Texas Society of
Certified Public Accountants

Submitted electronically to notice.comments@irscounsel.treas.gov

March 22, 2018

The Honorable David Kautter
IRS Acting Commissioner
CC:PA:LPD:PR (REG–120232–17; REG–120233–17)
Room 5207
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, D.C. 20044

RE: Proposed Regulations Centralized Partnership Audit Regime, Rules for Election Under Sections 6226 and 6227, Including Rules for Tiered Partnership Structures and Administrative and Procedural Provisions

Dear Acting Commissioner Kautter:

The Texas Society of Certified Public Accountants (TSCPA) is a nonprofit, voluntary professional organization representing 28,000 members. One of the expressed goals of the TSCPA is to speak on behalf of its members when such action is in the best interest of its constituency and serves the cause of the CPAs of Texas, as well as the public interest. TSCPA has established a Federal Tax Policy Committee (FTP) to represent those interests on tax-related matters. The FTP has been authorized by the TSCPA Board of Directors to submit comments on such matters of interest to the committee membership. The views expressed herein have not been approved by the Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policies of the TSCPA.

We write to comment on the proposed partnership audit regulations. Thank you for making some of the improvements we suggested in our letter dated May 31, 2017.[1] We understand that auditing hundreds or even thousands of individual partners is burdensome on the IRS with limited audit resources, and we generally support the concept of auditing at the entity level.

We appreciate that developing fair and simple procedures will require some compromises in precision when a partnership audit is conducted at the entity level for taxes that would have originally been reported and paid by the individual partners. However, we are concerned that the

[1]TSCPA letter to Hon. John A. Koskinen, Commissioner, Internal Revenue Service (May 31, 2017) https://www.tscpa.org/docs/default-source/comment-letters/federal-tax-policy/2017/irs-partnership-audit-regime-letter.pdf?sfvrsn=2.

proposed regulations generally seem to resolve questions not specifically addressed by statute in a manner favoring to the IRS and potentially detrimental to taxpayers. We call your attention to several such situations where we believe the regulations should be improved.

A. Executive Summary

The following is a summary of our comments, which are discussed in more detail below:

1. The effective date of the partnership audit rules should be delayed.

2. Individual partners should be allowed to raise partner-level penalty defenses at the audit level.

3. IRS authority to issue summary assessments for mathematical or clerical errors should be narrowly construed.

4. The proposed regulations should explain how a summary assessment for mathematical or clerical errors may be properly challenged where the normal abatement procedures are unavailable, require clear communication to taxpayers of such procedures and provide at least 30 days for such challenge from the date the taxpayer receives notification.

5. The minimum 30-day period for an affected partner to file an amended report should be extended to 60 days with a mechanism for requesting a further extension.

6. Partnerships should have the option of paying penalties at the partnership level while pushing out other adjustments to partners under IRC Section 6226.

7. Partnerships should have the option of both making a push-out election under Section 6226 and filing a lawsuit in either the U.S. District Court or Court of Federal Claims.

B. Comments

1. <u>The effective date of the partnership audit rules should be delayed.</u>

   On Jan. 4, 2018, the American Institute of CPAs (AICPA) urged the chairmen of the Senate Finance and House Ways and Means Committees and the ranking members of Congress for a one-year delay of the effective date of the partnership audit regulations.[2] We endorse

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[2] AICPA letter to Hon. Orrin G. Hatch, Chairman, Senate Finance Committee, et al. (Jan. 4, 2018) https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20180104-aicpa-request-for-delay-of-effective-date-of-bba-partnership-audit-provisions.pdf.

AICPA's letter and hope the added time would allow the IRS to resolve some of the issues addressed herein. We note the long period from enactment to the issuance of regulations very shortly before the effective date giving taxpayers little time to react to rules and adjust their governing instruments.

2. Individual partners should be allowed to raise partner-level penalty defenses at the audit level.

We believe the proposed regulations should provide some mechanism for partners to assert partner-level defenses to penalties before they are assessed. The proposed regulations were revised from the initial draft to provide that a partner in a partnership that makes a push-out election may assert a defense against a penalty based on a partner-level defense such as reasonable cause or good faith, by first paying the tax and penalty due, and then filing a claim for refund.[3] In situations where a partnership does not make a push-out election, the proposed regulations similarly state that a partner-level defense may not be raised in a partnership proceeding except as provided under the modification procedures set out under Section 6225.[4]

Assessing penalties first and asking questions later seems wholly inequitable given their inherently punitive nature and potential for very large penalties to be assessed. While this approach may be convenient for the IRS, it can be extremely burdensome for taxpayers, particularly where a partner has a clear basis for requesting waiver. This inequity and undue burden could be potentially avoided by permitting a partner to assert a partner-level defense as part of the audit process. Moreover, we do not believe it would impair the audit process for the IRS to consider potential partner-level defenses at some point during the partnership audit process. If the IRS ultimately agrees with the taxpayer that penalty waiver is merited, the taxpayer would avoid having to pay penalties that should never have been due, and costs of controversy for taxpayers and the IRS could be minimized.

As an example of the burden on a taxpayer, consider the situation where a partnership acquires an asset from a partner and several years later sells it for $10 million, claiming a basis of $9.5 million and a gain of $500,000. The IRS disagrees with the basis amount and assesses tax on an additional $8.5 million in gain, plus a valuation penalty of 40 percent, plus interest. This adjustment at the partnership level is pushed out to the partners. If a partner who owns 50 percent of the partnership has a partner-level reasonable cause defense against imposition of the penalty (e.g., perhaps attributable to due diligence efforts relating to determining basis in inherited property), the partner would have to pay his share of the full amount of the penalty up front, which would be roughly $400,000 plus interest, assuming

[3] Prop. Treas. Reg. Section 301.6232-1(d)(ii)(B).
[4] Prop. Treas. Reg. Section 301.6233(a)-1(c)(5).

long-term capital gain treatment ($8.5 million additional gain × 23.8 percent tax rate × 40 percent valuation penalty × 50 percent), and the partner would then have to file a refund claim. Moreover, the process of making the payment, filing a refund claim and going through the administrative process of challenging the penalties could take months or years.

If, on the other hand, a partner is permitted to assert a partner-level defense as part of the partnership audit, the IRS may very well agree the penalty should be waived as to the partner based on partner-level defenses. Rather than putting the partner in the position of paying the full amount of penalties and interest and then seeking waiver through a refund claim, we do not see that permitting the partner to address it on some level as part of the partnership audit process would harm the IRS in any way. We therefore recommend providing a mechanism to give partners an opportunity to present partner-level defenses on some level during a partnership audit before assessing penalties.

3. Issues related to mathematical or clerical errors

The proposed regulations describe exceptions to the normal assessment procedures and provide summary assessment procedures for partnership adjustments due to mathematical or clerical errors.[5] Included in this category are situations where a partnership-partner[6] fails to treat items consistently with the partnership's treatment of the items pursuant to Section 6222(a).[7] Any resulting assessment of an imputed underpayment attributable to such inconsistent treatment is not subject to the limitations under Section 6232(b) and Section 301.6232–1(c) of the proposed regulations, and therefore may be assessed without issuing a Notice of Final Partnership Adjustment.[8]

Where a summary assessment due to a "mathematical or clerical error" has been issued, the proposed regulations also state that a taxpayer may not file a petition for readjustment under Section 6234.[9] In addition, while the proposed regulations generally permit a partner who receives a summary assessment to request an abatement of such assessment within 60 days of the notice, this abatement procedure is not available where the summary assessment is the result of failure to comply with the consistency requirements in Section 6222(a).[10]

[5] id. Section 301.6232-1(d)(1).
[6] As defined in Prop. Treas. Reg. Section 301.6241–1(a)(7) (June 14 NPRM) https://www.federalregister.gov/documents/2017/06/14/2017-12308/centralized-partnership-audit-regime.
[7] id. Section 301.6232-1(d)(ii)(B).
[8] id. Section 301.6232-1(d)(1)(i).
[9] id.
[10] id. Section 301.6232-1(d)(1)(ii)(B).

a. *IRS authority to issue summary assessments for mathematical or clerical errors should be construed narrowly.*

Summary assessment procedures can be extremely detrimental to taxpayers by stripping them of their normal statutory remedies for challenging an assessment. The National Taxpayer Advocate has expressed significant concern with the summary assessment authority of the IRS, due to the potential for abuse and error.[11] Among other problems, the National Taxpayer Advocate recently reported that IRS databases, which provide the basis for summary assessments, are often unreliable.[12]

We therefore believe the summary assessment procedures described in the proposed regulations should be narrowly construed and applied. The proposed regulations should include a statement to that effect. We are concerned the IRS may otherwise be inclined to apply these procedures broadly even to complex partnership structures. For example, the proposed regulations should make clear that an assessment against a partner of a partnership-partner will not be treated as a mathematical or clerical error where the partner has reported the items at issue consistently with the partnership-partner, even though the partnership-partner may not have been consistent with the partnership in which it is a partner.

b. *The proposed regulations should explain how a summary assessment for mathematical or clerical errors may be properly challenged where the normal abatement procedures are not otherwise available.*

The proposed regulations should also explain how a taxpayer may properly challenge a clerical or mathematical error assessment made by the IRS under Section 301.6232-1(d)(ii)(B) where the normal abatement procedures are unavailable. If a taxpayer receives a summary assessment and believes it to be incorrect, what procedures are available to challenge that assessment? The proposed regulations state that the normal abatement procedures for challenging a summary assessment are <u>not</u> available. We believe the IRS must provide some procedure for taxpayers to challenge such assessments. Stripping a taxpayer of any right to challenge an assessment would create serious due process concerns under the U.S. Constitution.

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[11] NTABlog, *Why Correctible Error Authority Raises Significant Taxpayer Rights Concerns – Part 1* (Aug. 9, 2017) https://taxpayeradvocate.irs.gov/news/why-correctible-authority-error-raises-significant-taxpayer-rights-concerns-part-1.

[12] id., *Correctible Error Authority Part 2: Why Correctible Error Authority Creates More Problems Than It Resolves* (Aug. 16, 2017) https://taxpayeradvocate.irs.gov/news/correctible-error-authority-part-2-why-correctible-error-authority-creates-more-problems-than-it-resolves.

4. Issues related to push-out election

We appreciate the expansion of the push-out rules to allow multiple push-outs all the way to the ultimate taxpayer, but we are still concerned about several issues.

a. *The minimum 30-day period for an affected partner to file an amended report should be extended to 60 days with a mechanism for requesting a further extension.*

We strongly urge you to extend to 60 days the minimum 30-day period for an affected partner that is not a pass-through partner to file a return, taking into account partnership adjustments. We also urge you to provide a mechanism for requesting a further extension of this deadline when needed.

Proposed regulation Section 301.6226-3(e)(1) states that each pass-through partner that receives a statement under proposed Section 301.6226-2 must either make a payment in accordance with proposed Section 301.6226-3(e)(4) or push out the adjustments by furnishing statements to its partners and the IRS under proposed Section 301.6226-3(e)(3).[13] This process continues through as many tiers as necessary until either a pass-through partner or a non-pass-through partner takes the adjustment into account.[14]

The proposed regulations appear to create a minimum 30-day period for an affected partner that is not a pass-through partner to report and pay tax attributable to partnership adjustments to avoid penalties, presumably by filing an amended income tax return. Specifically, the proposed regulations state, "No addition to tax under Section 6651 related to any additional reporting year tax will be imposed if an affected partner that is not a pass-through partner reports and pays the additional reporting year tax within 30 days of the extended due date for the return for the adjustment year of the partnership that made the election under Section 301.6226-1…"[15] The due date for issuing statements to partners under these proposed regulations is "no later than the extended due date for the return for the adjustment year (as defined in Section 301.6241-1(a)(1)) of the partnership that made the election…"[16]

While we appreciate the minimum 30-day period for having the ultimate pass-through partner report and pay tax on the partnership adjustments, we believe the 30-day period may not allow sufficient time for accurate reporting. Where a partnership elects to push

[13] Prop. Treas. Reg. Section 301.6226-3(e)(1).
[14] id Section 301.6226-3(e)(iv).
[15] id. Section 301.6226-3(e)(3)(iv).
[16] id. Section 301.6226-3(e)(3)(ii).

out the adjustment concluded in the examination, some or perhaps all the partnership's partners may have already filed their tax returns. In this circumstance, the partners will be required to file an amended return to properly reflect the adjustment at the partnership level. The computations may be complex, particularly where the affected partner is a partner in a multi-tiered partnership structure. A 30-day limitation to file the partners' amended returns is inadequate, especially if the 30-day period falls within tax filing season and the partners are reliant on return preparers whose schedules are already consumed with original tax return filings.

This issue can be even more important in the context of multi-tiered partnerships. For example, where the "parent" of a tiered partnership has been assessed a tax deficiency and the parent makes the push-out election, the lower tier partnership also has the right to make a push-out election to its partners. In many circumstances it may take the lower tier partnership several days to decide whether it will push down its portion of the adjustments, leaving the ultimate partner substantially fewer than 30 days to make adjustments.

For these reasons, we believe the 30-day period should be extended to at least 60 days. Additionally, we believe there should be a mechanism in place for requesting and obtaining an extension of this deadline, where needed. Notably, the minimum 30-day period described above does not appear to be prescribed or mandated by statute. As such, it can and should be extended as there does not appear to be a statutory impediment for doing so.

b. *Partnerships should have the option of paying penalties at partnership level while pushing out other adjustments to partners under Section 6226.*

We believe a partnership should be allowed to pay penalties while pushing out only taxes and interest to partners. As currently drafted, the proposed regulations do not appear to provide this option. Proposed regulation Section 301.6226-1 provides rules relating to a partnership's election under Section 6226 to have its partners consider the partnership adjustments in lieu of paying the imputed underpayment determined under Section 6225.[17] The relevant language states that all the partnership level adjustments including penalties must be passed to the partners if the push-out election is made.[18]

The option to pay only penalties at the partnership level while pushing out other adjustments may be simpler for the IRS as well as for the partnership. In larger or publicly-traded partnerships, limited partners understand they must pay additional taxes

[17] id. Section 301.6226-1.
[18] id. Section 301.6226-1(b).

and interest, but they may not understand the complexities of tax positions that resulted in a penalty. Especially where the partners paying the penalty were not partners in the partnership during the reviewed year, it seems inequitable to require the partners to pay penalties where a partnership may be willing to do so at the partnership level. Pushing out the penalty will require a possibly long and complex explanation that may be burdensome to everyone and may cause unnecessary friction among partners. This may be fair in that the general partner often has made the decision that resulted in the penalty. This approach would also simplify the situation where a penalty is pushed out within the limited period allowed for the push-out, but the partnership is appealing the penalty.

c. *Partnerships should have the option of both making a push-out election under Section 6226 and filing a lawsuit in either the U.S. District Court or Court of Federal Claims.*

The regulations should also provide relief to a partnership that elects to push out the adjustments under Section 6226, but also desires to file a lawsuit challenging IRS adjustments in either U.S. District Court or the Court of Federal Claims. The proposed regulations require a partnership to deposit the amount of any imputed underpayment resulting from partnership adjustments as a condition to filing a lawsuit in either U.S. District Court or the Court of Federal Claims.[19] However, the proposed regulations provide no explanation as to how or whether this imputed tax deposit amount may or should be adjusted to reflect a push-out election made under Section 6226.

We are concerned the IRS could take the position that a partnership that makes a push-out election under Section 6226 is nevertheless required to pay the full amount of the imputed tax if it wishes to file a lawsuit in either of these two forums. This could result in the tax at issue being paid twice: once at the partner level and again at the partnership level for a partnership that wishes to litigate. We can discern no congressional intent that would require such potentially punitive treatment against a partnership in that situation.

We therefore believe the proposed regulations should provide a mechanism that would enable a partnership to file a lawsuit in either a U.S. District Court or the Court of Federal Claims and still make an election under Section 6226, without creating the risk of having tax on the partnership adjustments paid twice. One possible approach might be to reduce the imputed tax deposit amount by the amounts that would be reported by individual partners under a push-out election. Another might be to provide a clear mechanism for having the partnership obtain a refund of the imputed tax deposit before any amounts are paid by the push-out partners under Section 6226.

[19] Prop. Treas. Reg. Section 301.6234-1(b).

C. Conclusion

We would be pleased to answer any questions you may have or to work with you in any way to help improve procedures for partnership audits. Please feel free to contact me at 512-542-9300 or cmondrik@mondriklaw.com; David Colmenero at 214-749-2462 or dcolmenero@meadowscollier.com; or TSCPA Staff Liaison Patty Wyatt at 817-656-5100 or pwyatt@tscpa.net.

Sincerely,

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Texas Society of Certified Public Accountants

Principal responsibilities for drafting these comments was exercised by David E. Colmenero, JD, LL.M., CPA; Kenneth M. Horwitz, JD, LLM, CPA; and Julie Dale, CPA.

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