

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

(Also Part I, §§ 103, 702, 704, 706, 707, 761, 1.441-2T, 1.706-1, 1.761-2, 301.7701-4.)

Rev. Proc. 2002-68

SECTION 1. PURPOSE

This revenue procedure modifies and supersedes Rev. Proc. 2002-16, 2002-9 I.R.B. 572.

SECTION 2. BACKGROUND

Rev. Proc. 2002-16 provides procedures for certain partners to take into account on a monthly basis their distributive shares of partnership items if the partnership satisfies the definition of an eligible partnership and makes an election under the revenue procedure (Monthly Closing Election).

A partnership is generally eligible to make a Monthly Closing Election under Rev. Proc. 2002-16 if 95 percent of the partnership's income for the taxable year is income that is exempt from tax under § 103 of the Internal Revenue Code and the partnership's allocations of income, gain, loss, deduction, and credit are made in accordance with § 704(b). Only money market fund partners are eligible to consent to the Monthly Closing Election provided by Rev. Proc. 2002-16.

Since the issuance of Rev. Proc. 2002-16, the Department of the Treasury and the Internal Revenue Service have received a number of comments. Commentators noted that medium- and long-term bond funds often own interests in eligible partnerships, that these funds are subject to the same partnership timing difficulties as money market fund partners, and that it is costly and unnecessary to require separate reporting for non-fund partners in situations where substantially all of the partnership's income is exempt from taxation. Treasury and the Service agree that, in the interest of sound and efficient administration of the tax laws, all partners in eligible partnerships should be able to consent to the Monthly Closing Election.

Certain commentators noted that, to the extent that many otherwise eligible partnerships elected under § 761 to be excluded from subchapter K, these partnerships might not be able to elect into the procedures pro-

vided in Rev. Proc. 2002-16 without first seeking and receiving permission from the Service to revoke their § 761 elections.

Two of the requirements for eligibility to elect to be excluded from all or a portion of subchapter K are that the partners must own the partnership property as co-owners and the partners must be able to compute their income without the necessity of computing partnership taxable income. See § 1.761-2(a)(1) and (2) of the Income Tax Regulations. If a business entity (classified as a partnership) owns a tax-exempt bond and issues membership interests that apportion the benefits and burdens of that property to its members in a manner that differs significantly from direct investment in the bond (such as the preferred and residual interests in eligible partnerships that are described in Rev. Proc. 2002-16), the holders of those interests do not satisfy the requirement that they own the partnership property as co-owners. *Cf.* § 301.7701-4(c) of the Procedure and Administration Regulations. Moreover, if (as in the case of partnerships described in Rev. Proc. 2002-16) one class of partners has a right to partnership income that is superior to the right of another class of partners, then the net partnership income or loss allocated to the partners with inferior rights to partnership income can be determined only by computing the net income or loss of the partnership and then by reducing that net income by income allocable to partners with superior rights to partnership income. These partnerships do not meet the requirement of § 1.761-2(a)(1) that the members of the organization be able to compute their incomes without the necessity of computing partnership income.

If a partnership does not satisfy the requirements for making a § 761(a) election, any purported election under § 761(a) by that partnership is not effective and, therefore, need not be revoked. However, because there was some confusion as to whether the partnerships described in Rev. Proc. 2002-16 qualified to make an election under § 761(a) to be excluded from subchapter K, section 9 of this revenue procedure provides transition relief for many of these taxpayers.

Commentators have requested that consideration be given to simplified reporting procedures for some or all of the partnerships described in Rev. Proc. 2002-16. This revenue procedure eliminates the

monthly statements that were required under Rev. Proc. 2002-16 but does not eliminate the requirements that a partnership file Form 1065, *U.S. Return of Partnership Income*, and provide a Schedule K-1 (Form 1065) to each partner. Electing partnerships and consenting partners must keep adequate books and records of income, gain, loss, deduction, and credit relating to partnership items to enable the Service to determine each partner's share of the partnership's monthly income and expenses. Treasury and the Service request comments on additional simplified reporting procedures that may be appropriate. Finally, section 9 of this revenue procedure extends the transition period provided in Rev. Proc. 2002-16.

SECTION 3. SCOPE

This revenue procedure applies to eligible partnerships (described in section 3.01 of this revenue procedure) that elect the Monthly Closing Election and to partners that consent (described in section 6 of this revenue procedure) to take into account their distributive shares of partnership income on a monthly basis. In addition, section 9 of this revenue procedure applies to all eligible partnerships, whether or not they make the monthly closing election.

.01 Eligible Partnership.

(1) *Generally.* An entity is an eligible partnership if all of the following conditions are met as of the test date:

(a) The entity is a partnership for federal tax purposes;

(b) All allocations of income, gain, loss, deduction, and credit of the partnership are made in accordance with § 704(b); and

(c) At least 95 percent of the partnership's income for the test period was (or is reasonably expected to be) interest on tax-exempt obligations within the meaning of § 103 and substantially all of the partnership's expenses and deductions are properly allocable to producing or collecting that income or to managing, conserving, or maintaining property held for the production of that income.

(i) If, on the test date, the partnership has been in existence for at least 6 full calendar months, then the test period is the 6 full calendar months preceding the test date; and

(ii) If, on the test date, the partnership has not been in existence for at least

6 full calendar months, then the test period is the first 6 full calendar months of the partnership's existence.

(2) *Test Date.* The test date is the first day of the first month for which the Monthly Closing Election is effective.

SECTION 4. EFFECT OF MONTHLY CLOSING ELECTION AND CONSENT

If, at the end of any calendar month, an eligible partnership has a Monthly Closing Election in effect and one or more partners of the partnership has a Monthly Closing Consent in effect, then, with respect to each consenting partner, the partnership must close its books as described in § 1.706-1(c)(2) as if the partner had sold its entire interest in the partnership on the last day of that month. The consenting partner must include in its taxable income for that month the partner's distributive share of items described in § 702(a) earned by the partnership since the last closing of the books with respect to the partner and any guaranteed payments under § 707(c) to the partner that are deductible by the partnership since the last closing of the books with respect to the partner. If the partner is on a 52-53 week taxable year, then the provisions of § 1.441-2T(e) of the temporary Income Tax Regulations apply as if the last day of the month were the last day of the partnership's taxable year.

SECTION 5. MONTHLY CLOSING ELECTION

.01 *Manner of Partnership Making the Election.* An eligible partnership may make a Monthly Closing Election by filing a statement with the appropriate service center. The statement must be titled "ELECTION UNDER REVENUE PROCEDURE 2002-68," and must include:

(1) Identification of the partnership by name, address, and EIN, and the name and phone number of a contact person for the partnership;

(2) A statement that the partnership elects a monthly closing of the books for all present and future consenting partners;

(3) The signature of a person with authority to sign the partnership's Form 1065, *U.S. Return of Partnership Income*; and

(4) The effective month of the election. The election is effective for the calendar month in which the election is filed,

unless the partnership requests the election to be effective for either of the two immediately preceding calendar months. For example, if a calendar year partnership states that the monthly closing election is to begin for June, the partnership will close its books June 30. In computing taxable income for any year ending on or after June 30, a consenting partner must include the partner's share of partnership items and guaranteed payments for the period from the partnership's last closing of the books (generally December 31 of the prior year) through June 30. There will be a closing of the books and a monthly inclusion of the partner's share of these items and guaranteed payments at the end of each future month.

.02 *Time for Making the Election.* The partnership's Monthly Closing Election may be made at any time. See, however, section 6.02 of this revenue procedure for limitations on the time for a partner to effect a Monthly Closing Consent.

SECTION 6. MONTHLY CLOSING CONSENT

.01 *Manner of Partner Effecting the Consent.*

(1) A partner effects a Monthly Closing Consent by providing a statement of consent to the custodian or manager of the partnership. A copy of the statement of consent should also be attached to the partner's income tax return for the first taxable year in which the consent is effective (for example, if the partner is a Regulated Investment Company, the statement must be attached to its Form 1120 RIC, *U.S. Income Tax Return for Regulated Investment Companies*). Failure to attach a copy of the partner's statement of consent to the partner's income tax return does not invalidate the partner's consent.

(2) The statement of consent must be titled "STATEMENT OF CONSENT TO ELECTION UNDER REVENUE PROCEDURE 2002-68" and must include:

(a) Identification of both the consenting partner and the partnership by name, address, and TIN, and the name and phone number of a contact person for each;

(b) A statement that the partner consents to the partnership's election to a monthly closing of the books and that the partner will include in its taxable income its distributive share of partnership items described in § 702(a) and any guaranteed pay-

ments under § 707(c) in a manner that is consistent with the election;

(c) The signature of the partner; and

(d) The effective month of the consent. The consent is effective for the calendar month in which the partner acquires the partnership interest, unless the partner requests that the consent be effective for either of the two immediately following calendar months.

.02 *Additional Requirements for Making a Valid Monthly Closing Consent.* A partner does not qualify for the treatment described in section 4 of this revenue procedure unless:

(1) The partner provides the statement of consent described in section 6.01 of this revenue procedure to the custodian or manager of the partnership no later than the last day of the second calendar month after the calendar month in which the partner acquires the partnership interest; and

(2) The partnership's Monthly Closing Election is effective no later than the second calendar month after the calendar month in which the partner acquires the partnership interest.

.03 *Special Transitional Rule.* For purposes of satisfying the requirements of section 6.02, if an eligible partnership makes an election under this revenue procedure effective on or before December 31, 2003, partners with an interest in the partnership as of the first day of the month the partnership's election becomes effective will be treated as having acquired the interest in the partnership on the first day of that month.

SECTION 7. TERMINATION OF MONTHLY CLOSING ELECTION OR MONTHLY CLOSING CONSENT

.01 A Monthly Closing Election or a Monthly Closing Consent may be revoked only with the consent of the Commissioner.

.02 Each month after the third month after a partnership's Monthly Closing Election becomes effective, the definition of eligible partnership in section 3.01 of this revenue procedure is reapplied to the partnership, using the last day of the month as the test date and that month and the preceding 2 months as the test period. If for any month the partnership fails to satisfy the test mandated by the preceding sentence, then the partnership's Monthly Clos-

ing Election is terminated as of first day of the month. If the partnership subsequently qualifies as an eligible partnership, it may make another Monthly Closing Election only after obtaining the Commissioner's consent.

.03 If a consenting partner transfers its entire interest in a partnership with a Monthly Closing Election in effect and the consenting partner later acquires another interest in that partnership, then the partner's Monthly Closing Consent continues to be effective if the partnership continues to have its Monthly Closing Election in effect.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective on October 7, 2002. Partners and partnerships that consented and made elections under Rev. Proc. 2002-16 may continue reporting as authorized in that revenue procedure; however, the partnerships are no longer required to provide monthly statements.

SECTION 9. TRANSITION RULE

For any taxable year beginning before January 1, 2004, the Service will not challenge a partnership's or a partner's tax treatment that is consistent with an election to be excluded from the provisions of subchapter K under § 761(a), provided the partnership would be an eligible partnership as defined in this revenue procedure and the partners' inclusion of income, gain, loss, de-

duction, and credits is consistent with that permitted under this revenue procedure.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-16, 2002-9 I.R.B. 572, is modified and superseded.

SECTION 11. REQUEST FOR COMMENTS

Comments are requested regarding this revenue procedure. In particular, comments are requested concerning the establishment of modified income tax reporting procedures for eligible partnerships and consenting partners. All comments will be available for public inspection and copying. Comments should be sent to CC:ITA:RU (Rev. Proc. 2002-68), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may also be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (Rev. Proc. 2002-68), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. In the alternative, e-mail your comments to Notice.Comments@irscounsel.treas.gov. Please submit comments by December 6, 2002.

SECTION 12. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1768. An

agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information is in sections 5 and 6 of this revenue procedure. This information is required to inform the Service which partners and partnerships are making the designated election and to report income appropriately. The collection of information is required to obtain a benefit. The likely respondents are businesses.

The estimated total annual reporting and recordkeeping burden is 1,000 hours.

The estimated annual burden per respondent/recordkeeper is 1 hour. The estimated number of respondents and recordkeepers is 1000.

The estimated annual frequency of responses (used for reporting requirements only) is once.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 13. DRAFTING INFORMATION

The principal author of this revenue procedure is David A. Shulman of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact David A. Shulman at 202-622-3080 (not a toll-free call).