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August 11, 2017

The Honorable David J. Kautter
Assistant Secretary, Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William M. Paul
Chief Counsel (Acting)
Internal Revenue Service
U.S. Department of the Treasury
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments Regarding Centralized Partnership Audit Regime (REG-136118-15)

Dear Assistant Secretary Kautter and Chief Counsel Paul:

The Real Estate Roundtable appreciates the opportunity to submit comments on the Notice of Proposed Rulemaking regarding the Centralized Partnership Audit Regime.

Real estate partnerships represent nearly half of the 3.6 million partnerships in the United States. They include a wide variety of arrangements that range from two friends who purchase, improve, and lease a modest rental property to a large private real estate fund that raises capital from sophisticated institutional investors to develop large, mixed-use structures requiring years, if not decades, to plan, permit, and construct. In 2015, in response to widespread government concerns with the challenges of administering partnership tax rules, The Roundtable actively contributed to the development and modification of partnership audit reform legislation. The Roundtable continues to believe the new regime, if properly and fairly implemented, will address longstanding problems associated with the *Tax Equity and Fiscal Responsibility Act of 1982* (*TEFRA*), while preserving the fundamental precepts of entity choice and pass-through taxation that give root to American entrepreneurship and capital formation.

Critical to the success of partnership audit reform is a recognition by Treasury and the IRS that Congress did not intend in the *Bipartisan Budget Act of 2015* (*BBA*) to replace pass-through taxation with an entity-level tax on partnerships. Congress intended to permit partnerships to push adjustments through multiple-tiered partnerships. This is evident in recent bipartisan, bicameral technical corrections legislation, as well as post-enactment statements from the drafters.

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A mandatory, entity-level tax would arise if partnership representatives could not elect to push partnership adjustments through tiered partnerships. Simply stated, the notion that the tax is "passing through" to the appropriate partner would no longer apply. As time passed, prior tax liabilities would follow the entity, not the taxpayer. The tax burden would shift from the economic beneficiary of the underlying income to future, unsuspecting partners.

This outcome, unintended by Congress, would dramatically change the economic analysis and valuation of partnership interests and the liabilities associated with a partnership investment. The partnership tax structure would pose greater risks for investors, reducing its appeal. For example, a new partner's investment could be lost due to mismanagement of the partnership in prior years by a partner who has long since moved on and is no longer affiliated with the business.

The Department of Treasury should take great care in the partnership audit reform rule-making process in order to avoid unnecessary determinations that threaten the fundamental structure of partnership tax law. The ability to use the pass-through, partnership form to flexibly and effectively raise capital and conduct business is one of the hallmarks of the American economic model. Partnership taxation is a critical part of our "intangible infrastructure": the legal, regulatory, and tax system that makes the United States the envy of the world when it comes to entrepreneurship, risk-taking, and productive investment. Erosion of pass-through taxation and the partnership form, as outlined above, could undermine productivity growth, job creation, and American enterprise.

The proposed regulations under section 6226 reserved on the application of the push-out method to tiered partnerships, in part because of statutory ambiguities but also because of a number of practical issues and concerns. Treasury and the IRS can address administratively the issues raised in the preamble to the proposed regulations, and in other statements related to the application of the push-out method for tiered partnerships, without imposing undue tax burdens on partners and partnerships.

For example, under one approach, described in greater detail in comments submitted by RSM Principal and Real Estate Roundtable Tax Policy Advisory Committee member Donald Susswein, Treasury could issue regulations under section 6225(c)(6) or section 6227(b)(2) authorizing a new "Early Decision" procedure for pushing-out audit adjustments in tiered structures in order to address the administrative concerns of the IRS.

In general, if a taxpayer elected to use the Early Decision option, the push-out process for a tiered structure would begin approximately one year earlier than it would otherwise begin under the statutory provisions of section 6226. The accelerated timetable would address the principal administrative concerns raised by the IRS, specifically the "labor-intensive process of tracking, validating, and reconciling adjustments and payments through countless tiers." In short, partnership representatives would undertake the labor-intensive process themselves prior to closure of the audit. The determination and payment of partner-level tax liabilities would then operate within the existing, long-standing self-assessment system, the same way it operates with original returns, or with a single-tier push-out. However, in specific response to the concerns raised in the preamble about tiered push-outs, Early Decision would provide the IRS audit team—to the extent they deem it necessary—with a greater ability to review and approve preliminary or "draft" push-out statements by the partnership-partners (PSPs) in a tiered structure before the statements are issued in final form. In our view, such pre-issuance review probably would not be needed, but at least the IRS would have a structured process within which they could conduct such a review, if desired.

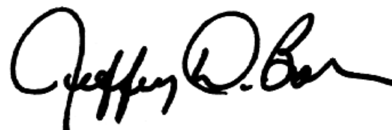
Partnership representatives would have a strong incentive to participate in Early Decision. The *BBA* included a 2% additional interest charge for taxpayers that use the push-out rules under section 6226. Under Early Decision, the additional 2% interest charge will not apply because Early Decision will be implemented under the authority of sections 6225(c)(6) or 6227(b)(2) of the *BBA*. The added interest charge only applies to tax adjustments pushed out under the authority of section 6226.

Despite this and other attractive features, some partnerships may choose not to participate in Early Decision, but will still elect to apply the push-out method under section 6226 if the technical corrections legislation is enacted. In that event, a similar IRS advance review process could apply. The main difference is that it would not commence as early as Early Decision and will not relieve any direct or indirect partners of the added 2% interest charge that applies under section 6226. Partnerships would be likely to participate in Early Decision, to the mutual benefit of the IRS and taxpayers.

The problems with *TEFRA* and the pre-*BBA* rules for auditing large and complex partnerships are well-known and well-documented. However, the original version of partnership audit reform was overreaching and would have stifled capital formation and economic activity. The final legislation sought to find an appropriate balance between taxpayer burdens and administrative concerns. Implementation of the new law will take time—it may be the most significant change in tax administration in over 20 years. Creating a set of rules for the push out of tax adjustments through tiered partnerships that works for taxpayers and avoids a mandatory, entity-level tax is critical to the long-term success of the new partnership audit regime.

Thank you in advance for your consideration of these comments.

Sincerely,



Jeffrey D. DeBoer
President and CEO

JDD/lh