July 29, 2019

The Honorable Charles P. Rettig
Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

RE: New Tax Basis Reporting Requirement in Instructions to Form 1065

Dear Commissioner Rettig:

The Texas Society of Certified Public Accountants (TXCPA) is a nonprofit, voluntary professional organization representing more than 28,000 members. One of the expressed goals of the TXCPA 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. TXCPA has established a Federal Tax Policy Committee to represent those interests on tax-related matters. The committee has been authorized by the TXCPA 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 TXCPA.

We write to express our concerns regarding a recent change in the 2018 *Instructions to IRS Form 1065* requiring a partnership, under certain circumstances, to report its individual partners' tax basis in a partnership. Compliance will be difficult and expensive, if not impossible, for many existing partnerships and the prescribed penalty is excessive. Our concern primarily involves existing partnerships that have historically reported basis to partners in reliance on, and in accordance with, the IRS' prior rules. We request some reasonable exceptions, a delayed effective date, and a notice and comment period for this new requirement.

The 2018 Instructions to IRS Form 1065 Change the Requirements for Reporting Basis to a Partner

The recently revised 2018 Instructions for IRS Form 1065 require that "tax basis" capital must be reported for any partner whose tax basis capital account would be negative either at the beginning or end of the taxable year, regardless of the accounting method used to report the entity's balance sheet.[1] The instructions add that, "[f]or these purposes, the term 'tax basis capital' means (i) the amount of cash plus the tax basis of property contributed to a partnership by a partner minus the amount of cash plus the tax basis of property distributed to a partner by the partnership net of any liabilities assumed or taken, subject to in connection with such contribution or distribution, plus (ii) the partner's cumulative share of partnership taxable income and tax-exempt income, minus (iii) the partner's cumulative share of taxable loss and nondeductible, noncapital expenditures."[2]

[1] 2018 Instructions for Form 1065 at p. 30.

[2] *Id.*

Prior to this new requirement, partnerships were generally required to report partner capital using tax basis, generally accepted accounting principles, Section 704(b) book, or some other method.[3] There was no requirement to report a partner's capital account using strictly a tax basis.

Failure to Comply May Result in Significant Penalties

Failure to comply with this new partner basis reporting requirement may result in significant penalties. Under Section 6698, a partnership is to be assessed a penalty of $195 per non-complying partner per month for up to a year, as adjusted for inflation. (For 2019, the penalty is $200 per partner.)[4] These penalties are automatically assessed.[5] Thus, a partnership with only 10 partners could be penalized up to $24,000 after only one year. A partnership with 100 partners could be penalized almost $250,000 after one year. Additional penalties could also apply under Section 6722 (failure to furnish correct payee statements) and Section 6038 (failure to furnish information with respect to foreign partnerships).

Although IRS Notice 2019-20 provides penalty relief where the partnership files the requisite basis information within one year of the original due date for taxable years that began after Dec. 31, 2017, but before Jan. 2, 2019, the notice does not extend the effective date, nor does it provide relief from the excessive penalties for any other circumstances.[6] In any event, this one-year extension of time for penalties applies only to the 2018 reporting year and may not provide enough time for many partnerships to come fully into compliance.

The New Requirement is Onerous and Even Impossible for Many Existing Partnerships to Satisfy

This new basis reporting requirement presents difficult compliance problems, particularly because it requires a beginning tax basis calculation for each partner. Arriving at a partner's beginning tax basis amount will require an analysis of all contributions and distributions, changes in ownership, changes in profit and loss allocations, special allocations, guaranteed payments and all other issues that might affect the partnership capital accounts since inception of the partnership. A partnership that has been in existence for 30 years would arguably have to go back 30 years to arrive at an accurate beginning tax basis amount.

In many cases, existing partnerships will be unable to access the historical documentation that would allow them to properly calculate each partner's beginning tax basis. These historical records may not even exist, especially given that they were not necessary under any previous requirement, and prior management, partners, records and professionals may no longer be available. Moreover, existing law only requires the taxpayer to keep records for as long as they may become material in the administration of any internal revenue law, which many taxpayers interpret to be until the statute of limitations for the requisite return expires.[7]

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[3] 2017 Instructions for Form 1065 at p. 28.

[4] IRC Section 6698(b); IRS Rev. Proc. 2017-57.

[5] Program Technical Advice 2013-015.

[6] IRS Notice 2019-20.

[7] Treas. Reg. Section 1.6001-1(e).

While this reporting requirement will be especially onerous for many smaller partnerships with limited resources, it will also be problematic for existing partnerships with a large number of partners, as it will require a historical tax basis calculation for each partner. Larger partnerships, particularly those with hundreds, or even thousands, of partners may be overwhelmed with computing this information on a historical basis. This would be especially concerning where individual partners have varying interests in the partnership and where partner turnover is high.

We understand the IRS may be concerned about individual partners who do not properly report the tax effect of distributions in excess of tax basis or losses in excess of their tax basis. While we recognize these issues may exist, the burden of proper reporting in these instances, including maintaining a taxpayer's outside basis amount, has historically been on the partner, not the partnership.

This Change Should Not Be Implemented Without a Proper Notice and Comment Period

Shifting this burden without appropriate regulatory notice and comment or express legislative authority seems inappropriate, particularly in view of the longstanding and extensive regulations under Section 704. This "tax basis" capital reporting requirement is analogous to a regulatory requirement, as it only appears in the 2018 Instructions to IRS Form 1065. While neither the code nor the regulations expressly impose this tax basis reporting requirement on partnerships, they incorporate form reporting requirements by reference.[8] As such, without a reasonable notice and comment period before imposing the requirement, the burden should remain on the reporting partner, not the partnership.

Recommendations

For the above reasons, we respectfully request that, at a minimum, the following revisions to this new requirement be implemented:

- Provide an exception from the new tax basis capital reporting requirement for partnerships with assets having a collective tax basis of less than $5 million.

- Provide an exception for partnerships that are below a certain number of partners, say 100, and above a certain number, say 1,000, with smaller partnerships having a disproportionate cost and larger partnerships having an onerous burden to comply.

- Given that this requirement is particularly burdensome for smaller partnerships which have been in existence for many years, grandfather the provision so that it applies to partnerships started since the new requirement.

- Alternatively, for partnerships that have existed for more than five years, permit those partnerships to rely on tax basis amounts provided by each of their partners for the beginning of a five-year look-back period and compute basis from that date forward in arriving at the current year tax basis amounts, rather than having to compute each partner's tax basis from the year of

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[8] IRC Section 6031(a); Treas. Reg. Section 1.6031(b)-1T(a)(3)(ii) (generally requiring partnerships to report information to the extent provided by forms or instructions).

inception. For example, a partnership could be permitted to simply ask a partner what their tax basis in the partnership was at the beginning of a five-year look-back period (e.g., Dec. 31, 2015, for the 2020 tax year) and compute tax basis from that date forward in order to determine the partner's beginning tax basis amount for the current year. Penalty waiver should also be available to partnerships that request information from a partner to comply with this new tax basis reporting requirement, but do not receive a timely response.

- Provide a reasonable opportunity for notice and comment before implementing this new reporting requirement and make it effective no earlier than for partnership tax returns due for the 2020 tax year or until the suggested process is complete. Partnership return preparation software is not ready to comply with the new requirement.

Thank you for considering our comments. We would be pleased to discuss them further if you or your staff members believe it would be helpful. Please feel free to contact me at 832-333-7431 or ddonnelly@cricpa.com or TXCPA Staff Liaison Patty Wyatt at 817-656-5100 or pwyatt@tscpa.net.

Sincerely,

David Donnelly

David P. Donnelly, CPA
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Texas Society of Certified Public Accountants

Principal responsibility for drafting these comments was exercised by David P. Donnelly, CPA; David E. Colmenero, JD, LL.M., CPA; Christina A. Mondrik, JD, CPA; Michael D. Williams, CPA; Kenneth M. Horwitz, JD, LL.M, CPA; Charles D. Pulman, JD, CPA and Paul Budd, JD, LL.M.

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