IRS Has 'Absolute' Discretion on BBA Zero-Adjustment Rule

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By Kristen A. Parillo

The IRS has broad discretion in deciding whether to exclude adjustments from the calculation of partnership imputed underpayments, according to an agency attorney.

A decision to apply the zero-adjustment rule under reg. section 301.6225-1(b)(4) is based on the facts and circumstances of a given case, Jennifer M. Black of the IRS Office of Associate Chief Counsel (Procedure and Administration) said April 28.

During a virtual conference hosted by the Practising Law Institute, Black was asked how the IRS handles interrelated or duplicative adjustments under the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015.

Describing a hypothetical situation in which the IRS recharacterized a partner's transfer of property as a disguised sale, Kate Kraus of Allen Matkins Leck Gamble Mallory & Natsis LLP said the agency could adjust at least six lines of the partnership's return to reflect the recharacterization.

If the partner had a gain of $100 from transferring the property, the IRS could make six positive adjustments (each $100), leaving the partnership owing tax on an imputed underpayment of $600, Kraus said. She added that the IRS could also separately audit the partner's individual return for not reporting the $100 gain.

Kraus noted that the IRS has authority under reg. section 301.6225-1(b)(4) to treat an adjustment as zero for purposes of calculating an imputed underpayment "if the effect of one partnership adjustment is reflected in one or more other partnership adjustments."

In the hypothetical involving the disguised sale, the IRS could apply that rule so the partnership would owe tax on $100 instead of $600, Kraus said. She asked how much leeway the IRS has in choosing to use the zero-adjustment rule.

"We have absolute discretion," Black said, adding that Treasury and the IRS created the rule to provide flexibility when determining imputed underpayments.

"I know everybody in the private sector always thinks the IRS is mean and out to get everyone," Black said. "But we don't get a cut of this money, so we don't really have a huge incentive to

stick it to you."

Whether to apply the rule depends on the facts and circumstances, Black said. "Sometimes it won't make sense to treat one as zero, but there may be times where it makes sense to treat many as zero," she said.

Requiring zero-adjustment treatment in prescribed circumstances wouldn't work, Black said, "because any rule you create that is an absolute, I will find you one case that becomes an exception."

Black noted that the Tax Court has jurisdiction under section 6234 to review imputed underpayments and that amended return modifications and push-out elections are also available. "Even if you made all six of those adjustments and didn't treat it as zero, if all six wouldn't result in tax, then when you file an amended return or a push-out, it won't result in tax," she said. "It comes out to what it would've been had they properly reflected those adjustments to begin with."