July 29, 2020

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments Concerning Notice 2020-43

Dear Commissioner Rettig:

Enclosed please find comments concerning Notice 2020-43. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Tom Callahan
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Jeffrey Van Hove, Senior Advisor, Office of Tax Policy, Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Bryan Rimmke, Attorney-Advisor, Department of the Treasury
Hon. Michael J. Desmond, Chief Counsel, Internal Revenue Service
William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
These comments (“Comments”) are submitted on behalf of the American Bar Association (the “ABA”) Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the ABA. Accordingly, they should not be construed as representing the position of the ABA.

Principal responsibility for preparing these Comments was exercised by Beverly Katz, Grace Kim, Kate Kraus, Amanda Wilson, Ossie Borosh, and Timothy Chan. They were reviewed by Jeanne Sullivan of the Committee on Government Submissions and Eric B. Sloan, Vice Chair for Government Relations for the Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

Contacts:

Beverly Katz  
(202) 533-3820  
Beverlykatz@kpmg.com

Amanda Wilson  
(407) 418-6220  
amanda.wilson@lowndes-law.com

Grace Kim  
(202) 521-1590  
Grace.kim@us.gt.com

Kate Kraus  
(213) 955-5662  
KKraus@allenmatkins.com

Date: July 29, 2020
I. Executive Summary

On June 5, 2020, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) issued Notice 2020-431 (the “Notice”), seeking comments on a proposed requirement that partnerships use only one of two alternative methods for reporting capital accounts to satisfy the new Tax Capital Reporting Requirement\(^2\) with respect to partnership tax years ending on or after December 31, 2020.

We understand that the Tax Capital Reporting Requirement reflects the Service’s desire to obtain information about a partner's basis in its partnership interest (“outside basis”), and the purpose of the new Tax Capital Reporting Requirement is to obtain a proxy for or estimate of the partners’ outside bases from the partnership. We applaud Treasury and the Service’s continuing approach to working with taxpayers in developing reporting guidance and appreciate the Service’s efforts to provide taxpayers with an opportunity to comment on the new Tax Capital Reporting Requirement.

We make the following recommendations:

1. The partners’ outside bases should be obtained directly from the partners, rather than from the partnership, and the tax forms should be updated to specifically require that such information be reported. For example, partners who are individuals could be required to report this information on their IRS Forms 1040, Schedule E.

2. Alternatively, if it is determined that it is too difficult administratively to obtain a partner’s outside basis directly from the partner, and that a proxy for that basis should be provided by the partnership, then a the partnership should be permitted to use any of the three method described in the Notice, the Modified Outside Basis Method (“MOB Method”), the Modified Previously Taxed Capital Method (“MPTC Method”), the Transactional Approach, or a combination of those approaches, as described below.

3. If the Tax Capital Reporting Requirement is imposed on partnerships, it should be made clear that such information is not a partner’s actual outside basis, and, in order to avoid confusion, we recommend the use of terms aligned with concepts of tax equity, such as the “partner’s estimated tax equity” or (“PETE”).

II. Discussion

A. Background

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\(^1\) 2020-27 I.R.B. 1.
\(^2\) This term is defined in the Notice as the requirement to “report partner capital accounts in Box L on the Schedule K-1 (Form 1065) or in Box F on the Schedule K-1 (Form 8865), each as they currently appear on the 2019 forms.”
On September 30, 2019, the Service released a draft of the 2019 Form 1065, U.S. Return of Partnership Income, and its schedule K-1, Partner’s Share of Income, Deductions, Credits, etc. (the “Draft Forms”). The Draft Forms contain numerous changes, including additional reporting. In particular, the Draft Forms require the partnership to report the amount of each partner’s tax basis capital account at the beginning of the tax year, increases and decreases during the year, and the balance at the end of the year. Related draft instructions were released on October 29, 2019, which expanded partner tax capital reporting to all partnerships, except for certain smaller partnerships, for each partner for the 2019 tax year.

On December 11, 2019, after receiving numerous comments regarding the difficulty of compliance with the requirements of the Draft Forms and requesting additional time, Treasury and the Service released Notice 2019-66, providing that the requirement to report partners’ shares of partnership capital on the tax basis method would not be effective for the 2019 tax year (for partnership taxable years beginning in calendar year 2019) but instead would be effective beginning in the 2020 tax year (for partnership taxable years that begin on or after January 1, 2020). As a result, the tax basis capital account reporting requirement for the 2019 tax year was the same as the requirements for the 2018 tax year, which permitted partnerships to provide capital account information using one of several approaches (tax basis, section 704(b), GAAP, or “other”), except when the requirement to report negative tax basis capital accounts on a partner-by-partner basis applied. Notice 2019-66 further provided that Treasury and the Service would issue additional guidance with respect to the definition of tax basis capital accounts for purposes of complying with the Tax Capital Reporting Requirement.

On June 5, 2020, Treasury and the Service released the Notice requesting public comments on a proposed requirement for partnerships to use only one of two alternative methods, the MOB Method or the MPTC Method, to satisfy the Tax Capital Reporting Requirement for tax years ending on or after December 31, 2020. The Notice describes each method and provides that partnerships would no longer be permitted to compute tax basis capital accounts using the Transactional Approach that has historically been used by taxpayers for computing, maintaining, and reporting (if applicable) tax basis capital accounts.

The Transactional Approach is defined in the Notice as developing and maintaining partner tax capital by applying the provisions and principles of subchapter K, including those contained in sections 705, 722, 733, and 742. Under the Transactional Approach, partnerships maintaining tax capital accounts (i) increase a partner’s tax capital account by the amount of money and the tax basis of property contributed by the partner to the partnership (less any liabilities assumed by the partnership or to which the

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3 A draft of the 2019 From 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, and its schedule K-1, Partner’s Share of Income, Deductions, Credits, etc., was released at the same time.
5 Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”) and all “Treas. Reg. §” references are to the Treasury regulations promulgated under the Code, all as in effect (or, in the case of proposed regulations which remain outstanding, as proposed) as of the date of these Comments.
property is subject) as well as allocations of income or gain made by the partnership with
respect to the partner, and (ii) decrease a partner’s tax capital account by the amount of
money and the tax basis of property distributed by the partnership to the partner (less any
liabilities assumed by the partner or to which the property is subject) as well as
allocations of loss or deduction made by the partnership with respect to the partner.

Informal discussion with Treasury and the Service indicated that the underlying
purpose of the Tax Capital Reporting Requirement is to provide the Service with a proxy
for (or estimate of) each partner’s outside basis to enable the Service to determine when a
partner has realized and should have recognized gain or loss with respect to its
partnership interest.

B. Partners to Report their Outside Basis

Given that the goal of the Tax Capital Reporting Requirement is to obtain the
partners’ outside bases, we recommend that such information be obtained directly from
the partners. The relevant tax forms (such as Form 1040, schedule E) could be modified
to require such reporting. This approach would be consistent with the position of
Treasury and the Service that outside basis is not a “partnership-related item”6 that falls
within the scope of the rules enacted by the Bipartisan Budget Act of 20157 (the “BBA”).

We note that, while the proposed BBA regulations included outside basis as a
partnership-related item,8 when the BBA regulations were finalized, outside basis was no
longer listed as an example of a partnership-related item. Instead, the final BBA
regulations state that outside basis is not a partnership-related item “because it is an item
or amount shown in the partner's books or records that results after application of the
Code to partnership-related items taking into account the facts and circumstances specific
to that partner.”9 The preamble further clarified that outside basis is not a partnership-
related item even if a partnership maintains this information on a voluntary basis, noting
that “the Code does not require this information be maintained by the partnership.”10

The preamble to the final BBA regulations explains that information such as
outside basis should not be handled under the BBA because it reflects the facts and
circumstances of the partners and the partnership might not have the necessary
information. Moreover, the parties who do have the information (namely, the partners)
are not allowed to participate in the proceedings under the BBA.11

While we recognize that there are circumstances in which the partnership will
need to know a partner’s outside basis, particularly in some cases where it is required to
make basis adjustments under sections 734(b) and 743(b), we agree with the explanation

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6 See section 6241(2)(B).
8 See Prop. Treas. Reg. §301.6241-6(b)(6).
Reg. 6,468, 6,471 (Feb. 27, 2019).
10 Preamble to Final Treas. Reg. §301.6241-1(a)(6)(iii), at 6,471 (Feb. 27, 2019).
11 Id. at 6,473.
in the preamble to the final BBA regulations and, for the same reasons, recommend that the partner’s outside basis should be obtained directly from the partner.

C. Partnership to Estimate Partner’s Outside Basis

If the recommendation above (requiring the partners to report their outside bases) is not accepted and Treasury and the Service require the partnership to report a proxy for outside basis on the partnership return, we recommend that partnerships be allowed to use the Transactional Approach, in addition to the other two methods described in the Notice (the MOB Method and the MPTC Method). Because the information-gathering effort appears to be aimed at obtaining an estimate of partners’ outside bases, we believe that any of the three methods, applied consistently (with the limited exception discussed below) by a partnership would be an appropriate way to balance the Service’s need for the information and the interest in avoiding unnecessary costs to comply with reporting requirements.

The Notice explains why the Transactional Approach is not acceptable as follows:

The Treasury Department and the IRS understand that many partnerships and other persons have maintain partner tax capital accounts according to the Transactional Approach, but due to the array of transactions that might affect partner tax capital, it is possible that partnerships and other persons that have been using the Transactional Approach may not have been adjusting partner tax capital accounts in the same way under similar fact patterns.

For this reason, the numbers produced by the Transactional Approach are not comparable from partnership to partnership and additional detailed guidance may be needed to obtain consistency. The Notice states that commentators explained providing this detailed guidance would “be a major project that would consume significant IRS resources.”

Although we appreciate these concerns, we believe that the Transactional Approach described in the Notice should be allowed even if practitioners do not agree on every aspect of the treatment of or the method of computing items because the information sought is merely an estimate of the partners’ outside basis. We note that neither of the methods approved in the Notice provide more than a rough estimate of the partners’ outside bases. For example, the MPTC Method makes assumptions that may not be consistent with the facts (that all debt is nonrecourse). And the MOB Method not only reduces the partners’ outside basis by the partners’ share of partnership liabilities but depends upon timely reporting from partners as to transactions that may affect basis. Given the number of tiered partnerships involved in commercial transactions, it may be difficult to obtain accurate information for applying the MOB Method.

Further, many partnerships use the Transactional Approach to maintain 704(b) capital accounts and tax basis capital accounts. In our view, this information is likely to provide the government with the same quality of information it would receive from the
other methods (the MOB Method or MPTC Method). For this reason, we believe that the extra burden that would be imposed on partnerships from having to comply with the other methods, while maintaining a parallel system of tracking section 704(b) and section 704(c) as required by subchapter K, outweighs the benefit to the government.

In that regard, we note that the use of the MPTC Method could be extremely time consuming and costly because it requires a calculation similar to a section 743(b) adjustment for all partners, each year. We acknowledge that basis adjustments under section 743(b) have been required for some time. However, those adjustments only apply in the limited circumstance in which there is a transfer of an interest and the partnership has a substantial built-in loss. Moreover, the adjustment is required to be made only with respect to the transferee partner, not all partners. If the Transactional Approach is not allowed, those partnerships that cannot use the MOB Method would be required to use the MPTC Method, which would subject them to significant additional compliance burden and expense.

Although we generally believe partnerships should be required to be consistent in their use of a permitted method, we believe an exception is permitted as partnerships transition to complying with the new requirement. That is, while many partnerships have used the Transactional Approach for purposes of tracking section 704(b) capital accounts, some previously may not have tracked their partners’ tax capital. Due to a lack of historical data or complexity in gathering it, it may not be feasible to retroactively use the Transactional Approach for this purpose. For those partnerships, we recommend allowing the use of one of the other methods provided in the Notice (the MOB Method or the MPTC Method) as a starting point and permitting the Transactional Approach to be used on a going forward basis. This would provide consistency in the estimates of partners’ outside bases while not imposing additional burden by requiring entirely new systems to be implemented.

D. Naming Convention

Lastly, we agree with the Notice’s approach of not defining tax basis capital and recommend that any subsequent guidance make clear that the information being provided to satisfy the Tax Capital Reporting Requirement is not a representation that the number reflects a partner’s actual outside basis, as that is an independent computation to be made at the partner level. As a matter of practice, partnerships often do not keep track of their partners’ outside bases, and partners do not rely on their partnerships for outside basis information, so any inference that the information being provided to the Service by a partnership constitutes partners’ outside basis would change the dynamics between partnerships and partners. To avoid confusion, we recommend that the information provided be referred to using terms other than “tax basis.” In that regard, we recommend the use of terms aligned with concepts of tax equity, such as the “partner’s estimated tax equity” or (“PETE”). The concept of tax equity is more in line with the amount calculated under the MOB Method, which requires the reduction of the partners’ outside basis by its share of partnership liabilities, suggesting a net equity concept.