October 9, 2018

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Re: Proposed Regulations (REG-136118-15) Regarding the Centralized Partnership Audit Regime

Dear Mmes. Porter and Zuba

The American Institute of CPAs (AICPA) offers the following comments and recommendations related to the notice of proposed rulemaking REG-136118-15 issued August 17, 2018 by the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) on the Centralized Partnership Audit Regime (the "Regime").

Specifically, we provide recommendations on the following issues related to the Regime:

1) Allocation of distributive shares in situations where neither the partner during the year under audit ("the reviewed year") nor their successor is identifiable;

2) Rule regarding subgrouping of reallocation and recharacterization adjustments;

3) Requirements related to requests for modifications under section 6225;[1]

4) Guidance related to filing of amended returns and the alternative filing procedures under section 6225;

5) Timing and procedures for submission of partner-level defenses;

6) Correcting errors in statements issued to reviewed year partners under section 6226 requiring those partners to report and pay any additional tax ("the push-out" election);

7) Application of taxes imposed by Chapter 2 and 2A of the Internal Revenue Code (IRC or "Code") to audit adjustments under the Regime;

8) Effect of provisions enacted under Pub. L No. 115-97 (commonly referred to as the Tax Cuts and Jobs Act (TCJA)) on audit adjustments under the Regime;

[1] All references herein to "section" or "§" are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.

9) Adjustment of partnership and partner-level tax attributes;

10) Interest on overpayments claimed by partner on required section 6226 reporting year returns;

11) Access to the IRS Office of Appeals ("Appeals") by partnerships subject to audit under the Regime; and

12) Substantial compliance with section 6226 filing and reporting requirements.

* * * * *

The AICPA is the world's largest member association representing the accounting profession, with more than 431,000 members in 137 countries and territories, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please feel free to contact Michael Greenwald, Chair, AICPA Partnership Taxation Technical Resource Panel, at (212) 842-7513 or MGreenwald@friedmanllp.com; Jonathan Horn, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204 or Jonathan.Horn@aicpa-cima.com; or me at (408) 924-3508 or Annette.Nellen@sjsu.edu.

Respectfully submitted,

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AMERICAN INSTITUTE OF CPAs

Comments on the Proposed Regulations (REG-136118-15) Regarding the Centralized Partnership Audit Regime

October 9, 2018

1. Allocation of distributive shares in situations where neither the reviewed year partner nor their successor is identifiable

OVERVIEW

Generally, the proposed regulations require that adjustments are allocated to the original reviewed year partner or their identified successor(s). Proposed Reg. § 1.704-1(b)(1)(vii)[2] provides rules for situations where the successor to a reviewed year partner is unidentifiable or a reviewed year partner's interest was entirely liquidated by the partnership.

RECOMMENDATION

The AICPA recommends that the IRS clarify which factors taxpayers should consider in determining the allocable shares for each specified partner treated as a successor partner under Prop. Reg. § 1.704-1(b)(1)(vii)(3) and Prop. Reg. § 1.704-1(b)(1)(vii)(4). In addition, we recommend that the IRS provide examples of the proper application of these rules in the final regulations.

ANALYSIS

Proposed Reg. § 1.704-1(b)(1)(vii)(3) states, in part, "*each partner in the adjustment year that is not an identifiable transferee partner and was not a partner in the reviewed year, (an unidentifiable transferee partner) is a successor to* ***the extent of the proportion of its interest in the partnership to the total interests of unidentifiable transferee partners in the partnership (considering all facts and circumstances***" (emphasis added).

Similarly, Prop. Reg. § 1.704-1(b)(1)(vii)(4) states, in part, "*The determination of the extent to which the adjustment year partners are treated as successors under this section must be made in a manner that reflects* ***the extent to which the adjustment year partners' interests in the partnership increased as a result of the liquidating distribution (considering all facts and circumstances)***" (emphasis added).

Taxpayers require guidance to determine which factors to use to properly allocate shares for each specified partner treated as a successor partner under the proposed regulations. Possible solutions include the specified partner's relative capital accounts, their relative profit interests, their relative allocable share in the reviewed year of the original item subject to adjustment (if determinable) or

[2] All references herein to "section" or "§" are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.

their relative allocable share in the year during which the adjustment becomes final ("the adjustment year") of item or items similar in character to the adjustment items.

2. Rule regarding subgrouping of reallocation and recharacterization adjustments

OVERVIEW

Generally, reallocation and recharacterization adjustments are placed into two separate subgroupings for purposes of the Regime – one containing the positive adjustment and one containing the negative adjustment. Under certain conditions described below, the proposed regulations indicate that multiple reallocation or recharacterization adjustments are eligible for placement into the same subgrouping.

RECOMMENDATION

The AICPA recommends that the IRS clarify whether and under what conditions positive and negative adjustments resulting from different reallocation or mechanization adjustments are permissibly placed into the same subgrouping.

ANALYSIS

Proposed Reg. § 301.6225-1(d))(3)(ii) states, in part, "*If a particular partner or group of partners has two or more reallocation adjustments allocable to such partner or group, such adjustments may be subgrouped in accordance with paragraph (d)(3)(i) of this section and netted in accordance with paragraph (e) of this section.*"

Similarly, Prop. Reg. § 301.6225-1(d))(3)(iv) states, in part, "*If a particular partner or group of partners has two or more recharacterization adjustments allocable to such partner or group, such adjustments may be subgrouped in accordance with paragraph (d)(3)(i) of this section and netted in accordance with paragraph (e) of this section.*"

In both cases, the proposed language seems to allow the inclusion in the same subgrouping of unrelated positive and negative adjustments provided that all of the adjustments apply to a particular partner or group of partners.

For example, Partnership P has three equal partners – A, B and C. The IRS proposes two reallocation adjustments. The first adjustment reallocates $100 of income from partner B to partner A. The second adjustment reallocates $40 of expense from partner C to partner A. It appears from the language of the proposed regulations that three subgroupings will result. One subgrouping containing the positive adjustment of $40 for partner C, a second subgrouping containing the negative adjustment of $100 for partner B and a third subgrouping for partner A. The subgrouping for partner A results in a net positive adjustment of $60, reflecting net result of the positive adjustment to income of $100 and the negative adjustment of $40 to expense.

Assuming partners A and B file amended returns, it appears that the partnership may request a modification for both sides of the reallocation adjustment related to the $100 income. Further, it

appears that the partnership is liable for the net increase in tax ("the imputed underpayment") based on the positive reallocation adjustment subgrouping assigned to partner C of $40.

We suggest that the final regulations include examples clarifying the proper grouping and netting of adjustments pursuant to Prop. Reg. § 301.6225-1(d)(3).

3. Requirements related to requests for modifications under section 6225

OVERVIEW

Proposed Reg. § 301.6225-2 sets forth the requirements for an audited partnership to request modification of the imputed underpayment determined on a Notice of Proposed Partnership Adjustment (NOPPA) issued following the examination. The proposed regulations describe the type of modifications the IRS will consider, the requirement documentation to support such requests and the timing of the process.

RECOMMENDATION

The AICPA recommends that the IRS modify Prop. Reg. § 301.6225-2(c)(2)(ii) to limit the required information submitted with any modification request to that specific information relevant to the type of modification requested.

ANALYSIS

Proposed Reg. § 301.6225-2(c)(2)(ii) states "In the case of **any modification request**, the partnership representative must furnish to the IRS **a detailed description of the partnership's structure, allocations, ownership, and ownership changes**, its relevant partners for each taxable year relevant to the request for modification, as well as **the partnership agreement as defined in §1.704-1(b)(2)(ii)(h) of this chapter for each taxable year relevant to the modification request**" (emphasis added).

Treasury Reg. §1.704-1(b)(2)(ii)(h) defines the partnership agreement as follows:

> "*For purposes of this paragraph, the partnership agreement includes all agreements among the partners, or between one or more partners and the partnership, concerning affairs of the partnership and responsibilities of partners, whether oral or written, and whether or not embodied in a document referred to by the partners as the partnership agreement…. In addition, the partnership agreement includes provisions of Federal, State, or local law that govern the affairs of the partnership or are considered under such law to be a part of the partnership agreement.*"

Requiring extensive and detailed documentation for each modification request will limit the ability of some partnerships to take advantage of this procedure. Such extensive detail on most aspects of a partnership's operations is not relevant to a request for rate modification based on the existence of a direct corporate partner.

We urge the IRS to establish realistic minimal documentation requirements for any modification request and create additional specific relevant requirements for the various types of modification requests permitted under the proposed regulations. The ability of the IRS to request supplemental information prior to approval (as expressed in Prop. Reg. § 301.6225-2(c)(4)) will ensure that they obtain documentation that they deem necessary for a particular set of facts and circumstances.

RECOMMENDATION

The AICPA recommends that the IRS define fair market value (FMV), solely for purposes of Prop. Reg. § 301.6225-1(b)(3)(iv) related to rate modifications and special allocations, as an easily determined amount. As one possibility, the IRS could allow the use of section 704(b) basis in determining FMV for purposes of this provision. The IRS could also eliminate the need to determine FMV by placing the portion of an adjustment requiring special allocations into a separate subgrouping.

We further recommend that regardless of how FMV is determined for purposes of this provision, such an action is not considered a revaluation for purposes of section 704.

ANALYSIS

Proposed Reg. § 301.6225-1(b)(3)(iv) describes the rules for requesting a rate modification based on the type of partner allocated an adjustment or character of the adjusted income in cases where a special allocation may apply. The requirement to determine the partner's distributive share based on a hypothetical sale of all partnership assets at FMV as of the close of the reviewed year is administratively burdensome and difficult to apply many years after the calculation date. The statutory language appears to mandate such an approach. However, FMV is undefined in both the statute and the proposed regulations and therefore, will generate significant disputes between the IRS and partnerships.

To simplify the administration of this provision, the IRS should define FMV, solely for purposes of this provision, as a more easily determined amount, such as by using section 704(b) basis. Alternatively, the IRS should permit a partnership to request that the adjustment items which are subject to a special allocation are placed into a separate subgrouping rather than require the FMV calculation. In this manner, the adjustment is allocated solely to the affected partners in the appropriate manner and the request for modification is considered separately from requests related to other portions of the adjustments.

RECOMMENDATION

The AICPA requests that the IRS provide clarification on the effect of various actions on the timeframe for requesting modifications, providing required information to the IRS and for the IRS to approve or deny modification requests.

ANALYSIS

Proposed Reg. § 301.6225-2(c)(3) provides, in part, that "***all information required*** *under this section with respect to a request for modification must be submitted to the IRS in the form and manner prescribed by the IRS* ***on or before 270 days after the date the NOPPA is mailed***" (emphasis added). Proposed Reg. § 301.6225-2(c)(4) provides, in part, that "*notification of approval will be provided to the partnership only after receipt of all relevant information* ***(including any supplemental information required by the IRS)*** *and all necessary payments with respect to the particular modification requested before expiration of the 270-day period*" (emphasis added).

While a partnership may request, and the IRS may grant, an extension of the 270-day modification period described in these sections, any such extension is granted solely at the discretion of the audit examiner. To help ensure that the modification request process takes place in a fair and equitable manner, without delays by the IRS or the partnership, we suggest that the final regulations should provide for the following:

- A specified timeframe in which the IRS must respond to a request for modification;
- If there is a pending request for modification at the expiration of the 270-day period, the IRS will automatically agree to an extension of that period until at least 30 days after they provide their response; and
- A specified timeframe for a partnership to respond to an IRS request for additional information during their review of a modification request. We suggest a minimum of 60 days. This issue is particularly significant if the request occurs near the expiration of the 270-day period;

RECOMMENDATION

The AICPA requests that the IRS clarify that a tax-exempt partner is not required to file an amended return or alternative "pull-in" statement as part of a request for modification of a reallocation or recharacterization adjustment unless the adjustment item is considered Unrelated Business Taxable Income (UBTI).

ANALYSIS

Generally, for the IRS to approve a modification request related to a reallocation or recharacterization adjustment, amended returns or alternative "pull-in" statements are required from all the affected partners. In cases where one or more of the affected partners are tax-exempt entities, as defined in Prop. Reg. § 301.6225-2(d)(3)(ii), the filing requirement imposes an unnecessary burden on taxpayers with no added benefit to the IRS. The IRS should provide that a partnership request for a reallocation or recharacterization modification related to a tax-exempt partner satisfies the amended return requirement by submitting the information required under Prop. Reg. § 301.6225-2(d)(3).

4. Guidance related to filing of amended returns and the alternative filing procedures under section 6225

<u>OVERVIEW</u>

One of the types of modification requests permitted involves the filing of amended returns or the use of an alternative to filing amended returns (commonly referred to as the "pull-in" option. Further guidance is needed in the final regulations on certain aspects of the procedures for filing the required information with the IRS, as well as the impact on taxpayers taking advantage of this process.

<u>RECOMMENDATION</u>

The AICPA recommends that the IRS include in the final regulations that a de minimis shortfall of interest or penalties resulting from a good faith effort by a taxpayer to calculate the correct amount shall not result in a denial of a modification request.

<u>ANALYSIS</u>

Proposed Reg. § 301.6225-2(d)(2)(ii) provides, in part, "*An amended return modification request …will not be approved unless the relevant partner filing the amended return has* ***paid all tax, penalties, additions to tax, additional amounts, and interest due*** *as a result of taking into account the adjustments …at the time such return is filed with the IRS*" (emphasis added).

In our experience, taxpayer calculated amounts of interest and penalties imposed on underpayment of taxes rarely precisely equals the same calculation when made by the IRS. Proper application of day counts, correct compounding, and simple math errors all contribute to these mis-matches.

It is likely that these minimal and unintentional shortfalls are not discovered until near the end or after the 270-day modification period. Disapproval or revocation of a prior approval in such a case would unfairly penalize a partnership and their partners.

<u>RECOMMENDATION</u>

The AICPA recommends that the IRS ease the restriction on the ability of a taxpayer using the amended return modification procedure to file subsequent amended returns when the subsequent amended return does not affect the items included in the partnership's audit adjustments.

<u>ANALYSIS</u>

Proposed Reg. § 301.6225-2(d)(2)(vii)(B) provides that "*If a relevant partner files an amended return under paragraph (d)(2) of this section, such partner may not file a subsequent amended return without the permission of the IRS.*"

There are multiple scenarios in which a relevant partner may find it necessary to file a subsequent amended return unrelated to the audit adjustments reported on the modification period amended

return. For example, a taxpayer might have an obligation to file an amended return upon receipt of an amended information return from a broker, financial institution, or another pass-through entity, as well as have an interest in a different partnership which is the subject of a separate audit under the Regime.

In all three of the examples cited above, there is a significant likelihood that the taxpayer's subsequent amended return will reflect an addition to tax and require an additional payment to the IRS. Requiring a taxpayer to request permission from the IRS in these situations is an administrative burden in terms of time and resources by both the taxpayer and the IRS.

Furthermore, the possibility that the IRS might deny permission if the unrelated changes result in a refund due to the taxpayer is unreasonable and inequitable.

RECOMMENDATION

The AICPA requests that the IRS clarify in the final regulations, the interaction of the alternative procedure with other provisions described in the proposed regulations, when filing amended returns.

ANALYSIS

The following uncertainties that require clarification as a result of the language in Prop. Reg. § 301.6225-2(d)(2)(x):

- The proposed regulations state that "A modification request submitted in accordance with the alternative procedure under this paragraph (d)(2)(x) is not a claim for refund with respect to any person." It is unclear if this language indicates that a taxpayer reporting a negative reallocation or recharacterization adjustment is not eligible to use the alternative "pull-in" procedure.

- It is unclear if using the alternative "pull-in" procedure trigger the "no further amended return" restriction described in Prop. Reg. § 301.6225-2(d)(2)(vii)(B).

RECOMMENDATION

The AICPA requests that the IRS provide clarification of the ability of a partner (filing amended returns or alternative "pull-in" statements as part of the modification process) to obtain refunds of overpayments in the following situations:

- The modification request related to the amended return or alternative "pull-in" statement is denied by the IRS;

- The Appeals office modifies the NOPPA in the taxpayer's favor upon which the amended return or alternative "pull-in" statement was based; and

- The partnership appeals the Notice of Final Partnership Adjustment (FPA) in Tax Court and the FPA is adjusted in the taxpayer's favor.

ANALYSIS

The information reported on an amended return or the alternative "pull-in" statement along with payment of any additional tax imposed during the modification period, is based on the NOPPA, which does not necessarily represent the final adjustments determined after a review by Appeals or the Tax Court. Further, the IRS may deny a modification request based upon these already filed returns or statements.

In the case of a denial of the modification request by the IRS, the audited partnership must pay an imputed underpayment amount calculated on adjustments already taken into account by the amended return filer resulting in the imposition and payment of double tax on the same adjustment. The IRS should establish a procedure and timeframe for the amended return filer to request a refund and expeditiously grant such a request.

In the case of a reduction in the amount of the relevant adjustment by Appeals or the Tax Court, a procedure must exist for the amended return filer to modify their filing and expeditiously receive a refund of the tax previously paid on the taxable favorable adjustments made by Appeals or the Tax Court. Without such a mechanism, the IRS will have collected an overpayment of tax based on an invalid assessment.

In both cases, it is critical that the IRS clarify that any relevant statute of limitations provisions which might normally preclude a taxpayer's refund request is suspended.

Finally, the ability of a taxpayer to request a refund of any duplicative payment of overpayment of tax is also applicable to any interest, penalties or addition to tax related to the same adjustments.

5. Timing and procedures for submission of partner-level defenses

OVERVIEW

The proposed regulations only allow partner specific penalty defenses (such as, reasonable cause or good faith) if the partner first pays the tax and penalty due and then files a claim for refund.

RECOMMENDATION

The AICPA recommends allowing the audited partnership to submit partner-level defenses for both direct and indirect partners as part of the modification process. A review by the IRS prior to requiring payment of the proposed penalties will permit an early determination regarding the validity of any partner-level defense and reduce the economic and administrative burdens on taxpayers.

The AICPA further recommends that in the case of a partnership electing the application of the section 6226 "push-out" procedures, allowing the direct and indirect partners to submit a statement supporting a partner-level defense with their reporting year return prior to requiring payment of the proposed penalty.

ANALYSIS

Proposed Reg. § 301.6225-2(d)(2)(viii) states, in part, "A relevant partner may raise a partner-level defense (as described in §301.6226-3(d)(3)) by first paying the penalty, addition to tax, or additional amount with the amended return filed under this paragraph (d)(2) and then filing a claim for refund in accordance with forms, instructions, and other guidance.

Proposed Reg. § 301.6226-3(d)(3) provides that a partner claiming a partner-level defense for the imposition of a penalty, addition to tax, or additional amount that relates to an adjustment reported on a section 6226 "push-out" statement must first pay the penalty and then file a claim for refund.

Since penalties can represent a large dollar amount, the requirement that taxpayers must provide advance payment of penalties, even in cases where they have a valid penalty defense, can create a significant economic burden on them. Furthermore, this requirement for prepayment of penalties and filing a claim for refund is contrary to the procedures in place for similar scenarios involving amended returns and audit adjustments.

6. Correcting errors in section 6226 push-out statements to partners

OVERVIEW

Proposed Reg. § 301.6226-2(d)(2) provides rules related to errors discovered by a partnership on the required statements submitted to partners under the section 6226 "push-out" procedures. For errors discovered within 60 days of the statement's due date, a partnership is required to correct the error without seeking IRS approval. For errors discovered more than 60 days after the statement's due date, the partnership must first obtain the consent of the IRS before issuing corrected statements.

Proposed Reg. § 301.6226-2(d)(3) provides rules for errors discovered by the IRS on the required statements submitted to partners under the section 6226 "push-out" procedures. In this situation, the IRS "may" require a partnership to issue corrected statements but is not obligated to permit the partnership to correct any errors.

In cases where the IRS denies a partnership the ability to issue corrected statements, it appears that no change to the amount of tax collected by the IRS occurs. Neither the partnership nor the partners appear obligated to pay any potential additional liability nor is the IRS required to refund any potential overpayment.

RECOMMENDATION

The AICPA recommends that the IRS modify the process and timing for all three correction scenarios described in the proposed regulations.

For errors discovered by the partnership, the partnership should have an automatic obligation and right to issue corrected statements for errors discovered no later than 60 days after the extended due date of the audited partnership's adjustment year tax return. For errors discovered by the partnership after this date, we suggest that the partnership must notify the IRS. Unless the IRS objects within 90 days of such notification, the partnership shall file the corrected statements. If the IRS issues a denial within the 90-day period, such denial shall include an explanation for the decision and the partnership shall have the ability to challenge the decision with Appeals.

For errors discovered by the IRS, the IRS may not unreasonably refuse to permit a partnership to issue corrected statements if correction of the error shall result in a reduced tax liability by the affected partners or correct the allocation of an adjustment between partners.

ANALYSIS

Audited partnerships will face intense pressures to calculate and issue statements to their direct partners within a short period of time following issuance of an FPA. In addition, pass-through partners, many of whom will have no knowledge of the audit's existence until receiving a "push-out" statement, will face equally short time constraints to make the "pay or push-out" decision and issue any required statements to their partners.

The potential for inadvertent errors occurring, particularly in audits involving multiple imputed underpayments, special allocations or other similarly complex issues, is significant. In some cases, discovery of the error will not take place until after statements were provided to indirect partners through multiple pass-through partners in a tiered structure.

The goal of an audit is to ensure that the correct amount of tax is collected from the correct taxpayer. Failure to permit a partnership to correct inadvertent errors which occur during the section 6226 "push-out" process appears contrary to that goal. Additionally, a violation of the IRC may result if a taxpayer is not permitted to correct an error resulting in the overpayment of tax.

7. Application of taxes imposed by Chapter 2 and 2A of the IRC to audit adjustments under the Regime

OVERVIEW

According to the preamble of the proposed regulations, section 6241(7)(a) provides that the Regime shall not apply to taxes imposed under Chapter 2 or 2A of the IRC, but "that any partnership adjustment determined under the centralized partnership audit regime for purposes of chapter 1 shall be taken into account for purposes of determining any such tax to the extent that such adjustment is relevant to such determination." The preamble further notes that section

6501(c) (12) establishes "the statute of limitation on assessment of taxes under chapter 2 or 2A which are attributable to any partnership adjustment."

RECOMMENDATION

The AICPA requests clarification on how the IRS intend to apply section 6241(7)(a) in the context of adjustments imposed under the Regime and taxes imposed under Chapter 2 and 2A.

ANALYSIS

Neither the statute nor the proposed regulations include any further information related to the obligation of taxpayers to calculate and pay the appropriate additional amounts of tax under Chapters 2 and 2A. The examples provided in Prop. Reg. § 301.6241-7(b)(2) relate to the imposition of tax under Chapters 3 and 4 of the IRC and are not relevant in this context.

Without guidance, taxpayers remain uncertain how and when they are required to take adjustments under the Regime into account to determine any additional tax liability under Chapters 2 and 2A. This lack of clarity leads to the potential for unintentional errors by otherwise compliant taxpayers, imposition of unwarranted penalties and confusion. Specifically, we request that the IRS address the following questions:

- Are taxpayers filing amended returns or alternative" pull-in" statements as part of a modification request expected to calculate and pay the appropriate additional amounts of tax under Chapters 2 and 2A?
- If yes, would a failure to take such action invalidate an otherwise valid modification request?
- Are taxpayers submitting adjustment statements under section 6226 as part of their reporting year tax report expected to calculate and pay the appropriate additional amounts of tax under Chapters 2 and 2A?
- If taxpayers fail to calculate and pay the appropriate additional amounts of tax under Chapters 2 and 2A will the IRS automatically issue assessments against those taxpayers?
- Does the IRS intend to issue such assessments using their Math Error Authority?
- Under what conditions, if any, does the IRS anticipate pursuing the additional amounts of tax potentially due under Chapters 2 and 2A from direct and indirect partners of a partnership which pays the imputed underpayment amount directly under section 6225?

8. Effect of provisions enacted under the TCJA on audit adjustments under the Regime

OVERVIEW

The TCJA contains new provisions which directly impact partnerships and the distributive shares of income and expenses to their partners. Section 163(j) concerning interest expense limitations and section 199A concerning the deduction for Qualified Business Income contain significant new partnership specific reporting and calculation elements.

RECOMMENDATION

The AICPA requests that the IRS include in the final regulations guidance on the impact of the new partnership related provisions of the TCJA, including examples of how the Regime's adjustments to partnership items and tax attributes specific to these new provisions are treated under sections 6225 and 6226 by partnerships and their partners.

ANALYSIS

The creation of entirely new reporting and calculation procedures for partnerships under certain provisions of the TCJA present significant challenges for taxpayers in determining the proper treatment of adjustments related to those provisions made under the Regime. These challenges exist regardless of whether a partnership elects to pay an imputed underpayment under section 6225 (both with and without any modification requests) or issue "push-out" statements under section 6226.

A central concern with several of these new provisions is that partnership items are treated under both the entity and aggregate concepts at the same time.

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9. Adjustment of partnership and partner-level tax attributes

OVERVIEW

The Regime, under section 6225, generally provides that a partnership is liable for the imputed underpayment resulting from adjustments to items of income, gain, loss, deduction, or credit of a partnership during the reviewed year. The partnership becomes liable for the imputed underpayment in the adjustment year. A partnership may request a reduction of the imputed underpayment through the application of various modifications under rules detailed in section 6225 and the related proposed regulations. Alternatively, a partnership may elect the section 6226 "push-out option" and have its reviewed year partners report the partnership's adjustments made by the IRS and pay any additional tax.

Under the proposed regulations, when a partnership pays the imputed underpayment under the rules of section 6225, an exclusive list of tax attributes ("specified tax attributes") requires adjustment for adjustment year partners. Pursuant to Prop. Reg. § 301.6225-4(a)(2) specified tax attributes are defined as "*the tax basis and book value of a partnership's property, amounts determined under section 704(c), adjustment year partners' bases in their partnership interests,*

and adjustment year partners' capital accounts determined and maintained in accordance with § 1.704-1(b)(2)."

Proposed Reg. § 301.6225-4, and the proposed amendments to Treas. Reg. § 1.704-1, Treas. Reg. § 1.705-1, and Treas. Reg. § 1.706-4 establish rules for partnerships and their partners to adjust these specified tax attributes related to the following scenarios:

- The adjustment of partnership asset basis and book value, along with the creation and allocation of notional items for purposes of affecting partner-level specified tax attributes;
- Situations in which reviewed year partners are not also adjustment year partners through a set of "successor" rules; and
- The allocation and treatment of any partnership expenditure (such as additional tax, interest and penalties) related to the imputed underpayment.

RECOMMENDATION

The AICPA recommends that the IRS provide a flexible procedure for applying audit adjustments to the tax attributes of audited partnerships and their partners.

ANALYSIS

When an audited partnership pays an imputed underpayment resulting from an audit, the proposed regulations provide mechanical rules to apply adjustments to specified tax attributes of the partnership and its partners to prevent the double taxation of income and ensure that the economic effect of the audit adjustment is properly reflected in the books and records of relevant taxpayers. The underlying premise of the proposed regulations – partnership adjustments made to the reviewed year's tax return result in the applications of adjustments to specified tax attributes to the adjustment year's accounts – does not always result in basis adjustments that benefit the appropriate partner or reflect the true economic impact of the changes. These issues are pronounced when partners from the reviewed year are no longer partners in the adjustment year or a significant shifting in the capital account allocations of the partners has occurred. Transactions involving property or partnership interests occurring in the intervening years between the reviewed year and the adjustment year result in further complications. The proposed regulations can become burdensome and inaccurate in the adjustment of basis and other specified tax attributes.

Additional issues arise in the case of a liquidation of a partner's entire interest in the partnership during or subsequent to the reviewed year. As stated in Prop. Reg. § 1.704-1(b)(4):

> *"the determination of the extent to which the Adjustment Year Partners are treated as successors under this section must be made in a manner that reflects the extent to which the Adjustment Year Partners' interests in the partnership increased as a result of the liquidating distribution (considering all facts and circumstances)."*

The language of this proposed rule is vague and will prove difficult to implement in many circumstances.

We recognize the difficulties involved in developing mechanical rules to determine the appropriate application of basis adjustments following completion of an audit under the Regime. A major contributor to the complexity involved is the myriad of relevant transactions that can occur between the reviewed year and the adjustment year. Instead of attempting to apply static mechanical rules which may result in unfair and illogical results, we recommend providing a flexible procedure that recognizes the potential need for unique adjustments in each situation.

Specifically, we recommend that as part of the modification process, the Partnership Representative should propose to the IRS examiner adjustments to tax attributes (including, but not limited to, "the tax basis and book value of a partnership's property, amounts determined under section 704(c), adjustment year partners' bases in their partnership interests, and adjustment year partners' capital accounts determined and maintained in accordance with § 1.704-1(b)(2)") of the audited partnership and its partners. The proposed adjustments to these tax attributes should properly reflect the audit adjustments, minimize the potential for double taxation or double allowance of a deduction and represent a reasonable attempt to allocate the economic effects of the audit to the proper reviewed year partner or their successor.

We support the method proposed by the IRS of using notional items to accomplish the allocation of adjustment items to the appropriate partners. Such a system will permit the necessary adjustments to partnership and partner tax attributes, while avoiding further tax complications under subchapter K.

The IRS examiner would approve or recommend changes to the proposal as part of the modifications approval process. Both the examiner and the Partnership Representative would need to approve in writing any original or modified proposal. If no agreement was reached prior to the issuance of the FPA, then the partnership would by default use the push-out option for any adjustments related to the remaining imputed underpayment amounts.

A flexible procedure to apply audit adjustments to the tax attributes of audited partnerships and their partners would provide the IRS and the partnership the ability to account for any unique circumstances or adjustment types without the restrictions inherent in a strict mechanical rule, as described in the proposed regulations.

RECOMMENDATION

The AICPA recommends that the IRS should provide audited partnerships an elective "simplified tax attribute adjustment procedure" (STAAP) under certain conditions.

Under this procedure, a partnership could apply the audit adjustments and non-deductible payment of tax, interest and penalties to the tax attributes of the adjustment year partners based upon their capital accounts.

To qualify for this procedure, only audited partnerships that accept limitations on the type of section 6225 modifications that could reduce their imputed underpayment would qualify.

The AICPA also recommends that the IRS provide audited partnerships an elective "enhanced STAAP" which would expand the types of section 6225 modifications allowed. Only audits resulting in unmodified imputed underpayments below a threshold amount would qualify for the enhanced STAAP.

ANALYSIS

In cases where a partnership has only minor audit adjustments to apply to its partners' tax attributes, a simplified method is preferable. We recommend that the IRS establish an elective STAAP, as well as an "enhanced STAAP" for partnerships meeting specified criteria.

In order to qualify for the STAAP election, a partnership could not request modifications to the proposed imputed underpayment other than the rate modifications for corporate partners or for long-term capital gains and qualified dividends adjustments. Under this procedure, a partnership would then allocate the audit adjustments and non-deductible payment of tax, interest and penalties to the tax attributes of the adjustment year partners based upon the end of the adjustment year's section 704(b) capital account percentages.

The enhanced STAAP would allow an audited partnership to request any of the available modifications to the proposed imputed underpayment (such as, amended returns or a tax-exempt partner). To qualify for the enhanced STAAP election, the proposed imputed underpayment amount (as determined on the NOPPA) could not exceed $2,500,000 provided that no adjustment year partner is a tax-exempt partner as defined in section 168(h)(2). If any adjustment year partner is a tax-exempt partner as defined in section 168(h)(2), then the limitation amount is reduced to $500,000. The partnership would allocate any remaining audit adjustments and non-deductible payments of tax, interest and penalties to the tax attributes of the remaining adjustment year partners. Remaining adjustment year partners would consist of those partners (or their successors) for which a modification was not made resulting in the reduction of any portion of a proposed adjustment amount on the FPA.

RECOMMENDATION

The AICPA recommends allowing an allocation of an adjustment to property of similar character following the allocation rules set forth in Treas. Reg. § 1.755-1(c) in cases where adjustments apply to specified tax attributes of partnership property held in the reviewed year, but no longer held in the adjustment year.

ANALYSIS

Proposed Reg. § 301.6225-4(b)(2) provides that a partnership must adjust the book value and tax basis of a partnership's property to reflect any partnership adjustment taken into account in determining the imputed underpayment under Prop. Reg. § 301.6225-1(c). It also indicates that

no adjustments are made with respect to property that was held by the partnership in the reviewed year but is no longer held by the partnership in the adjustment year.

When the property that gave rise to an imputed underpayment that was held by the partnership in the reviewed year is no longer held by the partnership in the adjustment year, the AICPA recommends that the adjustment is appropriately made to property of similar character in the same manner as the rules outlined in Treas. Reg. §1.755-1(c).

Example 1

A, B, and C form partnership PRS in 2019. Each partner contributes $100 for a total of $300 and agree to a one-third sharing in PRS's profits and losses. PRS uses the cash to purchase land (Asset 1) and two pieces of machinery (Assets 2 and 3) for $100 each. On its 2019 tax return, PRS claims a deduction of $300 under the section 168(k) 100% bonus depreciation provision on all three assets. In 2021, PRS sells Asset 1 for $150 and recognizes $150 of gain on its tax return since the tax basis in Asset 1 was $0. The depreciation recapture provisions of section 1245 result in PRS recognizing $100 of the gain as ordinary income and the remaining $50 as capital gain. PRS allocates the income and capital gain amounts proportionately to partners A, B, and C.

In 2022, an examination of PRS's 2019 tax return results in a positive partnership adjustment of $100 since Asset 1 was not qualified property under section 168(k). Since PRS no longer holds Asset 1, PRS is unable to allocate the $100 adjustment to the now disposed of property.

Our recommendation would allow the allocation of the adjustment to Assets 2 and 3 under the rules outlined in Treas. Reg. § 1.755-1(c).

In 2022, the adjusted basis and fair market value of PRS's assets prior to the audit adjustment are as follows:

	Adjusted Tax Basis	Fair Market Value
Asset 2	$ 0	$ 90
Asset 3	$ 0	$ 60
Total	**$ 0**	**$ 150**

Following the rules outlined in Treas. Reg. §1.755-1(c), the $100 adjustment is first allocated between the ordinary income property class and capital gain asset class. The adjustment relates to property that under the "duty of consistency doctrine" is considered ordinary income property under section 1245. Assets 2 and 3 are both ordinary income property subject to section 1245 depreciation recapture (since the inherent gain in each property does not exceed the depreciation previously deducted). The $100 adjustment is allocated between the ordinary income assets (Asset 2 and Asset 3) in proportion to the excess of the fair market value and the adjusted tax basis of each asset. The fair market value of Asset 2 exceeds its adjusted basis by $90. Therefore, the basis of Asset 2 is increased by $60 ($100 multiplied by $90 divided by $150). The fair market value of Asset 3 exceeds its adjusted basis by $60. Therefore, the basis of Asset 3 is increased by $40 ($100 multiplied by $60 divided by $150).

Following the application of the audit adjustments, the adjusted basis and fair market value of PRS's assets are as follows:

	Adjusted Tax Basis	Fair Market Value
Asset 2	$ 60	$ 90
Asset 3	$ 40	$ 60
Total	**$ 100**	**$ 150**

RECOMMENDATION

The AICPA recommends that the IRS allow any reasonable method of applying successor rules for mergers and divisions occurring between the reviewed year and the adjustment year.

ANALYSIS

We urge the IRS to permit maximum flexibility and approve any reasonable method proposed by a partnership for applying the successor rules in the context of mergers and divisions which may have occurred between the reviewed year and the adjustment year.

RECOMMENDATION

The AICPA recommends treating the remittance by a former partner to the partnership (under a reimbursement or indemnification agreement of an allocable share of tax, interest and penalties paid by the partnership under section 6225) as a tax-free receipt by the partnership.

We also recommend that the payment reduce the partnership's section 705(a)(2)(B) expense and that the partnership should allocate the reduction in full to the former partner's successor.

In addition, we recommend that the payment by the former partner is treated as a nondeductible expense by that partner.

ANALYSIS

Proposed Reg. § 301.6241-4(a) provides that payments made by a partnership for an imputed underpayment, interest, penalties or any addition to tax resulting from an adjustment under the Regime are nondeductible. The preamble to the proposed regulations states that when a partnership pays an imputed underpayment under section 6225, it has the effect of converting what is normally a nondeductible partner-level expenditure into a nondeductible partnership-level expenditure. The General Explanation of Tax Legislation Enacted in 2015 ("Bluebook") published by the Joint Committee on Taxation on March 14, 2016, states on page 79:

> *"Partners, former partners, and the partnership may have entered into indemnification agreements under the partnership agreement with respect to the risk of tax liability of former or new partners being borne economically by new or former partners, respectively. Because the payment of tax by a partnership under*

the centralized system is nondeductible, payments under an indemnification or similar agreement with respect to or arising from the tax are nondeductible."

We agree with the statement in the Bluebook and recommend that the appropriate treatment for a remittance by a former partner to the partnership under a reimbursement agreement (or indemnification) for amounts of tax, interest and penalties paid by the partnership under section 6225 is as a tax-free receipt by the partnership that reduces the partnership's section 705(a)(2)(B) expense and is a nondeductible expense to the former partner.

Proposed Reg. § 1.704-1(b)(2)(iii)(f) provides that the allocation of these nondeductible expenditures is substantial only if the partnership allocates the expenditure in proportion to the notional items to which it relates. This treatment is consistent with the flow-through nature of partnerships under subchapter K.

In instances where a former partner remits to the partnership, under a reimbursement agreement (or indemnification), for its share of any such nondeductible expenditure paid by the partnership, we recommend that the resulting reduction in the partnership's section 705(a)(2)(b) expense is allocated in full to the former partner's successor.

The following example demonstrates the application of this recommendation.

Example 2

A and B form partnership PRS in 2019. Each partner contributes $100 for a total of $200 and agree to an equal sharing of PRS's profits and losses. In 2019, PRS received a cash payment for services of $200, which it did not record on its books. PRS reported no income or loss on its 2019 tax return. At the end of year 2019, A sells its entire interest in PRS to C, an unrelated party, for $100 (no gain or loss). At the time of the sale the balance in the assets, capital accounts and outside bases of PRS are as follows:

Partnership (PRS)					**Partners**			
						Outside		
	Basis	Book	Value			Basis	Book	Value
Cash	$ 200	$ 200	$ 200		Partner A	$ 100	$ 100	$ 100
					Partner B	$ 100	$ 100	$ 100
Total	**$ 200**	**$ 200**	**$ 200**		**Total**	**$ 200**	**$ 200**	**$ 200**

In 2021, an examination of PRS's 2019 tax return results in a positive partnership adjustment of $200 of income (cash), creating an imputed underpayment of $74 ($200 multiplied by the highest individual rate of 37%). PRS pays the $74 imputed underpayment. Immediately following the payment, the balance in the assets, capital accounts and outside bases of PRS are as follows:

Partnership (PRS)					Partners			
						Outside		
	Basis	Book	Value			Basis	Book	Value
Cash	$ 326	$ 326	$ 326		Partner C	$ 163	$ 163	$ 163
					Partner B	$ 163	$ 163	$ 163
Total	**$ 326**	**$ 326**	**$ 326**		**Total**	**$ 326**	**$ 326**	**$ 326**

Following completion of the audit, PRS is reimbursed by A (the former partner) under an indemnification agreement for A's share of the imputed underpayment of $37 ($74 multiplied by 50%). PRS allocates the entire amount of the reimbursement to C since the notional income item which gave rise to that portion of the liability was allocated to C, as the successor partner to A. As a result of this allocation, the balance in the assets, capital accounts and outside bases of PRS are as follows:

Partnership (PRS)					Partners			
						Outside		
	Basis	Book	Value			Basis	Book	Value
Cash	$ 363	$ 363	$ 363		Partner C	$ 200	$ 200	$ 200
					Partner B	$ 163	$ 163	$ 163
Total	**$ 363**	**$ 363**	**$ 363**		**Total**	**$ 363**	**$ 363**	**$ 363**

10. Interest on overpayments claimed by partner on required section 6226 reporting year returns

OVERVIEW

The proposed regulations impose interest on any increase in tax for each tax year reported under the section 6226 "push-out" procedures. However, the IRS has determined that they will not pay interest on refunds resulting from a decrease in tax for any tax year similarly reported.

RECOMMENDATION

The AICPA recommends that the IRS modify the proposed regulations to indicate that the IRS will pay interest on refunds issued on prior overpayments resulting from a taxpayer's statements filed under section 6226 with their reporting year tax return.

ANALYSIS

As noted in the preamble, "section 206(e) of the TTCA[3] amended section 6226(b) to provide that decreases, as well as increases, in chapter 1 tax that result from taking into account partnership adjustments are used in computing a partner's additional reporting year tax." The preamble further states that "the TTCA did not similarly amend the reference to "increases" in section 6226(c)(2)

[3] Technical Corrections Act of 2018, contained in Title II of the Consolidated Appropriations Act of 2018.

with the result that interest only applies to the increases in the Chapter 1 tax that would have resulted from taking into account the partnership adjustments under section 6226. No provision under the centralized partnership audit regime provides for interest in the case of a decrease in Chapter 1 tax that would have resulted in the first affected year or any intervening year if the adjustments were taken into account in those years."

In our opinion, section 6226(c)(2) is intended to increase the normal statutory rate of interest imposed, not exclude interest on overpayments. Typically, the IRS either imposes or pays interest on changes reported on an amended return at the underpayment rate under section 6621(a)(2). The language of section 6226(c)(2)(C) modifies this rate solely for purposes of increases in tax by imposing interest "*at the underpayment rate under section 6621(a)(2), determined by substituting "5 percentage points" for "3 percentage points" in subparagraph (B) thereof.*"

Section 6226(c) does not expressly preclude payment of interest on decreases in tax nor is there any reason to believe that Congress intended to override the existing rules for such situations.

11. Access to the IRS Office of Appeals by partnerships subject to audit under the Regime

OVERVIEW

Included in the Taxpayer's Bill of Rights posted on the IRS website is "The Right to Appeal an IRS Decision in an Independent Forum." This right is explained, in part, as "Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including certain penalties. Taxpayers have the right to receive a written response regarding a decision from the Office of Appeals."

There is no reference in the preamble, the proposed regulations or any other information issued to date by the IRS on application of the appeals process to any decision of the IRS under Regime.

RECOMMENDATION

The AICPA recommends that the final regulations provide an explicit right to challenge via the Appeals process, the following actions or determinations by the IRS:

- A determination by the IRS that an election to opt out under section 6221 is invalid;
- A denial by the IRS of a requested modification under section 6225 to an imputed underpayment amount;
- A denial by the IRS of a requested change to a grouping or subgrouping made under section 6225;
- A denial by the IRS of a penalty defense (both partner and partnership-level) raised by the partnership as part of the section 6225 modification period or by a partner that reports adjustments under section 6226;

- The underlying adjustments to the partnership's return appearing on a NOPPA;
- A determination by the IRS affecting the allocation of tax attributes to reviewed year partners or their successors;
- A refusal by the IRS to permit a partnership to issue corrected statements under section 6225;
- A determination by the IRS that a partnership has ceased to exist under section 6241; and
- Any other decision by the IRS which directly affects the proposed audit adjustments, the calculation of imputed underpayment, or the ability of a partnership to make any valid election under the Regime.

ANALYSIS

The Regime creates a significant number of new elections and procedures which will apply to partnerships under examination. In many cases, the IRS has the authority under the Regime to invalidate these elections, deny requested modifications to the adjustments or the calculation of tax and overrule partnership decisions on the allocation of adjustments or tax attributes to its partners.

Further, the Regime establishes stringent statutory deadlines for certain actions which will preclude sufficient time for a partnership to challenge the decisions made by the IRS.

Such absolute authority, mainly invested in a single IRS employee (the examiner assigned to the audit), is contrary to good tax policy and specifically the IRS's own Taxpayer's Bill of Rights. It is essential that the IRS explicitly identify those actions and decisions under the Regime which a taxpayer may challenge with Appeals, the specific timeframes for taking such actions and the effect of such challenges on the various new statutory deadlines under the Regime.

In addition to the recommendations above, we suggest that the IRS develop a fair and equitable Appeals process under the Regime which considers the following:

- A partnership should have the right to appeal the determinations under sections 6221 and 6241 above within 60 days of receipt of the determination;
- Establish a single unified appeals process for a partnership to challenge both the underlying adjustments and any denial of requested modifications. If a partnership has submitted no requests for modification of the imputed underpayment, then its right to challenge the underlying adjustments with Appeals shall expire upon the conclusion of the 270-day period following the mailing of a NOPPA (including any extensions of that period agreed to by the IRS). If a partnership has filed a request for modification, then its right to challenge the underlying adjustments and any denial of the requested modification shall expire on the later of the conclusion of the 270-day period following

the mailing of a NOPPA (including any extensions of that period agreed to by the IRS) or 45 days after the IRS has either accepted or denied all properly submitted requests for modification of the imputed underpayment amount; and

- The IRS should not have the ability to issue an FPA until at least 30 days after a final decision is made on all issues and determinations challenged by a partnership with Appeals.

12. Substantial compliance with section 6226 filing and reporting requirements

OVERVIEW

Proposed Reg. § 301.6226-3(e)(3)(i) requires pass-through partners to issue statements to partners holding an interest in the pass-through partner at any time during the taxable year to which the adjustments relate. It appears that a failure to meet all of the requirements of Prop. Reg. § 301.6226-3(e)(3) results in an invalid push-out election. An invalid push-out results in the pass-through partner having to pay an amount of tax calculated in a manner similar to an imputed underpayment under Prop. Reg. § 301.6226-3(e)(2).

RECOMMENDATION

The AICPA recommends that the final regulations provide that a partnership's election to push-out the adjustments under section 6226 is not invalidated if they have substantially complied with the regulatory requirements or if they have inadvertently failed to provide the required statements representing a de minimis amount of the total adjustments subject to reporting. In addition, a partnership should have the ability to correct any errors discovered by the partnership or the IRS provided they take this action within a reasonable timeframe.

ANALYSIS

When a pass-through partner substantially complies with the requirements of Prop. Reg. § 301.6226-3(e)(3) and partners receiving valid statements take into account their share of the adjustment, there is the potential to make the related tax payment more than once. For example, a pass-through partner is allocated a $100 increase to taxable income from an audited partnership. The pass-through partner sends push-out statements to affected partners totaling $98 of the $100 adjustment. However, $2 of the adjustment was not pushed out on statements to affected partners because the pass-through partner inadvertently failed to send a statement to one former partner. As a result of one missed push-out statement, the push-out election is considered invalid and the pass-through partner is liable for tax on the entire $100 while the other partners have also paid their allocable share of the tax.

We suggest that the pass-through partner is considered to have substantially completed its obligations under Prop. Reg. § 301.6226-3(e)(3) and is not liable for the $98 that was pushed out and properly reported by the other partners. Proposed Reg. § 301.6226-3(e)(2) should only apply to $2 (the portion of the adjustment that was not properly pushed out) and the pass-through partner should pay an amount calculated similar to an imputed underpayment on that amount.

Similarly, Prop. Reg. § 301.6226-1(c) provides for the potentially harsh result of duplicative tax payments where an audited partnership otherwise substantially complies with the requirements of the push-out election.