July 20, 2017

The Honorable Kevin Brady  
Chairman  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, D.C. 20515

The Honorable Orrin G. Hatch  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, D.C. 20510

The Honorable Richard E. Neal  
Ranking Member  
House Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, D.C. 20515

The Honorable Ron Wyden  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, D.C. 20510

Re: Centralized Partnership Audit Regime Effective Date

Dear Chairmen Brady and Hatch, and Ranking Members Neal and Wyden:

I am writing on behalf of the Section of Taxation of the American Bar Association to express our support for legislation that would delay by one year the effective date of the Centralized Partnership Audit Regime (the “Regime”) that was enacted as part of the Bipartisan Budget Act of 2015 (“Act”). Please note that the views expressed herein are presented on behalf of the Section of Taxation. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

The Regime fundamentally changes not only how partnerships will be audited by the Internal Revenue Service (the “Service”), but also who will be responsible for paying any additional tax liability. Under the Act, the effective date for the Regime generally is for partnership returns filed for partnership taxable years beginning after December 31, 2017.1 We believe that a brief delay of one year is necessary for the Department of the Treasury (“Treasury”) and the Service to promulgate rules required for the operation of the Regime and for taxpayers and their advisors to prepare adequately for these complex rules.

1 Section 1101 of the Act (new section 6421(g) of the Internal Revenue Code of 1986, as amended (the “Code”)).
The Regime replaces the existing partnership tax audit procedures, commonly referred to as the TEFRA\textsuperscript{2} rules. Although the Regime preserves the general concept that an income tax audit by the Service is conducted at the partnership level (rather than through audits of each partner individually), it makes important changes to how the audit is conducted and who participates on behalf of the partnership. Critically, in a change that goes well beyond procedure, the Regime departs from one of the core principles of partnership income taxation: that partners, and not the partnership, are responsible for paying income tax on the taxable income earned through the activities of the partnership. Instead, under the Regime, the partnership entity generally is responsible for satisfying any additional tax liability resulting from the audit. The purpose of our request is not to challenge the desirability of these changes; rather, we want to highlight the reasons why more time is needed by both the Government and taxpayers to prepare for the Regime.

It bears emphasis that virtually every partnership operating in the United States (including other types of business entities treated as partnerships for federal tax purposes) will need to amend its partnership agreement to address the important changes under the Regime. It is not a matter of simply waiting for partnership audits under the Regime to begin. As just one example, any additional liability for a year that has been audited may be owed and paid by the partnership years later, rather than by the persons who were partners during the year audited, as would be the case under the TEFRA rules. Partnerships also need to evaluate how the new Regime partnership rules apply concerning allocations, capital accounting, and a partner’s basis in his partnership interest – all critical issues that are not adequately addressed in the statute or the proposed regulations described below. Making any needed changes to partnership agreements will take time, and unless the effective date is delayed, partnerships will need to make these changes without the benefit of clear (or in many cases, any) rules. We believe that imposing such a burden is fundamentally unfair to taxpayers and contrary to sound tax administration. It also can be mitigated by a delay of the effective date.

On January 18, 2017, extensive proposed regulations for the Regime, spanning almost 300 pages, were made public informally.\textsuperscript{3} Despite the length of these proposed rules, important issues were either reserved for future guidance or simply not addressed. These proposed regulations had not been published in the Federal Register prior to start of the current Administration, and therefore their publication in the Federal Register was delayed until June 14, 2017.\textsuperscript{4} Although we anticipate that Treasury and the Service will move expeditiously to finalize the proposed regulations once the comment period ending August 14, 2017 has closed and a public hearing is held on September 18, 2017, it is not realistic to believe that Treasury and the Service will issue comprehensive, final rules interpreting legislation of this magnitude in time for taxpayers and practitioners to act before January 1, 2018.

\textsuperscript{2} Tax Equity and Fiscal Responsibility Act of 1982.
\textsuperscript{3} See Original REG-136118-15 (informally released on January 18, 2017).
Separately, Congress has already indicated that changes to the Regime’s statutory provisions are needed. The Technical Corrections Act of 2016 (the “Technical Corrections”),\(^5\) if enacted, would have made a number of important changes to the Regime. For example, under the Technical Corrections, the Regime’s rule would not apply to taxes imposed, or amounts required to be withheld, under chapters 2 (self-employment tax), 2A (tax on net investment income), 3 (withholding tax on nonresident alien individuals or foreign corporations), or 4 (withholding tax for certain foreign accounts) of the Code.\(^6\) The Technical Corrections also would have altered the amended return and “pull-in” procedures in the Regime\(^7\) and the handling of a “push-out” election when the audited partnership has indirect or direct partners that are partnerships or S corporations (i.e., “push-outs” for passthrough partners in tiered structures).\(^8\) These are just some of the changes that would have been made under the Technical Corrections, and if the current Congress still intends to pursue these changes, then taxpayers, the Service and Treasury should be given sufficient time to prepare for them before the Regime becomes effective.\(^9\)

We thank you for your time and attention to this important matter affecting taxpayers of all types – businesses and individuals – and would look forward to meeting with you and your staffs to discuss these issues further.

Sincerely,

William H. Caudill
Chair, Section of Taxation

cc: Hon. Steven T. Mnuchin, Secretary, Department of the Treasury
    Thomas C. West, Acting Assistant Secretary (Tax Policy), Department of the Treasury
    Hon. John A. Koskinen, Commissioner, Internal Revenue Service
    William M. Paul, Acting Chief Counsel, Internal Revenue Service

\(^{5}\) H.R. 6439, 114th Cong. (2016).
\(^{6}\) H.R. 6439, 114th Cong. § 202 (2016) (amending sections 6225(a) and (b) of the Code).
\(^{7}\) H.R. 6439, 114th Cong. §§ 202, 203, and 206(b) (2016) (amending section 6225(c) of the Code).
\(^{9}\) We note that the Regime, including as interpreted in the proposed regulations, does not address a partnership’s pre-payment right to review by the IRS Office of Appeals. Additional time is needed to address this apparent deviation from the procedures that apply to the assessment and collection of income taxes generally, including in situations involving income from a partnership under the TEFRA rules.