implementing the Centralized Partnership Audit Regime

The June 14 NPRM addressed various issues concerning the scope and process of the new centralized partnership audit regime. Unless otherwise noted, all references to proposed regulations in this preamble refer to the regulations proposed by the June 14 NPRM.

Proposed §§ 301.6225–1, 301.6225–2, and 301.6225–3 provide rules relating to partnership adjustments, including the computation of the imputed underpayment, modification of the imputed underpayment, and the treatment of adjustments that do not result in an imputed underpayment.

Proposed § 301.6225–1 sets forth rules for computing the imputed underpayment, and proposed § 301.6225–2 sets forth the rules under which the partnership may request a modification to adjust the imputed underpayment calculated under proposed § 301.6225–1. The modification rules contained in proposed § 301.6225–2 generally allow: (1) Modifications that result in the exclusion of certain adjustments, or portions thereof, from the calculation of the imputed underpayment (such as a modification under proposed § 301.6225–2(d)(2) (amended returns by partners), (d)(3) (tax-exempt partners), (d)(5) (certain passive losses of publicly traded partnerships), (d)(7) (partnerships with partners that are qualified investment entities described in section 860 of the Internal Revenue Code (Code)), (d)(8) (partner closing agreements), and, if applicable, (d)(9) (other modifications)); (2) rate modifications, which affect only the taxable rate applied to the total netted partnership adjustment (described in proposed § 301.6225–2(d)(4)); and (3) modifications to the number and composition of imputed underpayments (described in proposed § 301.6225–2(d)(6)).

Proposed § 301.6225–3 sets forth rules for the treatment of adjustments that do not result in an imputed underpayment. In general, pursuant to proposed § 301.6225–3(b)(1) the partnership takes the adjustment into account in the adjustment year as a reduction in non-separately stated income or as an increase in non-separately stated loss depending on whether the adjustment is to an item of income or loss. Proposed § 301.6225–3(b)(2) provides that if an adjustment is to an item that is required to be separately stated under section 702 of the Internal Revenue Code (Code) the adjustment shall be taken into account by the partnership on its adjustment year return as an adjustment to such separately stated item. Proposed § 301.6225–3(b)(3) provides that an adjustment to a credit is taken into account as a separately stated item.

Proposed §§ 301.6226–1, 301.6226–2, and 301.6226–3 provide rules relating to the election under section 6226 by a partnership to have its reviewed year partners take into account the partnership adjustments in lieu of paying the imputed underpayment determined under section 6225, the statements the partnership must send to its partners, and the rules for how the partners take into account the adjustments, including the computation and payment of the partners' liability. If a partnership makes the election under section 6226 to ''push out'' adjustments to its reviewed year partners, the partnership is not liable for the imputed underpayment. Instead, under proposed § 301.6226–3, reviewed year partners must pay any additional chapter 1 tax that results from taking the adjustments reflected on the statements into account in the reviewed year and from changes to the tax attributes in the intervening years. In addition to being liable for the additional tax, the partner must also calculate and pay any penalties, additions to tax, or additional amounts determined to be applicable during the partnership-level proceeding, and any interest determined in accordance with proposed § 301.6226–3(d).

Finally, proposed § 301.6241–1 provides definitions for purposes of the centralized partnership audit regime.

On December 19, 2017, proposed rules (REG–120232–17 and REG–120233–17) were published in the **Federal Register** (82 FR 60144) that would allow tiered partnerships to push out audit adjustments through to the ultimate taxpayers and provides rules implementing the procedural and administrative aspects of the partnership audit regime. For proposed rules regarding international provisions under the centralized partnership audit regime, see (REG–119337–17) published in the **Federal Register** on November 30, 2017 (82 FR 56765).

Explanation of Provisions

1. In General

These proposed regulations provide rules that were reserved in the June 14 NPRM under proposed §§ 301.6225–4 and 301.6226–4. It also provides related proposed amendments to §§ 1.704–1, 1.705–1, and 1.706–4. Specifically, these rules address how and when partnerships and their partners adjust tax attributes to take into account partnership adjustments under both sections 6225 and 6226. The public provided comments in response to the June 14 NPRM, and some comments discussed issues relevant to the reserved sections under proposed §§ 301.6225–4 and 301.6226–4, which were taken into consideration in drafting these proposed regulations.

Because these regulations are supplementing the regulations published in the June 14 NPRM, the numbering and ordering of some of the provisions do not follow typical conventions. The Department of the Treasury (Treasury Department) and the IRS anticipate that these provisions will be appropriately integrated when both these regulations and the proposed regulations in the June 14 NPRM are finalized.

These proposed rules are consistent with the policy described in ''The General Explanation of Tax Legislation Enacted for 2015'' (Bluebook), which explained that ''[u]nder the centralized partnership audit regime, the flowthrough nature of the partnership under subchapter K of the Code is unchanged, but the partnership is treated as a point of collection of underpayments that would otherwise be the responsibility of partners.'' Joint Comm. on Taxation, JCS–1–16, ''General Explanations of Tax Legislation Enacted in 2015'', 57 (2016).

The preamble to the June 14 NPRM announced that the Treasury Department and the IRS intended to provide additional rules providing for adjustments to the basis of partnership property and book value of any partnership property if the partnership adjustment is a change to an item of gain, loss, amortization or depreciation (*i.e.,* the change is basis derivative). These proposed regulations, when finalized, will provide this guidance.

2. Provisions Relating to Section 6225

A. In General

The June 14 NPRM defines a partnership adjustment as any adjustment to any item of income, gain, loss, deduction, or credit of a partnership (as defined in proposed § 301.6221(a)–1(b)(1)), or any partner's distributive share thereof (as described in proposed § 301.6221(a)–1(b)(2)). See proposed § 301.6241–1(a)(6). Under the rules in proposed § 301.6225–1, each partnership adjustment is either (i) taken into account in the determination

of an imputed underpayment, or (ii) considered a partnership adjustment that does not give rise to an imputed underpayment. For a partnership adjustment that is taken into account in the determination of the imputed underpayment, these proposed regulations provide rules for adjusting partnership asset basis and book value, rules for the creation of notional items, rules for allocating these notional items under section 704(b), successor rules for situations in which reviewed year partners (as defined in proposed § 301.6241–1(a)(9)) are not adjustment year partners (as defined in proposed § 301.6241–1(a)(2)), and rules for determining the impact of notional items on tax attributes in certain situations. See section (2)(B) of this preamble. These regulations also provide rules for the allocation of any partnership expenditure related to the imputed underpayment. See section (2)(B)(vii) of this preamble. Finally, these regulations provide guidance in the case of a partnership adjustment that does not give rise to an imputed underpayment. See section (2)(C) of this preamble.

B. Adjustments in the Case of a Partnership Adjustment That Results in an Imputed Underpayment

i. In General

Prior to the enactment of the centralized partnership audit regime, in the case of an adjustment to an item of income, gain, loss, deduction or credit in the context of an examination by the IRS for or related to a partnership, partnership adjustments were generally taken into account by the partners of the partnership for the year under examination by a new or corrected allocation of the relevant item, and partners took those items into account with respect to the partnership year under examination. In contrast, under the centralized partnership audit regime, for a partnership adjustment that is taken into account in the determination of an imputed underpayment, the partnership adjustment is generally taken into account by the partnership in the year in which the related payment obligation (the imputed underpayment) arises. Further, in light of the fact that these partnership adjustments are with respect to a partnership year that is earlier than the year in which the imputed underpayment arises, the partners of the partnership may have changed in the later year.

Under subchapter K, a partnership generally computes items of income, gain, loss, deduction or credit under section 703, which are then allocated to the partners under section 704. Under section 705, a partner increases its basis in its partnership interest (outside basis) by its distributive share of taxable income of the partnership as determined under section 703(a). However, in the case of a positive partnership adjustment that is taken into account in the determination of an imputed underpayment, section 6225 does not itself provide for an item of taxable income under section 703(a) to be allocated to partners. Instead, calculations are made at the partnership level and the partnership pays the liability in the form of an imputed underpayment. Failure to provide adjustments to outside basis that reflect the partnership adjustments that resulted in the imputed underpayment could lead to a partner being effectively taxed twice on the same item of income, once indirectly on payment of the imputed underpayment and again on a disposition of the partnership interest or on a distribution of cash by the partnership. Taxing the same item of income twice is not consistent with the flowthrough nature of partnerships under subchapter K. Thus, these proposed regulations provide for adjustment to a partner's basis in its interest—and certain other tax attributes that are interdependent with basis under subchapter K—in order to prevent effective double taxation or other distortions.

Specifically, under proposed § 301.6225–4(a)(1), when there is a partnership adjustment (as defined in proposed § 301.6241–1(a)(6)), the partnership and its adjustment year partners (as defined in proposed § 301.6241–1(a)(2)) generally must adjust their specified tax attributes (as defined in proposed § 301.6225–4(a)(2)). Specified tax attributes are the tax basis and book value of a partnership's property, amounts determined under section 704(c), adjustment year partners' bases in their partnership interests, and adjustment year partners' capital accounts determined and maintained in accordance with § 1.704–1(b)(2). See proposed § 301.6225–4(a)(2).

In the case of a partnership adjustment that results in an imputed underpayment, the adjustments to specified tax attributes must be made on a partnership-adjustment-by-partnership-adjustment basis, and thus are created separately for each partnership adjustment (whether a negative adjustment or a positive adjustment) without regard to their summation as part of the determination of the total netted partnership adjustment in proposed § 301.6225–1(c)(3). See proposed § 301.6225–4(b)(1).

ii. Manner of Adjusting Specified Tax Attributes

The partnership must first make appropriate adjustments to the book value and basis of property to take into account any partnership adjustment. See proposed § 301.6225–4(b)(2). This rule also requires amounts determined under section 704(c) to be adjusted to take into account the partnership adjustment. The partnership does not make any adjustments to the book value or basis of partnership property with respect to property that was held by the partnership in the reviewed year but is no longer held by the partnership in the adjustment year. Comments are requested as to whether, in these situations, a partnership should be allowed to adjust the basis (or book value) of other partnership property (such as in a manner similar to the rules that apply in allocating section 734(b) adjustments under section 755 (*i.e.,* § 1.755–1(c))).

Proposed § 301.6225–4(b)(3) provides that notional items are then created with respect to the partnership adjustment, and these notional items are then allocated according to the rules described in section (2)(B)(iii) of this preamble. The items are considered notional items because their sole purpose is to affect partner-level specified tax attributes, and thus they are not considered to be items for purposes of adjusting other tax attributes.

In the case of a partnership adjustment that is an increase to income or gain, a notional item of income or gain is created in an amount equal to the partnership adjustment. Similarly, in the case of a partnership adjustment that is an increase to an expense or a loss, a notional item of expense or loss is created in an amount equal to the partnership adjustment. See proposed § 301.6225–4(b)(3)(ii) and (iii).

However, in the case of a partnership adjustment that is a decrease to income or gain, a notional item of expense or loss is created in an amount equal to the partnership adjustment. Similarly, in the case of a partnership adjustment that is a decrease to an expense or a loss, a notional item of income or gain is created in an amount equal to the partnership adjustment. See proposed § 301.6225–4(b)(3)(iv) and (v). These rules have the effect of reversing out the reviewed year allocation to the extent necessary to reflect the partnership adjustment.

Thus, under these proposed regulations, an adjustment year partner

increases its outside basis for notional income that is allocated to it. Similarly, a partnership that determines and maintains capital accounts in accordance with § 1.704–1(b)(2)(iv) also adjusts capital accounts for notional items. See proposed § 301.6225–4(e), *Example 1.* In the case of a partnership adjustment that reflects a net increase or net decrease in credits as determined under proposed § 301.6225–1(d), the partnership creates one or more notional items of income, gain, loss, or deduction that reflects the change in the item giving rise to the credit. See proposed § 301.6225–4(b)(3)(vi).

Under these proposed regulations, only specified tax attributes are adjusted. Treasury Department and the IRS considered proposing broader rules for adjusting other tax attributes than those included in these proposed regulations. Tax attributes are defined in the June 14 NPRM as anything that can affect, with respect to a partnership or a partner, the amount or timing of an item of income, gain, loss, deduction, or credit (as defined in proposed § 301.6221(a)–1(b)(1)) or that can affect the amount of tax due in any taxable year. Examples of tax attributes include, but are not limited to, basis and holding period, as well as the character of items of income, gain, loss, deduction, or credit and carryovers and carrybacks of such items. See proposed § 301.6241–1(a)(10).

Comments are requested as to whether tax attributes other than specified tax attributes should be adjusted, at either the partner or the partnership level, when the partnership pays an imputed underpayment. Specifically, commenters are requested to address whether guidance should provide a general rule that partnership adjustments and notional items are taken into account as items for all purposes of Subtitle A, except to the extent of the partner's actual tax due. For example, guidance could provide that the partner level tax calculation includes notional items for purposes of calculating the tentative tax due, but that for purposes of determining the ultimate tax due, the partner's share of the imputed underpayment would be subtracted. Alternatively, guidance could provide a list of tax attributes that are generally adjusted, and a list of those that are not.

Specific tax attributes for which comments are requested include gross income rules for publicly traded partnerships under section 7704(b) and qualified investment entities described in section 860. Other tax attributes for which comments are requested include net operating loss carryforwards, other tax accounting under subchapter K, and those that contain limitations based on adjusted gross income (for example, the earned income credit allowed under section 32, the child tax credit allowed under section 24). Comments are also requested as to whether any special rules should be provided for adjustments to tax attributes in the cross-border context, and how those adjustments should differ, if at all, from adjustments to tax attributes made in the domestic context.

These regulations also contain rules to coordinate the changes to specified tax attributes made under these rules with other rules of the Code, including the rest of the centralized partnership audit regime. See proposed § 301.6225–4(a)(4). To the extent a partner or partnership appropriately adjusted tax attributes prior to a final determination under subchapter C of chapter 63 with respect to a partnership adjustment (for example, in the context of an amended return modification described in proposed § 301.6225–2(d)(2) or a closing agreement described in proposed § 301.6225–2(d)(8)), those tax attributes are not adjusted under this section. For example, when a partnership requests a modification of the imputed underpayment with respect to a partner-specific tax attribute (for example, a net operating loss) by the filing of an amended return by a partner or by entering into a closing agreement, the partner-specific tax attribute must be reduced to the extent it is used to modify the imputed underpayment.

The IRS is considering providing in forms, instructions, or other guidance that partnerships will be required to provide information to their partners about the amount and nature of changes to tax attributes and any other information needed by the partners.

iii. Allocation of Notional Items

Under section 704(b), a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined under the partnership agreement if the allocation under the agreement has substantial economic effect. Section 1.704–1(b)(2)(i) provides that the determination of whether an allocation of income, gain, loss, or deduction (or item thereof) to a partner has substantial economic effect involves a two-part analysis that is made at the end of the partnership year to which the allocation relates. In order for an allocation to have substantial economic effect, the allocation must have both economic effect (within the meaning of § 1.704–1(b)(2)(ii)) and be substantial (within the meaning of § 1.704–1(b)(2)(iii)). If the allocation does not have substantial economic effect, or the partnership agreement does not provide for the allocation, then the allocation must be made in accordance with the partners' interest in the partnership under § 1.704–1(b)(3).

Commenters recommended applying the existing rules in subchapter K, including section 704(b), in the context of section 6225. While the basic principles of section 704(b) remain sound in the context of notional items, the unique nature of partnership adjustments under section 6225 requires the application of these principles to be modified. See proposed § 1.704–1(b)(1)(viii)(*a*). Specifically, the allocation of notional items cannot have substantial economic effect because the allocation relates to two different years—while generally determined with respect to the reviewed year, notional items are taken into account in the adjustment year. Thus, the proposed regulations provide that the allocation of a notional item does not have substantial economic effect, but, to address this issue, further provide that the allocation will be deemed to be in accordance with the partners' interests in the partnership if the allocation of a notional item of income or gain described in proposed § 301.6225–4(b)(3)(ii), or expense or loss described in proposed § 301.6225–4(b)(3)(iii), is made in the manner in which the corresponding actual item would have been allocated in the reviewed year under the section 704 regulations. Additionally, the allocation of a notional item of expense or loss described in proposed § 301.6225–4(b)(3)(iv), or a notional item of income or gain described in proposed § 301.6225–4(b)(3)(v), must be allocated to the reviewed year partners that were originally allocated that excess item in the reviewed year (or their successors). See proposed § 1.704–1(b)(4)(xi). As described in section (2)(B)(iv) of this preamble, however, these rules require treating successors as reviewed year partners.

iv. Successors

While the determination of partnership adjustments under section 6225 is made with respect to reviewed year partners, it is the adjustment year partners that bear the economic burden (or benefit) of a partnership adjustment. As noted in section (2)(B)(i) of this preamble, outside basis adjustments must be made to avoid effectively taxing the same item of income twice. While this concern is clearest when a reviewed year partner remains a partner in the adjustment year, the same concern generally exists when the interest is

transferred as the failure to provide outside basis would result in effectively taxing the same item of income twice, just with respect to two different taxpayers. Thus, these regulations provide successor rules under proposed § 1.704–1(b)(1)(viii)(*b*) for purposes of adjusting specified tax attributes, including outside basis.

A reviewed year partner's successor is generally defined as either a transferee that succeeds to the transferor partner's capital account under proposed § 1.704–1(b)(2)(iv)(*l*), or, in the case of a complete liquidation of a partner's interest, as the remaining partners to the extent their interests increased as a result of the liquidated partner's departure. See proposed §§ 1.704–1(b)(1)(viii)(*b*) and 301.6225–4(e), *Example 3.*

The June 14 NPRM provides that if any reviewed year partner with respect to whom an amount was reallocated is not also an adjustment year partner, the portion of the adjustment that would otherwise be allocated to such reviewed year partner is allocated instead to the adjustment year partner or partners who are the successor or successors to the reviewed year partner. See proposed § 301.6225–3(b)(4). Further, this rule provides that if the partnership cannot identify an adjustment year partner that is a successor to the reviewed year partner described in the previous sentence or if a successor does not exist, the portion of the adjustment that would otherwise be allocated to that reviewed year partner is allocated among the adjustment year partners according to the adjustment year partners' distributive shares.

A commenter stated that this rule in the June 14 NPRM allocating a reallocation adjustment that does not result in an imputed underpayment could result in situations in which partners in a publicly traded partnership described in section 7704(b) own units that are not fungible. In response to this comment and due to administrability concerns, the Treasury Department and the IRS reconsidered this rule and have concluded that it is appropriate to provide rules in these proposed regulations relating to any situation in which a partnership is unable, after exercising reasonable diligence, to determine a successor for a partnership adjustment under section 6225 (not only reallocation adjustments). These rules require that the proposed standard in the June 14 NPRM be replaced with a new proposed regulation. Therefore, these regulations amend proposed § 301.6225–3(b)(4) by removing the final two sentences and provide a rule in proposed § 1.704–1(b)(1)(viii)(*b*)(*3*) that if a partnership cannot determine the transferee for a partnership interest under proposed § 1.704–1(b)(1)(viii)(*b*)(*2*), the successor is deemed to be those partners in the adjustment year who were not also partners in the reviewed year or otherwise identifiable as successors to reviewed year partners, in proportion to their respective interests in the partnership.

Comments are requested as to whether these new proposed rules would similarly result in issues with respect to the fungibility of these partnership interests and, if so, specific recommendations for the final regulations to address fungibility concerns consistent with the centralized partnership audit regime, the rules of subchapter K, and the general framework of these proposed regulations. Specifically, commenters are requested to consider how the successor rules should operate when, due to the redemption of all reviewed year partners, there are no identifiable successors to reviewed year partners in the adjustment year.

Treasury and the IRS considered other alternatives to the successor rules in these proposed regulations, including allocating notional items only to adjustment year partners that were reviewed year partners, either solely in the amount for which they would have been allocated the notional item, or allocating to them (and no other partners) the full amount of the notional items. These proposed rules contain successor rules because that approach preserves the economics of the partners that were partners in both the reviewed and the adjustment year, and also facilitates any necessary private contracts between buyers and sellers of partnership interests. Comments are requested as to whether an approach other than successor rules are better suited to preserving the single-layer of tax in subchapter K while avoiding potential for abuse or other inappropriate tax results.

Comments are also requested as to how these successor rules should apply in the case of partnership mergers and divisions.

Finally, comments are requested on issues similar to those noted in the June 14 NPRM in section (5)(D)(ii) of the preamble, namely whether the allocation of adjustments to a successor of a reviewed year partner that was a tax-exempt partner may raise issues concerning private benefit to a person other than a tax-exempt partner, including issues that might affect the tax-exempt partner's status under section 501(c); excise taxes under chapter 42 of subtitle D of the Code or under sections 4975, 4976, or 4980; or requirements under title I of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)) as amended (ERISA), such as the fiduciary responsibility rules under part 4 thereof. The Treasury Department and the IRS request comments from the public on whether these potential issues may be adequately addressed in partnership agreements or whether guidance is needed to address these potential issues. Any comments related to title I of ERISA will be shared with the Department of Labor.

v. Adjusting Specified Tax Attributes in Certain Circumstances

For certain types of partnership adjustments, notional items are not created. Specifically, notional items are not created for a partnership adjustment that does not derive from items that would have been allocated in the reviewed year under section 704(b), such as a partnership adjustment based upon a partner's failure to report gain under section 731, a partnership adjustment that is a change of an item of deduction to a section 705(a)(2)(B) expenditure, or a partnership adjustment to an item of tax-exempt income. See proposed § 301.6225–4(b)(4). Nevertheless, in these situations specified tax attributes are adjusted for the partnership and its reviewed year partners (or their successors) in a manner that is consistent with how the partnership adjustment would have been taken into account under the partnership agreement in effect for the reviewed year taking into account all facts and circumstances. See proposed § 301.6225–4(e), *Example 5.*

vi. Special Rules for Outside Basis in Certain Cases

As noted in section (2)(B)(i) of this preamble, partners normally adjust their outside bases for notional items that are allocated to them. However, in certain cases, the proposed rules do not provide for adjustments to outside basis. Specifically, when a tax-exempt partner transfers its interest to a partner that is not tax-exempt (taxable partner) between the reviewed year and the adjustment year and the partnership requests a modification because of the reviewed year partner's status as a tax-exempt entity, the successor taxable partner is disallowed a basis adjustment. See proposed § 301.6225–4(b)(6)(iii)(B). Without this rule, a taxable successor partner would have a basis increase when no imputed underpayment was paid with respect to the partner's share of the partnership

adjustment. Comments are requested as to whether this rule should be extended to rate modifications described in proposed § 301.6225–2(d)(4) as well. A basis adjustment is also disallowed when a reviewed year partner transfers its interest to a related party in a transaction in which not all gain or loss is recognized during an administrative proceeding under subchapter C of chapter 63 of the Code (subchapter C of chapter 63) and a principal purpose of the transfer was to shift the economic burden of the imputed underpayment among related parties. Comments are requested regarding whether basis adjustments should be disallowed in any other circumstances.

vii. Accounting and Allocation of Partnership Section 705(a)(2)(B) Expenditures

Proposed § 301.6225–4(c) describes how the partnership's expenditure arising from an imputed underpayment and any other amount under subchapter C of chapter 63 is taken into account by the partnership and its partners. No deduction is allowed under subtitle A of the Code for any payment required to be made by a partnership under subchapter C of chapter 63 and the amount is treated as an expenditure described in section 705(a)(2)(B). See proposed § 301.6241–4(a).

For an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners. This means that, in the event that there is an economic benefit or burden that corresponds to the allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden. See § 1.704–1(b)(2)(ii). Generally, an allocation of income, gain, loss, or deduction (or item thereof) to a partner will have economic effect if, and only if, throughout the full term of the partnership, the partnership agreement provides: (1) For the determination and maintenance of the partners' capital accounts in accordance with § 1.704–1(b)(2)(iv); (2) for liquidating distributions to the partners to be made in accordance with the positive capital account balances of the partners; and (3) for each partner to be unconditionally obligated to restore the deficit balance in the partner's capital account following the liquidation of the partner's partnership interest. In lieu of satisfying the third criterion, the partnership may satisfy the qualified income offset rules set forth in § 1.704–1(b)(2)(ii)(*d*).

Section 1.704–1(b)(2)(iv)(*i*) provides specific rules for determining whether an allocation of a section 705(a)(2)(B) expenditure has substantial economic effect. Specifically, it requires that a partner's capital account be decreased by allocations made to such partner of expenditures described in section 705(a)(2)(B). See also § 1.704–1(b)(2)(iv)(*b*). Further, under section 705(a)(2)(B), the adjusted basis of a partner's interest in a partnership is decreased (but not below zero) by expenditures of the partnership that are not deductible in computing its taxable income and not properly chargeable to capital account.

Several commenters addressed how the partnership's payment of an imputed underpayment should be allocated among its partners and how the payment should be given effect. With respect to the payment's allocation, commenters recommended that the expenditure be allocated among the partners in accordance with their partnership agreement, subject to the rules of section 704(b) (including the regulatory requirements for substantial economic effect). The Treasury Department and the IRS agree with the commenters that the expenditure should be allocated under section 704. These proposed regulations contain special rules for allocating the expenditure under section 704(b).

With respect to book capital account adjustments for the imputed underpayment, commenters recommended that partners' capital accounts be adjusted to reflect the partnership's payment of the imputed underpayment. The Treasury Department and the IRS agree with this comment but conclude that because the expenditure is treated as an expenditure under section 705(a)(2)(B) pursuant to the June 14 NPRM (proposed § 301.6241–4(a)), existing rules provide this result.

The Treasury Department and the IRS have concluded, however, that the existing rules that determine whether the economic effect of an allocation is substantial should be modified to take into account the unique nature of these expenditures. When a partnership pays an imputed underpayment under section 6225, it has the effect of converting what would have been a non-deductible partner-level expenditure into a non-deductible partnership-level expenditure. The proposed regulations provide that an allocation of the nondeductible expenditure will be considered to be substantial only if the partnership allocates the expenditure in proportion to the notional item to which it relates, taking into account appropriate modifications. See proposed §§ 1.704–1(b)(2)(iii)(*a*) and (*f*), 301.6225–4(c) and 301.6225–4(e), *Example 4.* This rule aligns the economics of the income allocation (in this case, the notional income allocation) with the directly associated imputed underpayment expense in a manner consistent with the flowthrough nature of partnerships under subchapter K. Absent this substantiality rule in the regulations, partnerships could inappropriately allocate expenses to partners in the adjustment year in a manner inconsistent with the underlying economic arrangement of the partners. These new substantiality rules also apply to a payment made by a pass-through partner under proposed § 301.6226–3(e)(4).

Similarly, for partnerships that do not maintain capital accounts, the allocation of the expenditure cannot be in accordance with the partners' interests in the partnership to the extent it shifts the economic burden of the payment of the imputed underpayment away from a partner (or its successor) that would have been allocated the corresponding notional income item. However, the regulations provide that an allocation of an expense that satisfies the new substantiality rule and in which the partner's distribution rights are reduced by the partner's share of the imputed underpayment is deemed to be in accordance with the partners' interests in the partnership. See proposed § 1.704–1(b)(4)(xii). These proposed regulations do not address the extent to which the partnership may later reverse this allocation with a special chargeback or similar provision. Comments are requested on this issue.

One commenter recommended rules specifying that a partner's contribution of funds to the partnership for payment of an imputed underpayment will result in an increase in that partner's capital account. This comment is not adopted because the existing rules in subchapter K provide sufficient guidance for this circumstance. A commenter also recommended rules addressing the availability of a corporation's deduction under temporary § 1.163–9T(b)(2) for a payment of interest in respect of an underpayment of tax. This comment is not adopted because it is beyond the scope of these proposed regulations.

The proposed regulations also provide that in order for an allocation of an expenditure for interest, penalties, additions to tax, or additional amounts as determined under section 6233 to be substantial, it must be allocated to the reviewed year partner in proportion to the allocation of the related imputed underpayment, the related payment made by a pass-through partner under proposed § 301.6226–3(e)(4), or the

related notional item to which it relates (whichever is appropriate), taking into account modifications under proposed § 301.6225–2 attributable to that partner. See proposed § 1.704–1(b)(2)(iii)(*f*)(*3*). This rule has a similar purpose as the rule in proposed § 1.704–1(b)(2)(iii)(*f*)(*2*) in that it aligns the economics of these expenses with the partnership items to which they relate. Under this rule, an expense for interest imposed under the Code will generally be allocated in proportion to the imputed underpayment from which it derives. Also, an expense arising from a substantial understatement of tax under section 6662(d) for an imputed underpayment will generally be allocated in proportion to the notional income item to which it relates.

In situations in which the reviewed year partner is not an adjustment year partner, the successor rules in proposed § 1.704–1(b)(1)(viii)(*b*) apply to the allocation of these expenditures. Under those rules, a partner admitted after the reviewed year will not ordinarily be allocated any section 705(a)(2)(B) expenditure in the adjustment year.

C. Partnership Adjustments That Do Not Result in an Imputed Underpayment

The June 14 NPRM provides that the rules under subchapter K apply in the case of a partnership adjustment that does not result in an imputed underpayment. See proposed § 301.6225–3(c). Further, proposed § 1.704–1(b)(4)(xiii) of these regulations provides that an allocation of an item arising from a partnership adjustment that does not result in an imputed underpayment (as defined in proposed § 301.6225–1(c)(2)) does not have substantial economic effect but will be deemed to be in accordance with the partners' interests in the partnership if it is allocated in the manner in which the item would have been allocated in the reviewed year under the regulations under section 704, taking into account the successor rules described in section (2)(B)(iv) of this preamble.

3. Provisions Relating to Section 6226

A. In General

Section 6226(b) describes how partnership adjustments are taken into account by the reviewed year partners if a partnership makes an election under section 6226(a). Under section 6226(b)(1), each partner's tax imposed by chapter 1 of subtitle A of the Code (chapter 1 tax) is increased by the aggregate of the adjustment amounts as determined under section 6226(b)(2). This increase in chapter 1 tax is reported on the return for the partner's taxable year that includes the date the statement described under section 6226(a) is furnished to the partner by the partnership (reporting year). The aggregate of the adjustment amounts is the aggregate of the correction amounts. See proposed § 301.6226–3(b).

The adjustment amounts determined under section 6226(b)(2) fall into two categories. Under section 6226(b)(2)(A), in the case of the taxable year of the partner that includes the end of the partnership's reviewed year (first affected year), the adjustment amount is the amount by which the partner's chapter 1 tax would increase for the partner's first affected year if the partner's share of the adjustments were taken into account in that year. Under section 6226(b)(2)(B), in the case of any taxable year after the first affected year, and before the reporting year (that is, the intervening years), the adjustment amount is the amount by which the partner's chapter 1 tax would increase by reason of the adjustment to tax attributes determined under section 6226(b)(3) in each of the intervening years. The adjustment amounts determined under section 6226(b)(2)(A) and (B) are added together to determine the aggregate of the adjustment amounts for purposes of determining additional reporting year tax, which is the increase to the partner's chapter 1 tax in accordance with section 6226(b)(1).

Section 6226(b)(3) provides two rules regarding adjustments to tax attributes that would have been affected if the partner's share of adjustments were taken into account in the first affected year. First, under section 6226(b)(3)(A), in the case of an intervening year, any tax attribute must be appropriately adjusted for purposes of determining the adjustment amount for that intervening year in accordance with section 6226(b)(2)(B). Second, under section 6226(b)(3)(B), in the case of any subsequent taxable year (that is, a year, including the reporting year, that is subsequent to the intervening years referenced in 6226(b)(3)(A)), any tax attribute must be appropriately adjusted.

Under the June 14 NPRM, a reviewed year partner's share of the adjustments that must be taken into account by the reviewed year partner must be reported to the reviewed year partner in the same manner as originally reported on the return filed by the partnership for the reviewed year. See proposed § 301.6226–2(f). If the adjusted item was not reflected in the partnership's reviewed year return, the adjustment must be reported in accordance with the rules that apply with respect to partnership allocations, including under the partnership agreement. However, under proposed § 301.6226–2(f)(1), if the adjustments, as finally determined, are allocated to a specific partner or in a specific manner, the partner's share of the adjustment must follow how the adjustment is allocated in that final determination.

Section 301.6226–4(b) of these proposed regulations provides that the reviewed year partners or affected partners (as described in § 301.6226–3(e)(3)(i)) must take into account items of income, gain, loss, deduction or credit with respect to their share of the partnership adjustments as contained on the statements described in proposed § 301.6226–2 (pushed-out items) in the reporting year (as defined in proposed § 301.6226–3(a)). Similarly, partnerships adjust tax attributes affected by reason of a pushed-out item in the reviewed year. In the case of a reviewed year partner that disposed of its partnership interest prior to the reporting year, that partner may take into account any outside basis adjustment under these rules in an amended return to the extent otherwise allowable under the Code.

Unlike the proposed rules under section 6225 and subchapter K described in section 2 of this preamble, under section 6226, all tax attributes (as defined in proposed § 301.6241–1(a)(10)) are adjusted for pushed out items of income, gain, deduction, loss or credit.

B. Section 704(b)

Section (2)(B)(iii) of this preamble discusses the general mechanics of section 704(b). In accordance with the principles set forth in section 704(b), an allocation of a pushed-out item does not have substantial economic effect within the meaning of section 704(b)(2). However, the allocation of such an item will be deemed to be in accordance with the partners' interests in the partnership if it is allocated in the adjustment year in the manner in which the item would have been allocated under the rules of section 704(b), including § 1.704–1(b)(1)(i) (or otherwise taken into account under subtitle A) in the reviewed year (as defined in proposed § 301.6241–1(a)(8)), followed by any subsequent taxable years, concluding with the adjustment year (as defined in proposed § 301.6241–1(a)(1)). See proposed § 1.704–1(b)(4)(xiv).

C. Timing

Under the June 14 NPRM, a reviewed year partner that is furnished a statement under proposed § 301.6226–2 is required to pay any additional chapter 1 tax (additional reporting year tax) for the partner's taxable year which

includes the date the statement was furnished to the partner in accordance with proposed § 301.6226–2 (the reporting year) that results from taking into account the adjustments reflected in the statement. See proposed § 301.6226–3. The additional reporting year tax is the aggregate of the adjustment amounts, as determined in proposed § 301.6226–3(b) and described in (3)(A) of this preamble.

A commenter recommended that adjustments to capital accounts and basis should be made to the reviewed year partners in the reviewed year to prevent distortions. This comment is not adopted because, in this context, section 6226 clearly applies to the adjustment year. These proposed regulations provide that adjustments to partnership-level tax attributes are calculated with respect to each year beginning with the reviewed year, followed by subsequent taxable years, concluding with the adjustment year. See proposed § 301.6226–4(b).

D. Effect of a Payment by Pass-Through Partner

These proposed regulations provide that to the extent a pass-through partner (as defined in proposed § 301.6241–1(a)(5)) makes a payment in lieu of issuing statements to its owners described in proposed § 301.6226–3(e)(4), that payment will be treated similarly to the payment of an amount under subchapter C of chapter 63 for purposes of any adjustments to bases and capital accounts, and accordingly, the rules contained in proposed § 301.6225–4 will apply to determine any appropriate adjustments to bases and capital accounts. See proposed § 301.6226–3(e). To the extent that the pass-through partner continues to push out the partnership adjustments to its partners in accordance with proposed § 301.6226–3(e)(3), the partners receiving those adjustments will adjust their bases and capital accounts in accordance with the guidance provided in proposed § 301.6226–4.

Comments are requested as to how S corporations, trusts, and estates that are pass-through partners that pay an amount under proposed § 301.6226–3(e), and their shareholders and beneficiaries, respectively, should take these payments into account and adjust tax attributes.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. Because the proposed regulations would not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for 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 *http://www.irs.gov.*

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at *http://www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, then notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAX

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.704–1 is amended by:

■ 1. Adding paragraph (b)(1)(viii).

■ 2. Adding a sentence to the end of paragraph (b)(2)(iii)(*a*).

■ 3. Adding paragraphs (b)(2)(iii)(*f*), (b)(2)(iv)(*i*)(*4*), and (b)(4)(xi), (xii), (xiii), (xiv), and (xv).

The additions read as follows:

§ 1.704–1 Partner's distributive share.

* * * * *

(b) * * *

(1) * * *

(viii) *Items relating to a final determination under the centralized partnership audit regime*—(*a*) *In general.* Certain items of income, gain, loss, deduction or credit may result from a final determination under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) (relating to the centralized partnership audit regime). Special rules under section 704(b) and § 1.704–1(b) apply to these items that take into account that the item relates to the reviewed year (as defined in § 301.6241–1(a)(8) of this chapter) but occurs in the adjustment year (as defined in § 301.6241–1(a)(1) of this chapter). See paragraphs (b)(2)(iii)(*a*) and (*f*), (b)(2)(iv)(*i*)(*4*), and (b)(4)(xi), (xii), (xiii), (xiv), and (xv) of this section.

(*b*) *Successors*—(*1*) *In general.* In the case of a transfer or liquidation of a partnership interest subsequent to a reviewed year, a successor has the meaning provided in paragraph (b)(1)(viii)(*b*) of this section. In the case of a subsequent transfer by a successor of a partnership interest, the principles of paragraph (b)(1)(viii)(*b*) of this section will also apply to the new successor.

(*2*) *Identifiable transferee partner.* Except as otherwise provided in paragraph (b)(1)(viii)(*b*)(*3*) of this section, in the case of a transfer of all or part of a partnership interest during or subsequent to the reviewed year, a successor is the partner to which the reviewed year transferor partner's capital account carried over (or would carry over if the partnership maintained capital accounts) under paragraph (b)(2)(iv)(*l*) of this section (an *identifiable transferee partner*).

(*3*) *Unidentifiable transferee partner.* If, after exercising reasonable diligence, the partnership cannot determine an identifiable transferee partner under paragraph (b)(1)(viii)(*b*)(*2*) of this section, each partner in the adjustment year that is not an identifiable transferee partner and was not a partner in the reviewed year, (an *unidentifiable transferee partner*) is a successor to the extent of the proportion of its interest in the partnership to the total interests of unidentifiable transferee partners in the

partnership (considering all facts and circumstances).

(*4*) *Liquidation of partnership interest.* In the case of a liquidation of a partner's entire interest in the partnership during or subsequent to the reviewed year, the successors to the liquidated partner are certain adjustment year partners (as defined in § 301.6241–1(a)(2) of this chapter) as provided in this paragraph (b)(1)(viii)(*b*)(*4*). The determination of the extent to which the adjustment year partners are treated as successors under this section must be made in a manner that reflects the extent to which the adjustment year partners' interests in the partnership increased as a result of the liquidating distribution (considering all facts and circumstances).

(2) * * *

(iii) * * *

(*a*) * * * Notwithstanding any other sentence of this paragraph (b)(2)(iii)(*a*), an allocation of any of the following will be substantial only if the allocation is described in paragraph (b)(2)(iii)(*f*) of this section: An expenditure for any payment required to be made by a partnership under subchapter C of chapter 63 (relating to the centralized partnership audit regime), adjustments reflected on a statement furnished to a pass-through partner (as defined in § 301.6241–1(a)(5) of this chapter) under § 301.6226–3(e)(4) of this chapter, or interest, penalties, additions to tax, or additional amounts described in section 6233.

* * * * *

(*f*) *Certain expenditures under the centralized partnership audit regime*—(*1*) *In general.* The economic effect of an allocation of an expenditure for any payment required to be made by a partnership under subchapter C of chapter 63 (as described in § 301.6241–4(a) of this chapter) is substantial only if the expenditure is allocated in the manner described in this paragraph (b)(2)(iii)(*f*). For partnerships with allocations that do not satisfy paragraph (b)(2)(ii) of this section, see paragraph (b)(4)(xi) of this section.

(*2*) *Expenditures for imputed underpayments or similar amounts.* Except as otherwise provided, an expenditure for an imputed underpayment under § 301.6225–1 of this chapter (or for an amount computed in the same manner as an imputed underpayment under § 301.6226–3(e)(4)(iii) of this chapter) is allocated to the reviewed year partner (or its successor, as defined in paragraph (b)(1)(viii)(*b*) of this section) in proportion to the allocation of the notional item (as described in § 301.6225–4(b) of this chapter) to which the expenditure relates, taking into account modifications under § 301.6225–2 of this chapter attributable to that partner.

(*3*) *Interest, penalties, additions to tax, or additional amounts described in section 6233.* An expenditure for interest, penalties, additions to tax, or additional amounts as determined under section 6233 (or penalties and interest described in § 301.6226–3(e)(4)(iv) of this chapter) is allocated to the reviewed year partner (or its successor, as defined in paragraph (b)(1)(viii)(*b*) of this section) in proportion to the allocation of the portion of the imputed underpayment with respect to which the penalty applies (or amount computed in the same manner as an imputed underpayment under § 301.6226–3(e)(4) of this chapter) or related notional item to which it relates (whichever is appropriate), taking into account modifications under § 301.6225–2 of this chapter attributable to that partner.

(*4*) *Imputed underpayments unrelated to notional items.* In the case of an imputed underpayment that results from a partnership adjustment for which no notional items are created under § 301.6225–4(b)(2) of this chapter, the expenditure must be allocated to the reviewed year partner (or its successor, as defined in paragraph (b)(1)(viii)(*b*) of this section) that would have borne the economic benefit or burden of the partnership adjustment if the partnership and its partners had originally reported in a manner consistent with the partnership adjustment that resulted in the imputed underpayment with respect to the reviewed year.

(iv) * * *

(*i*) * * *

(*4*) *Certain expenditures under the centralized partnership audit regime.* Notwithstanding paragraph (b)(2)(iv)(*i*)(*1*) of this section, the economic effect of an allocation of an expenditure for any payment required to be made by a partnership under subchapter C of chapter 63 (as described in § 301.6241–4(a) of this chapter) is substantial only if the expenditure is allocated in the manner described in paragraph (b)(2)(iii)(*f*) of this section. For partnerships with allocations that do not satisfy paragraph (b)(2)(ii) of this section, see paragraph (b)(4)(xii) of this section.

* * * * *

(4) * * *

(xi) *Notional items under the centralized partnership audit regime.* An allocation of a notional item (as described in § 301.6225–4(b) of this chapter) does not have substantial economic effect within the meaning of paragraph (b)(2) of this section. However, the allocation of a notional item of income or gain described in § 301.6225–4(b)(1)(ii) of this chapter, or expense or loss described in § 301.6225–4(b)(1)(iii) of this chapter, will be deemed to be in accordance with the partners' interests in the partnership if the notional item is allocated in the manner in which the corresponding actual item would have been allocated in the reviewed year under the rules of this section, treating successors (as defined in paragraph (b)(1)(viii)(*b*) of this section) as reviewed year partners. Additionally, the allocation of a notional item of expense or loss described in § 301.6225–4(b)(3)(iv) of this chapter, or a notional item of income or gain described in § 301.6225–4(b)(3)(v) of this chapter, will be deemed to be in accordance with the partners' interests in the partnership if the notional item is allocated to the reviewed year partners (or their successors as defined in paragraph (b)(1)(viii)(*b*) of this section) in the manner in which the excess item was allocated in the reviewed year.

(xii) *Certain section 705(a)(2)(B) expenditures under the centralized partnership audit regime.* An allocation of an expenditure for any payment required to be made by a partnership under subchapter C of chapter 63 (relating to the centralized partnership audit regime and as described in § 301.6241–4(a) of this chapter) will be deemed to be in accordance with the partners' interests in the partnership, as provided in paragraph (b)(3) of this section, only if the expenditure is allocated in the manner described in paragraph (b)(2)(iii)(*f*) of this section and if the partners' distribution rights are reduced by the partners' shares of the imputed underpayment.

(xiii) *Partnership adjustments that do not result in an imputed underpayment under the centralized partnership audit regime.* An allocation of an item arising from a partnership adjustment that does not result in an imputed underpayment (as defined in § 301.6225–1(c)(2) of this chapter) does not have substantial economic effect within the meaning of paragraph (b)(2) of this section. However, the allocation of such an item will be deemed to be in accordance with the partners' interests in the partnership if allocated in the manner in which the item would have been allocated in the reviewed year under the rules of this section, treating successors as defined in paragraph (b)(1)(viii)(*b*) of this section as reviewed year partners.

(xiv) *Partnership adjustments subject to an election under section 6226.* An allocation of an item arising from a partnership adjustment that results in an imputed underpayment for which an election is made under § 301.6226–1 of this chapter does not have substantial economic effect within the meaning of paragraph (b)(2) of this section. However, the allocation of such an item will be deemed to be in accordance with the partners' interests in the partnership if allocated in the adjustment year (as defined in § 301.6241–1(a)(1) of this chapter) in the manner in which the item would have been allocated under the rules of this section (or otherwise taken into account under subtitle A of the Code) in the reviewed year (as defined in § 301.6241–1(a)(8) of this chapter), followed by any subsequent taxable years, concluding with the adjustment year (as defined in § 301.6241–1(a)(1) of this chapter).

(xv) *Substantial economic effect under sections 168(h) and 514(c)(9)(E)(i)(ll).* An allocation described in paragraphs (b)(4)(xi) through (xiv) of this section will be deemed to have substantial economic effect for purposes of sections 168(h) and 514(c)(9)(E)(i)(ll) if the allocation is deemed to be in accordance with the partners' interests in the partnership under the applicable rules set forth in paragraphs (b)(4)(xi) through (xiv) of this section.

* * * * *

■ **Par. 3.** Section 1.705–1 is amended by adding paragraph (a)(10) to read as follows:

§ 1.705–1 Determination of basis of partner's interest.

(a) * * *

(10) For rules relating to determining the adjusted basis of a partner's interest in a partnership following a final determination under subchapter C of chapter 63 of the Internal Revenue Code (relating to the centralized partnership audit regime), see §§ 301.6225–4 and 301.6226–4 of this chapter.

* * * * *

■ **Par. 4.** Section 1.706–4 is amended by redesignating paragraphs (e)(2)(viii) through (xi) as paragraphs (e)(2)(ix) through (xii), respectively, and adding a new paragraph (e)(2)(viii) to read as follows:

§ 1.706–4 Determination of distributive share when a partner's interest varies.

* * * * *

(e) * * *

(2) * * *

(viii) Any item arising from a final determination under subchapter C of chapter 63 of the Internal Revenue Code (relating to the centralized partnership audit regime) with respect to a partnership adjustment resulting in an imputed underpayment for which no election is made under § 301.6226–1 of this chapter.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

■ **Par. 5.** The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par 6.** Section 301.6225–3 as proposed to be amended at 82 FR 27334 (June 14, 2017) is further amended by revising paragraph (b)(4) to read as follows:

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

* * * * *

(b) * * *

(4) *Reallocation adjustments.* A partnership adjustment that does not result in an imputed underpayment pursuant to § 301.6225–1(c)(2)(i) 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. 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.

* * * * *

Par. 7. Section 301.6225–4 is added to read as follows:

§ 301.6225–4 Effect of a partnership adjustment on specified tax attributes of partnerships and their partners.

(a) *Adjustments to specified tax attributes*—(1) *In general.* When there is a partnership adjustment (as defined in § 301.6241–1(a)(6)), the partnership and its adjustment year partners (as defined in § 301.6241–1(a)(2)) generally must adjust their specified tax attributes (as defined in paragraph (a)(2) of this section) in accordance with the rules in this section. For a partnership adjustment that results in an imputed underpayment (as defined in § 301.6241–1(a)(3)), specified tax attributes are generally adjusted by making appropriate adjustments to the book value and basis of partnership property under paragraph (b)(2) of this section, creating notional items based on the partnership adjustment under paragraph (b)(3) of this section, allocating those notional items as described in paragraph (b)(5) of this section, and determining the effect of those notional items for the partnership and its reviewed year partners (as defined in § 301.6241–1(a)(9)) or their successors (as defined in § 1.704–1(b)(1)(viii)(*b*) of this chapter) under paragraph (b)(6) of this section. Paragraph (c) of this section describes how to treat an expenditure for any payment required to be made by a partnership under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) including any imputed underpayment. Paragraph (d) of this section describes adjustments to tax attributes in the case of a partnership adjustment that does not result in an imputed underpayment (as described in § 301.6225–1(c)(2)).

(2) *Specified tax attributes.* Specified tax attributes are the tax basis and book value of a partnership's property, amounts determined under section 704(c), adjustment year partners' bases in their partnership interests, and adjustment year partners' capital accounts determined and maintained in accordance with § 1.704–1(b)(2) of this chapter.

(3) *Timing.* Adjustments to specified tax attributes under this section are made in the adjustment year (as defined in § 301.6241–1(a)(1)). Thus, to the extent that an adjustment to a specified tax attribute under this section is reflected on a federal tax return, the partnership adjustment is generally first reflected on any return filed with respect to the adjustment year.

(4) *Effect of other sections.* The determination of specified tax attributes under this section is not conclusive as to tax attributes determined under other sections of the Internal Revenue Code (Code), including the centralized partnership audit regime. For example, a partnership that files an administrative adjustment request (AAR) under section 6227 adjusts tax attributes as appropriate. Further, to the extent a partner or partnership appropriately adjusted tax attributes prior to a final determination under subchapter C of chapter 63 with respect to a partnership adjustment (for example, in the context of an amended return modification described in § 301.6225–2(d)(2) or a closing agreement described in § 301.6225–2(d)(8)), those tax attributes are not adjusted under this section. Similarly, to the extent a partner filed a return inconsistent with the treatment of items on a partnership return, a reviewed year partner (or its successor) does not adjust tax attributes to the extent the partner's prior return was consistent with the partnership adjustment. For the rules

regarding consistent treatment by partners, see § 301.6222–1.

(5) *Election under section 6226*—(i) *In general.* Except as otherwise provided in paragraph (a)(5)(ii) of this section, tax attributes are adjusted for a partnership adjustment that results in an imputed underpayment with respect to which an election is made under § 301.6226–1 in accordance with § 301.6226–4, and not the rules of this section.

(ii) *Pass-through partners and indirect partners.* A pass-through partner (as defined in § 301.6241–1(a)(5)) that is a partnership and pays an amount under § 301.6226–3(e)(4) treats its share of each partnership adjustment reflected on the relevant statement as a partnership adjustment described in paragraph (a)(1) of this section, treats the amount computed in the same manner as an imputed underpayment under § 301.6226–3(e)(4)(iii) as an imputed underpayment determined under § 301.6225–1 for purposes of § 1.704–1(b)(2)(iii)(*a*) and (*f*) of this chapter, treats items arising from an adjustment that does not result in an imputed underpayment as an item under paragraph (d) of this section, and finally treats amounts with respect to any penalties, additions to tax, and additional amounts and interest computed as an amount described in § 1.704–1(b)(2)(iii)(*f*)(*3*) of this chapter.

(6) *Reflection of economic arrangement.* This section and the rules in § 1.704–1(b)(1)(viii), (b)(2)(iii)(*a*) and (*f*), (b)(2)(iv)(i)(4), and (b)(4)(xi), (xii), (xiii), (xiv), and (xv) of this chapter must be interpreted in a manner that reflects the economic arrangement of the parties and the principles of subchapter K of the Code, taking into account the rules of the centralized partnership audit regime.

(b) *Adjusting specified tax attributes in the case of a partnership adjustment that results in an imputed underpayment*—(1) *In general.* This paragraph (b) applies with respect to each partnership adjustment that was taken into account in the calculation of the imputed underpayment under § 301.6225–1(c).

(2) *Book value and basis of partnership property*—Partnership-level specified tax attributes must be adjusted under this paragraph (b)(2). Specifically, the partnership must make appropriate adjustments to the book value and basis of property to take into account any partnership adjustment. No adjustments are made with respect to property that was held by the partnership in the reviewed year but is no longer held by the partnership in the adjustment year. Amounts determined under section 704(c) must also be adjusted to take into account the partnership adjustment.

(3) *Creation of notional items based on partnership adjustment*—(i) *In general.* In order to give appropriate effect to each partnership adjustment for partner-level specified tax attributes, notional items are created with respect to each partnership adjustment, except as provided in paragraph (b)(4) of this section.

(ii) *Increase in income or gain.* In the case of a partnership adjustment that is an increase to income or gain, a notional item of income or gain is created in an amount equal to the partnership adjustment.

(iii) *Increase in expense or loss.* In the case of a partnership adjustment that is an increase to an expense or a loss, a notional item of an expense or loss is created in an amount equal to the partnership adjustment.

(iv) *Decrease in income or gain.* In the case of a partnership adjustment that is a decrease to income or gain, a notional item of expense or loss is created in an amount equal to the partnership adjustment.

(v) *Decrease in expense or loss.* In the case of a partnership adjustment that is a decrease to an expense or to a loss, a notional item of income or gain is created in an amount equal to the partnership adjustment.

(vi) *Credits.* If a partnership adjustment reflects a net increase or net decrease in credits as determined under § 301.6225–1(d), the partnership may have one or more notional items of income, gain, loss, or deduction that reflects the change in the item that gives rise to the credit, and those items are treated as items in paragraph (b)(3)(ii), (iii), (iv), or (v) of this section. For example, if a partnership adjustment is to a credit, a notional item of deduction may be created when appropriate. See section 280C.

(4) *Situations in which notional items are not created*—(i) *In general.* In the case of a partnership adjustment described in this paragraph (b)(4), or when the creation of a notional item would duplicate a specified tax attribute or an actual item already taken into account, notional items are not created. Nevertheless, in these situations specified tax attributes are adjusted for the partnership and its reviewed year partners or their successors (as defined in § 1.704–1(b)(i)(viii)(*b*) of this chapter) in a manner that is consistent with how the partnership adjustment would have been taken into account under the partnership agreement in effect for the reviewed year taking into account all facts and circumstances. See § 1.704–1(b)(2)(iii)(*f*)(*4*) of this chapter for rules for allocating the expenditure for an imputed underpayment in these circumstances.

(ii) *Adjustments for non-section 704(b) items.* Notional items are not created for a partnership adjustment that does not derive from items that would have been allocated in the reviewed year under section 704(b). See paragraph (e) of this section, *Example 5.*

(iii) *Section 705(a)(2)(B) expenditures.* Notional items are not created for a partnership adjustment that is a change of an item of deduction to a section 705(a)(2)(B) expenditure.

(iv) *Tax-exempt income.* Notional items are not created for a partnership adjustment to an item of income of a partnership exempt from tax under subtitle A of the Code.

(5) *Allocation of the notional items.* Notional items are allocated to the reviewed year partners or their successors under § 1.704–1(b)(4)(xi) of this chapter.

(6) *Effect of notional items*—(i) *In general.* The partnership creates notional items of income, gain, loss, deduction, or credit in order to make appropriate adjustments to specified tax attributes. See paragraph (e) of this section, *Example 1.*

(ii) *Partner capital accounts.* For purposes of capital accounts determined and maintained in accordance with § 1.704–1(b)(2) of this chapter, a notional item of income, gain, loss, deduction or credit is treated as an item of income, gain, loss, deduction or credit (including for purposes of determining book value). Similar adjustments may be appropriate for partnerships that do not determine and maintain capital accounts in accordance with § 1.704–1(b)(2) of this chapter.

(iii) *Partner's basis in its interest*—(A) *In general.* Except as otherwise provided, the basis of a partner's interest in a partnership is adjusted (but not below zero) to reflect any notional item allocated to the partner by treating the notional item as an item described in section 705(a).

(B) *Special basis rules.* The basis of a partner's interest in a partnership is not adjusted for any notional items allocated to the partner—

(*1*) When a partner that is not a tax-exempt entity (as defined in § 301.6225–2(d)(3)(iii)) is a successor under § 1.704–1(b)(1)(viii)(*b*) of this chapter to a reviewed year tax-exempt partner (as defined in § 301.6225–2(d)(3)(iii)), to the extent that the IRS approved a modification under § 301.6225–2 because the tax-exempt partner was not subject to tax; or

(*2*) When the notional item would be allocated to a successor that is related

(within the meaning of sections 267(b) or 707(b)) to the reviewed year partner, the successor acquired its interest from the reviewed year partner in a transaction (or series of transactions) in which not all gain or loss is recognized during an administrative adjustment proceeding with respect to the partnership's reviewed year under subchapter C of chapter 63, and a principal purpose of the interest transfer (or transfers) was to shift the economic burden of the imputed underpayment among the related parties.

(c) *Determining a partner's share of an expenditure for any payment required to be made by a partnership under subchapter C of chapter 63.* Payment by a partnership of any amount required to be paid under subchapter C of chapter 63 as described in § 301.6241–4(a) is treated as an expenditure described in section 705(a)(2)(B). Rules for determining whether the economic effect of an allocation of these expenses is substantial are provided in § 1.704–1(b)(2)(iii)(*f*) of this chapter and rules for determining whether an allocation of these expenses is deemed to be in accordance with the partners' interests in the partnership are provided in § 1.704–1(b)(4)(xii) of this chapter.

(d) *Adjusting tax attributes for a partnership adjustment that does not result in an imputed underpayment.* The rules under subchapter K apply in the case of a partnership adjustment that does not result in an imputed underpayment. See § 301.6225–3(c). Accordingly, tax attributes (as defined in § 301.6241–1(a)(10)) are adjusted under those rules. An item arising from a partnership adjustment that does not result in an imputed underpayment (as defined in § 301.6225–1(c)(2)) is allocated under § 1.704–1(b)(4)(xiii) of this chapter.

(e) *Examples.* The following examples illustrate the rules of this section. For purposes of these examples, unless otherwise stated, Partnership is subject to the provisions of subchapter C of chapter 63, Partnership and its partners are calendar year taxpayers, all partners are U.S. persons, and the highest rate of income tax in effect for all taxpayers is 40 percent for all relevant periods.

Example 1. (i) In 2019, A, B, and C are individuals that form Partnership. A contributes Whiteacre, which is unimproved land with an adjusted basis of $400 and a fair market value of $1000, and B and C each contribute $1000 in cash. The partnership agreement provides that all income, gain, loss, and deduction will be allocated in equal ⅓ shares among the partners. The partnership agreement also provides that the partners' capital accounts will be determined and maintained in accordance with § 1.704–1(b)(2)(iv) of this chapter, distributions in liquidation of the partnership (or any partner's interest) will be made in accordance with the partners' positive capital account balances, and any partner with a deficit balance in his capital account following the liquidation of his interest must restore that deficit to the partnership (as provided in § 1.704–1(b)(2)(ii)(*b*)(*2*) and (*3*) of this chapter).

(ii) Upon formation, Partnership has the following assets and capital accounts:

	Partnership basis	Book	Value		Outside basis	Book	Value
Cash	$2,000	$2,000	$2,000	A	$400	$1,000	$1,000
Whiteacre	400	1,000	1,000	B	1,000	1,000	1,000
				C	1,000	1,000	1,000
Totals	2,400	3,000	3,000		2,400	3,000	3,000

(iii) In 2019, Partnership makes a $120 payment for Asset that it treats as a deductible expense on its partnership return.

	Partnership basis	Book	Value		Outside basis	Book	Value
Cash	$1,880	$1,880	$1,880	A	$360	$960	$1,000
Whiteacre	400	1,000	1,000	B	960	960	1,000
Asset	0	0	120	C	960	960	1,000
Totals	2,280	2,880	3,000		2,280	2,880	3,000

(iv) Partnership does not file an AAR for 2020. The IRS determines in 2021 (the adjustment year) that Partnership's $120 expenditure was not allowed as a deduction in 2019 (the reviewed year), but rather was the acquisition of an asset for which cost recovery deductions are unavailable. Accordingly, the IRS makes a partnership adjustment that disallows the entire $120 deduction, which results in an imputed underpayment of $48 ($120 × 40 percent). Partnership does not request modification under § 301.6225–2. Partnership pays the $48 imputed underpayment.

(v) Partnership first determines its tax attribute adjustments resulting from the partnership adjustment by applying paragraph (b) of this section. Pursuant to paragraph (b)(2)(i) of this section, Partnership must re-state the basis and book value of Asset to $120. Further, pursuant to paragraph (b)(3)(ii) of this section, a $120 notional item of income is created. The $120 item of notional income is allocated in equal shares ($40) to A, B, and C in 2021 under § 1.704–1(b)(4)(xi) of this chapter. Accordingly, in 2021 Partnership increases the capital accounts of A, B, and C by $40 each, and increases A, B, and C's outside bases by $40 each under paragraph (b)(5)(ii) and (iii) of this section, respectively.

(vi) As described in paragraph (c) of this section, Partnership's payment of the $48 imputed underpayment is treated as an expenditure described in section 705(a)(2)(B) under § 301.6241–4. Under § 1.704–1(b)(4)(xii) of this chapter, Partnership determines each partner's properly allocable share of this expenditure in 2021 by allocating the expenditure in proportion to the allocations of the notional item to which the expenditure relates. Accordingly, each of A, B, and C have a properly allocable share of $16 each, which is the same proportion (⅓ each) in which A, B, and C share the $120 item of notional income. Thus, A, B and C's capital accounts are each decreased by $16 in 2021 and A, B and C's outside bases are each decreased by $16 in 2021. The allocation of the expenditure under the partnership agreement has economic effect under § 1.704–1(b)(2)(ii) of this chapter and, because the allocation of the expenditure is determined in accordance with § 1.704–1(b)(2)(iii)(*f*) of this chapter, the economic effect of these allocations is deemed to be substantial.

(vii) The payment is also reflected by a $48 decrease in partnership cash for book purposes under § 1.704–1(b)(4)(ii) of this

chapter. Therefore, in 2021, A's basis in Partnership is $384 and his capital account is $984. B and C each have a basis and capital account of $984.

	Partnership basis	Book	Value		Outside basis	Book	Value
Cash	$1,832	$1,832	$1,832	A	$384	$984	$984
Whiteacre	400	1,000	1,000	B	984	984	984
Asset	120	120	120	C	984	984	984
Totals	2,352	2,952	2,952		2,352	2,952	2,952

Example 2. (i) The facts are the same as in *Example 1* of this paragraph (e), except the IRS approves modification under § 301.6225–2(d)(3) with respect to A, which is a tax-exempt entity, and under § 301.6225–2(d)(4) with respect to C, which is a corporation subject to a tax rate of 35%. These modifications reduce Partnership's overall imputed underpayment from $48 to $30.

(ii) As in *Example 1* of this paragraph (e), Partnership determines its tax attribute adjustments resulting from the partnership adjustment by applying paragraph (b) of this section. Pursuant to paragraph (b)(3)(ii) of this section, a $120 notional item of income is created. The $120 item of notional income is allocated in equal shares ($40) to A, B, and C in 2021 under § 1.704–1(b)(4)(xi) of this chapter. Accordingly, in 2021 Partnership increases the capital accounts of A, B, and C by $40 each, and increases A, B, and C's outside bases by $40 each under paragraph (b)(5) (ii) and (iii) of this section, respectively.

(iii) However, the modifications affect how Partnership must allocate the imputed underpayment expenditure among A, B, and C in 2021 (the adjustment year) pursuant to § 1.704–1(b)(2)(iii)(*f*) of this chapter. Specifically, Partnership allocates the $30 expenditure in 2021 in proportion to the allocation of the notional item to which it relates (which is ⅓ each as in *Example 1* of this paragraph (e)), but it must also take into account modifications attributable to each partner. Accordingly, B's allocation is $16 (its share of the imputed underpayment, for which no modification occurred), and A and C have properly allocable shares of $0 and $14, respectively (their shares, taking into account modification). Thus, A's capital account is decreased by $0, B's capital account is decreased by $16, and C's capital account is decreased by $14 in 2021 and their respective outside bases are decreased by the same amounts in 2021.

(iv) The payment is also reflected by a $30 decrease in partnership cash for book purposes. Therefore, in 2021, A's basis in Partnership is $400 and his capital account is $1000, B's basis and capital account are both $984, and C's basis and capital account are both $986.

	Partnership basis	Book	Value		Outside basis	Book	Value
Cash	$1,850	$1,850	$1,850	A	$400	$1,000	$1,000
Whiteacre	400	1,000	1,000	B	984	984	984
Asset	120	120	120	C	986	986	986
Totals	2,370	2,970	2,970		2,370	2,970	2,970

Example 3. The facts are the same as in *Example 1* of this paragraph (e). However, in 2020, C transfers its entire interest in Partnership to D (an individual) for cash. Under § 1.704–1(b)(2)(iv)(l) of this chapter, C's capital account carries over to D. In 2021, the year the IRS determines that Partnership's $120 expense is not allowed as a deduction, D is C's successor under § 1.704–1(b)(1)(viii)(*b*)(*2*) of this chapter with respect to specified tax attributes and the payment of the imputed underpayment treated as an expenditure under section 705(a)(2)(B).

Example 4. The facts are the same as in *Example 1* of this paragraph (e), except that the partnership agreement provides that the section 705(a)(2)(B) expenditure for imputed underpayments made by the partnership are specially allocated to A (all other items continue to be allocated in equal shares). Accordingly, in 2021, the section 705(a)(2)(B) expenditure is allocated entirely to A, which reduces its capital account by $120, which has economic effect under § 1.704–1(b)(2)(ii) of this chapter. However, the economic effect of this allocation is not substantial under § 1.704–1(b)(2)(iii)(*a*) of this chapter because it is not allocated in the manner described in § 1.704–1(b)(2)(iii)(*f*) of this chapter. The allocation will also not be deemed to be in accordance with the partners' interests in the partnership under § 1.704–1(b)(3)(ix) of this chapter because it is not allocated pursuant to the rules under § 1.704–1(b)(4)(xii) of this chapter.

Example 5. (i) In 2019, Partnership has two partners, A and B. Both A and B have a $0 basis in their interests in Partnership. Further, Partnership has a $200 liability as defined in § 1.752–1(a)(4) of this chapter. The liability is treated as a nonrecourse liability as defined in § 1.752–1(a)(2) of this chapter so that A and B both are treated as having a $100 share of the liability under § 1.752–3 of this chapter. In 2021 (the adjustment year), the IRS determines that the liability was inappropriately classified as a nonrecourse liability, should have been classified as a recourse liability as defined in § 1.752–1(a)(1) of this chapter, and that A should have no share of the recourse liability under § 1.752–2 of this chapter. As a result of the liability misclassification, the IRS assesses an imputed underpayment of $40 ($100 × 40%) resulting from the $100 decrease in A's share of partnership liabilities under §§ 1.752–1(c) and 1.731–1(a)(1)(i) of this chapter. Partnership does not request modification under § 301.6225–2. Partnership pays the $40 imputed underpayment.

(ii) Pursuant to paragraph (b)(4)(ii) of this of this section, notional items are not created with respect to this partnership adjustment. Instead, under paragraph (b)(4)(i) of this section, specified tax attributes are adjusted in a manner that is consistent with how the partnership adjustment would have been taken into account under the partnership agreement in effect for the reviewed year taking into account all facts and circumstances. In this case, no specified tax attributes are adjusted.

(iii) However, because A would have borne the economic burden of the partnership adjustment if the partnership and its partners had originally reported in a manner consistent with the partnership adjustment, the $40 imputed underpayment section 705(a)(2)(B) expenditure is allocated to A under § 1.704–1(b)(2)(iii)(*f*)(*4*) of this chapter.

(f) *Applicability date*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T 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 § 301.9100–22T is in effect.

■ **Par. 8.** Section 301.6226–4 is added to read as follows:

§ 301.6226–4 Effect of a partnership adjustment on tax attributes of partnerships and their partners.

(a) *Adjustments to tax attributes*—(1) *In general.* When a partnership adjustment (as defined in § 301.6241–1(a)(6)) is taken into account by the reviewed year partners (as defined in § 301.6241–1(a)(9)) or affected partners (as described in § 301.6226–3(e)(3)(i)) pursuant to an election made by a partnership under § 301.6226–1, the partnership and its reviewed year partners or affected partners must adjust their tax attributes (as defined in § 301.6241–1(a)(10)) in accordance with the rules in this section.

(2) *Application to pass-through partners and indirect partners.* To the extent a pass-through partner (as defined in § 301.6241–1(a)(5)) pays an amount computed in the same manner as an imputed underpayment under § 301.6226–3(e)(4)(iii) (paying partnership), the paying partnership and its affected partners (as defined in § 301.6226–3(e)(3)(i)) or their successors must make adjustments to their tax attributes in accordance with the rules in § 301.6225–4.

(3) *Allocation of partnership adjustments.* Partnership adjustments are allocated to the reviewed year partners or affected partners under § 1.704–1(b)(4)(xiv) of this chapter.

(b) *Adjusting tax attributes when an election under section 6226 is made.* For partnership adjustments that are taken into account by the reviewed year partners or affected partners because an election is made under § 301.6226–1, each partner's share of the partnership adjustments are determined under § 301.6226–2(f). Accordingly, the reviewed year partners or affected partners must take into account items of income, gain, loss, deduction or credit with respect to their share of the partnership adjustments as reflected on the statements described in § 301.6226–2 or § 301.6226–3(e)(3) (pushed-out items) in the reporting year (as defined in § 301.6226–3(a)). Similarly, partnerships adjust tax attributes affected by reason of a pushed-out item in the adjustment year (as defined in § 301.6241–1(a)(1)), but these adjustments are calculated with respect to each year beginning with the reviewed year (as defined in § 301.6241–1(a)(8)), followed by any subsequent taxable years, concluding with the adjustment year (as defined in § 301.6241–1(a)(1)).

(c) *Example.* The following example illustrates the rules of this section. For purposes of this example, Partnership is subject to the provisions of subchapter C of chapter 63 of the Internal Revenue Code, Partnership and its partners are calendar year taxpayers, all partners are U.S. persons, and the highest rate of income tax in effect for all taxpayers is 40% for all relevant periods.

Example. (i) In 2021, J, K and L form Partnership by each contributing $500 in exchange for partnership interests that share all items of income, gain, loss and deduction in identical shares. Partnership immediately purchases Asset on January 1, 2021 for $1500, which it depreciates using the straight-line method with a 10-year recovery period beginning in 2021 ($150) so that each partner has a $50 distributive share of the depreciation, resulting in an outside basis of $450 for each partner. Accordingly, at the end of 2022, J, K and L have an outside basis and capital account of $400 each ($500 less $50 of their respective allocable shares of depreciation in 2021 and $50 in 2022).

	Partnership basis	Book	Value		Outside basis	Book	Value
Asset	$1,200	$1,200	$1,500	J	$400	$400	$500
				K	400	400	500
				L	400	400	500
Totals	1,200	1,200	1,500		1,200	1,200	1,500

(ii) The IRS initiates an administrative proceeding with respect to Partnership's 2021 taxable year (reviewed year) in 2023 (adjustment year) and determines that Asset should have been depreciated with a 20-year recovery period beginning in 2021, resulting in a $75 partnership adjustment that results in an imputed underpayment. The IRS does not initiate an administrative proceeding with respect to Partnership's 2022 taxable year, and Partnership does not file an administrative adjustment request for that taxable year. Partnership makes an election under § 301.6226–1 with respect to the imputed underpayment. Therefore, J, K and L each are furnished a statement described in § 301.6226–2 by Partnership reflecting the $25 income adjustment for 2021. Pursuant to § 301.6226–2(e)(6), the statement furnished by Partnership to J, K, and L also reflects a $25 income adjustment to the 2022 intervening year.

(iii) Tax attributes must be adjusted to reflect the $75 pushed-out item of income that is taken into account in equal shares ($25) by J, K, and L with respect to 2021. Specifically, J, K and L's outside bases and capital accounts must be increased $25 each with respect to the 2021 tax year. Additionally, tax attributes must be adjusted with respect to 2022, as an intervening year. Specifically, J, K and L must increase their outside bases and capital accounts by $25 each with respect to the 2022 tax year. As a result, J, K and L each have an outside basis and capital account of $425 ($400 minus $25 of depreciation for 2023 plus $25 of income realized with respect to 2021 plus $25 of income realized with respect to 2022). Asset's basis and book value must also be changed in 2023. Thus, after adjusting tax attributes to take into account the election under § 301.6225–1 and taking into account other activities of Partnership in 2023, accounts are stated as follows:

	Partnership basis	Book	Value		Outside basis	Book	Value
Asset	$1,275	$1,275	$1,500	J	$425	$425	$500
				K	425	425	500
				L	425	425	500
Totals	1,275	1,275	1,500		1,275	1,275	1,500

(d) *Applicability date*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22T 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 § 301.9100–22T is in effect.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 110

[Docket Number USCG–2017–1125]

RIN 1625–AA01

Anchorage Grounds; Saint Lawrence Seaway, Cape Vincent, New York

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish at the request of the Saint Lawrence Seaway Development Corporation, two separate anchorage grounds, Carleton Island Anchorage and Tibbetts Point Anchorage, near Cape Vincent, New York. The Federal Anchorage Ground designations will enable a pilot to disembark a safely anchored vessel which will help reduce pilot fatigue, increase pilot availability, and reduce costs incurred by vessels transiting the Seaway. We invite your comments on this proposed rulemaking.

DATES: Comments and related material must be received by the Coast Guard on or before May 3, 2018.

ADDRESSES: You may submit comments identified by docket number USCG–2017–1125 using the Federal eRulemaking Portal at *http://www.regulations.gov.* See the ''Public Participation and Request for Comments'' portion of the **SUPPLEMENTARY INFORMATION** section for further instructions on submitting comments.

FOR FURTHER INFORMATION CONTACT: If you have questions about this proposed rulemaking, call or email Lieutenant Jason Radcliffe, Ninth District, Waterways Operations, U.S. Coast Guard; telephone 216–902–6060, email *jason.a.radcliffe2@uscg.mil.*

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
DHS Department of Homeland Security
FR Federal Register
NPRM Notice of proposed rulemaking
Pub. L. Public Law
§ Section
U.S.C. United States Code

II. Background, Purpose, and Legal Basis

The Coast Guard proposes to establish two anchorage grounds one in the vicinity of Carleton Island, New York and the second near Tibbetts Point, New York. Each area has historically been used as an anchorage and the Saint Lawrence Seaway Development Corporation, at the request of its waterway users, has requested each area to be officially designated as Federal Anchorage Grounds.

Without this designation, pilots who anchor a ship in the respective areas are unable to disembark during sustained delay periods which hinder compliance with rest requirements and complicate pilot availability and logistics for other vessels. The Coast Guard proposes this rulemaking under authority in 33 U.S.C. 471, 1221 through 1236, 2071; 33 CFR 1.05–1; Department of Homeland Security Delegation No. 0170.1.

III. Discussion of Proposed Rule

The Coast Guard is proposing to establish two new anchorage areas to be known as Carleton Island Anchorage and Tibbetts Point Anchorage.

The Carleton Island Anchorage would be located just northeast and adjacent to Carleton Island and Millen Bay. The boundaries of Carleton Island Anchorage are presented in the proposed regulatory text at the end of this document. The anchorage would be approximately .75 square miles. Proposed Carleton Island Anchorage is primarily intended for use by up-bound inland or ocean going bulk freight and tank ships, towing vessels and barges that need to anchor and wait for the availability of a Lake Ontario Pilot. Under this proposed rule no anchors would be allowed to be placed in the channel and no portion of the hull or rigging would be allowed to extend outside the limits of the anchorage area.

The Tibbetts Point Anchorage would be located just west and adjacent to Tibbetts Point and Fuller Bay. The boundaries of Tibbett's Point Anchorage are presented in the proposed regulatory text at the end of this document. The anchorage would be approximately 1.5 square miles. Proposed Tibbett's Point Anchorage is primarily intended for use by down-bound inland or ocean going bulk freight and tank ships, towing vessels and barges that need to anchor and wait for the availability of a River Pilot. Under this proposed rule no anchors would be allowed to be placed in the channel and no portion of the hull or rigging would be allowed to extend outside the limits of the anchorage area.

Whenever the maritime or commercial interests of the United States so require, the Saint Lawrence Seaway Development Corporation or their designated representative may direct the movement of any vessel anchored or moored within the anchorage area. The Coast Guard has ascertained the view of the Buffalo, New York District and Division Engineer, Corps of Engineers, U.S. Army, about the specific provisions of this proposed rule.

IV. Regulatory Analyses

We developed this proposed rule after considering numerous statutes and Executive Orders related to rulemaking. Below we summarize our analyses based on a number of these statutes and Executive orders and we discuss First Amendment rights of protestors.

A. Regulatory Planning and Review

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

Executive Order 13771 directs agencies to control regulatory costs through a budgeting process. This NPRM has not been designated a ''significant regulatory action,'' under Executive Order 12866. Accordingly, the NPRM has not been reviewed by the Office of Management and Budget, and pursuant to OMB guidance it is exempt from the requirements of Executive Order 13771.

We conclude that this proposed rule is not a significant regulatory action based on the location and size of the proposed anchorage grounds, as well as the historical automatic identification system (AIS) data. The impacts on routine navigation are expected to be minimal because the proposed anchorage grounds are located outside the navigational channel. When not occupied, vessels would be able to maneuver in, around and through the anchorage.

B. Impact on Small Entities

The Regulatory Flexibility Act of 1980, 5 U.S.C. 601–612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during rulemaking. The term ''small entities'' comprises small