OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE SERVICE CENTER ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, BROOKLYN
CC:NER:BRK
Attn: Jody Tancer

FROM: Acting Assistant Chief Counsel (Income Tax & Accounting)
CC:DOM:IT&A

SUBJECT: Significant Service Center Advice Under RRA98 TEFRA and Spousal Notice Requirements

This responds to your request for Significant Advice in connection with a question posed by the TEFRA coordinator of the Brookhaven Service Center.

ISSUE

Whether § 3201(d) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98) requires the Service to send separate "TEFRA Notices" to a nonpartner spouse in TEFRA audit cases where a partner in a TEFRA partnership and his/her spouse file a joint income tax return under § 6013 of the Code?

CONCLUSION

Under certain circumstances, § 3201(d) of RRA98 may require the Service to send separate TEFRA Notices to nonpartner spouses where a TEFRA partner files a joint income tax return with his/her spouse. The determination of which TEFRA notices are practicable under § 3201(d) of RRA98 is a business decision to be made by the Service.

DISCUSSION

In order to determine if, under § 3201(d) of the RRA98, it is necessary to send a TEFRA Notice to a nonpartner spouse it is first necessary to understand the purpose of (1) § 3201(d) of RRA98, (2) the partnership audit procedures required by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 646, and (3) the specifics of the Service's current TEFRA Notice procedure.

Section 6013 permits a husband and wife to file one joint income tax return. Section 6013(d)(3) provides that if a joint return is made, the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several.

Section 3201(d) of RRA98 provides that the Secretary of the Treasury shall, wherever practicable, send any notice relating to a joint return separately to each individual filing the joint return. The legislative history of § 3201(d) is minimal; however, the intent of this provision is to ensure that all joint filers will be: (1) made aware of activities that will affect their individual liability on a joint return and (2) fully informed of their rights and responsibilities with respect to the administration of their federal income tax obligations.

Section 3201(d) imposes a two-prong test to determine if a separate notice must be mailed to both spouses where a joint income tax return is filed. First, is the communication with the taxpayer a notice relating to a joint return? Second, is it practicable to send a notice separately to each individual filing the joint return? In order to determine if separate TEFRA Notices must be sent to both spouses where a joint return is filed, it is first necessary to understand both the basic taxation of partnerships as well as the specifics of the TEFRA audit procedures. The tax treatment of partnerships is generally controlled by Subchapter K of the Code (§§ 701 through 761). Section 701 provides that the partners of a partnership in their separate or individual capacities, and not the partnership itself, will be liable for the income taxes of the partnership. In other words, a partnership is a conduit entity in which all items of gains, losses, credits, deductions, etc. flow through from the entity to the individual partners of the partnership. As such, the tax attributes of the partnership flow through to the individual partners in proportion to their allocable share of partnership items.

Where a partner is married and files a joint income tax return, the partner and his/her spouse are jointly and severally liable for the partner's share of income from the partnership as provided by § 6013(d)(3). Thus, partnership items relating to one spouse affect the tax treatment of both spouses on a joint return.

In 1982 Congress enacted TEFRA, which contained distinct partnership level audit procedures for certain partnerships. The TEFRA audit rules do not, however, apply to all partnerships. Section 6231(a)(1) defines a partnership for TEFRA purposes as a partnership required to file a Form 1065, "U.S. Partnership Return of Income," except partnerships with 10 or fewer partners, each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner (TEFRA partnership).

The TEFRA partnership provisions, §§ 6221 through 6233, require consistent treatment of partnership items among a TEFRA partnership and its partners. Accordingly all TEFRA partnership items will be determined at the partnership level in a unified partnership proceeding rather than a separate proceeding with each partner. See H.R. CONF. REP. NO. 97-760, 97th Cong., 2d Sess. 600 (August 17, 1982).

The TEFRA audit procedures provide for two distinct types of statutory notices to partners. Section 6223(a)(1) requires the Service to mail each "notice partner"[1], whose name and address is furnished to the Service, notice of the beginning of an administrative proceeding at the partnership level (NBAP). Section 6223(a)(2) requires the Service to mail each "notice partner", whose name and address is furnished to the Service, notice of the final partnership administrative adjustment (FPAA).

Section 6231(a)(2) defines the term "partner," for purposes of TEFRA, as (A) a partner in the partnership, and (B) any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership. Section 301.6231(a)(2)-1T(a) of the procedure and administration regulations provides that, generally, a spouse who files a joint return with an individual holding a separate interest in the partnership shall be treated as a partner for purposes of subchapter C of chapter 63, of the Code (the TEFRA partnership rules). Section 301.6231(a)(2)-1T(a)(3) provides that except for partner's spouses identified on the partnership return or identified as a partner, for purposes of the TEFRA partnership rules, a spouse who files a joint return with an individual holding a separate interest in the partnership shall be treated as receiving any notice received by the individual holding the separate interest. Accordingly, under the existing regulations, a nonpartner spouse is deemed to receive all TEFRA Notices received by his/her partner spouse. Section 301.6231(a)(12)-1T(b)(2) provides that an individual who holds a joint interest in a

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[1] See § 6231(a)(8) for a definition of notice partner. Note that for partnerships with more than 100 partners a partner must have at least a 1 percent interest in the partnership to receive notice, § 6223(b)(1).

partnership with his or her spouse and is identified on the return as a partner shall be entitled to receive separate notices. Of course, these temporary regulations were written prior to enactment of § 3201(d) of RRA98.

The Service has interpreted the phrase "any notice" in § 3201(d) of RRA98 to include, at a minimum, all notices required to be sent to taxpayers by the Internal Revenue Code, such as statutory notices of deficiency required by § 6212. Both the NBAP and FPAA notices are required by the Code. Accordingly, it is necessary to determine if the NBAP and FPAA notices meet the two prongs of the § 3201(d) test as outlined above.

Both the NBAP and FPAA notices are notices relating to a joint return. Nonpartner spouses of partners who file joint returns will be jointly and severally liable for any adjustment to the joint return in accordance with § 6013(d)(3). Since the NBAP and FPAA notices both meet the first prong of the § 3201(d) test, it is next necessary to determine if they also meet the second prong of the § 3201(d) test.

Currently, the Service adheres to the following procedure with respect to TEFRA audits. First, an examiner selects a partnership return for audit based upon internal guidelines. After the examiner reviews the return and determines that an audit is appropriate she accesses the partnership database which contains the names and addresses of the partners in the partnership as listed on the partners' schedule K-1s. NBAPs are system generated for all partners known to the Service in accordance with statutory requirements. Once the audit is complete and a final determination with respect to the partnership return has been made, the examiner again consults the partnership database for a list of known partners as required by statute. FPAAs are system generated and mailed to the address of each individual partner as listed on the partners' schedule K-1s. If either the NBAP or FPAA are returned to the Service as undeliverable, the Service consults the masterfile for the last know address of the individual partner.

As discussed above, both the NBAP and FPAA notices relate to potential joint return liability. In order to determine if separate notices are necessary for each spouse it is necessary to determine if it is practicable to mail separate NBAP and FPAA notices.

The determination of whether mailing of separate NBAP and/or FPAA notices in TEFRA cases is practicable is a business decision to be made by the Service after considering all relevant facts and circumstances. Factors to consider in making that decision include, but are not limited to: how the notice is generated

(i.e. manually or machine generated[2]); the volume mailed each year; whether the notice is sent by regular, certified, or registered mail; and economic factors, such as how much it would cost to produce a duplicate notice, the cost and difficulty of reprogramming, and the estimated implementation cost. A decision regarding what is practicable in a particular situation will need to be revisited as circumstances change. While it may not be feasible today to reprogram computers in light of Y2K and other concerns, it may be feasible to reprogram in the near future.

Finally, we believe consideration should also be given to the information available to the examiner prior to the mailing of the NBAP and FPAA notices. Under current practice the examiner has no reason to know whether a joint income tax return was filed by an individual partner unless an NBAP or FPAA is returned to the Service as undeliverable. If an NBAP or FPAA notice is returned undeliverable, the examiner consults the masterfile for the first time. At this stage the examiner knows, or should know, the filing status of the partner. The Service may conclude that it is more practicable to send separate TEFRA notices once it has consulted the masterfile because the examiner knows whether the partner filed a joint return, while at the same the Service may also conclude that it is not practicable to send a separate TEFRA notice under normal circumstances because the masterfile is not consulted prior to mailing a TEFRA notice, and, accordingly, an examiner preparing a TEFRA notice without consulting the masterfile would not know whether or not a partner filed a joint return. However, as stated above the determination of practicability is not a legal issue. Instead, the determination of practicability is a business decision to be made by the Service.

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[2] Note that the Service has determined that all manually generated notices required by statute will be mailed to each spouse filing a joint return in separate envelopes regardless of which IRS function generates the notice. *See, e.g.* Chief of Operations Officer, John M. Dalrymple's October 6, 1998, memorandum to Regional Commissioners Executive Officer for Service Center Operations regarding Relief from Joint and Several Liability on Joint Return, IRC Section 6015.

If you have any questions regarding this memorandum, please contact Marc C. Porter at (202) 622-4940.

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