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May 25, 2016

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Re: *Report No. 1347 on the Partnership Audit Rules of the Bipartisan Budget Act of 2015*

Gentlemen:

I am pleased to submit the attached report of the Tax Section commenting on the new partnership audit rules enacted in November 2015 as part of the Bipartisan Budget Act of 2015 (the "**BBA**"). These rules constitute a "big bang" for partnership audits: they both completely overhaul the way partnerships are audited and introduce new methods for collecting additional taxes due as a result of a partnership audit. The existing rules, enacted as part of the

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Tax Equity and Fiscal Responsibility Act of 1982 ("**TEFRA**"), were repealed in their entirety for partnership tax returns for tax years beginning after December 31, 2017.

The enactment of the BBA was a direct response to significant problems encountered by the IRS under the existing TEFRA regime when auditing partnerships and collecting additional taxes. Numerous reports written by governmental agencies, bar associations, journalists and scholars had made a compelling case that the rules were not working properly and that something needed to be done. At the same time, the solution was far from clear in light of the proliferation of complex partnership structures and arrangements, the increasing complexity of the substantive partnership (and other) tax rules, and the need for the system to be fair, administrable, and consistent with the other principles of good tax administration. We commend Congress, Treasury and the IRS on tackling these important and difficult topics, and we are pleased to offer our assistance as you take on the work of implementing these new rules.

Implementing the BBA rules will be a wide-ranging project that will include, among other things, issuing extensive regulatory guidance, updating numerous forms for tax returns and reporting (including Form 1065, Form 1120, Form 1120S, and Form 1040), adopting entirely new internal IRS procedures, training IRS personnel and making necessary changes to IRS computer systems. Each of these "workstreams" will raise difficult issues; however, to our mind the hardest ones will come in the first stage, when the fundamental design decisions need to be made. There is still a lot to do on this front because the statute is quite complex and leaves many issues to be resolved by Treasury and the IRS (either by not addressing them in the statutory text or by an explicit statutory mandate to the Secretary to address them through guidance).

The goal of the report is to assist Treasury and the IRS in making these first stage decisions. Accordingly, we address issues that we believe are fundamental design issues (including some of the questions on which the IRS asked for comments in Notice 2016-23). These issues are complex and in many cases interconnected. Once these first stage decisions have been made, many other issues (some of great importance) will need to be addressed. We look forward to addressing these additional issues in subsequent reports.

Our approach throughout this report is to explain each issue (illustrating it with examples where we think that is helpful), describe the various options for addressing the issue (again with illustrative examples where we think it is helpful), evaluate those options and provide our recommendations. In evaluating the options, we have taken into account the history to the enactment of the statute and our understanding of its goals, the intended meaning of the statute, and the principles of good tax administration. We note where we think statutory technical corrections or other changes should be considered, although we have endeavored to limit these legislative suggestions because we recognize the urgency to commence the administrative guidance process.

Our key recommendations are summarized below. We have generally tried to propose solutions that can be implemented through the regulatory process, but have recommended in a few instances statutory corrections or modifications which we see as critical.

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The last major overhaul of the partnership rules took place more than 30 years ago, as part of the Tax Equity and Fiscal Responsibility Act of 1982. It is not an exaggeration to say that the TEFRA rules were written for a completely different time: since their enactment both the use and complexity of partnerships have increased exponentially. Given this new environment, we share the assessment made by various Congressional and governmental reports that the TEFRA regime does not allow the IRS to audit partnerships efficiently and creates a strong incentive for the IRS to focus limited audit resources on corporate taxpayers. This raises significant horizontal equity concerns.

The issue is a difficult one, however, because multiple substantive and procedural issues combine to make the conduct of a partnership audit, as well as the collection of the tax resulting from that audit, very difficult. By necessity, the rules require therefore that a balance be struck between the administrability and fairness of the regime. We applaud Congress's willingness to tackle this complex issue.

A. The Coordination of the Three Payment Methods with Subchapter K and the Interpretation of Section 6225 as a Withholding Tax

We believe that the BBA is an important procedural reform, intended to increase the effectiveness, efficiency and fairness of partnership audits and of the resulting collections. Consistent with the reasons for its enactment and goals, the new BBA regime should not materially affect the substantive tax liabilities resulting from items derived through partnerships. Under the BBA, if a partnership audit determines that the partnership should have reported additional income or gain (or less credits) on its Form 1065 and the Schedule K-1s it issued to its partners, the audited partnership is required to pay to the IRS an "imputed underpayment" (which is basically an approximation of how much tax would have been paid if that additional income or gain were taxed at the partner level at the highest possible rate under the Code for the year under audit). This is the main method set out in the BBA for the collection of the additional taxes resulting from a partnership audit.

Thus, the statute moves the tax collection point from many partners to one centralized point (the partnership); this is clearly a response to some of the difficulties encountered under TEFRA. However, for the reasons detailed in the report, the way in which the imputed underpayment is computed and the fact that the computations do not take into account the interaction of the partnership-level adjustments with the individual partners' other tax attributes means that the amount collected may be materially different from the tax that the partners would have paid if they had taken the adjustments into account under the normal substantive tax rules. Depending upon the facts, there could therefore be over-collection or under-collection, and the amounts could be significant. We believe that this difference in total tax collected is not necessary to respond to the problems raised under TEFRA.

In addition, the imputed underpayment rules (which are set out in section 6225) are subject to two exceptions which, if available and elected into by the partners or the partnership, move the tax collection point back to the partner level. Partners and partnerships can be expected to try to use whichever of the three payment methods results in the smallest payments under their particular facts.

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To understand and illustrate how these rules work and their implications, the report uses a hypothetical simple fact pattern, traces through the results for each partner and the IRS under all three payment methods and compares their results to each other and to the results that would have occurred if the partnership had prepared its return initially identically to the outcome of the audit (what we call the "**Correct Return Position**"). The report also addresses the implication of the audit adjustments on the partners' basis, capital accounts and other Subchapter K attributes as well as the consequences of indemnity payments made between current and former partners. We recommend approaches to these matters that we believe are most consistent with Subchapter K and minimize distortion.

Our detailed analysis of the consequences of the three payment methods shows that the amount collected under the imputed underpayment method may differ significantly from the amount collected under Correct Return Position (as well as from the amount collected under the other two payment methods). If this is indeed how these rules work, we find this result very troubling. We are concerned about the possibility for manipulation and even abuse by taxpayers, and the likelihood that such an application of the BBA rules would further erode taxpayers' belief in the integrity and fairness of the tax system. The BBA regime, and in particular section 6225, will need to be fair, workable, and consistent with the tax law outside of the BBA in order for it to succeed.

We believe that section 6225 can be implemented in a way that achieves these goals by treating section 6225 as a withholding tax mechanism, similar to the regime that currently exists under section 1446 with respect to effectively connected taxable income of a partnership that is allocable to foreign partners. We refer to this approach as the Withholding Tax Approach. Under this approach, the payment by the partnership would ensure that the IRS collected an initial amount that approximates the total tax due; after the IRS had collected this initial amount, each partner would then properly take into account its share of the audit adjustments along with a credit for the corresponding amount of initial taxes paid by the partnership and settle up with the IRS by paying any additional taxes due or claiming a refund of any amount overpaid.[1] Under this approach, the BBA's solution to the TEFRA collection difficulties should be addressed, and the fairness problems outlined above should be minimized. Indeed, the results of proceeding under section 6225 would essentially match the Correct Return Position.

We believe that the Withholding Tax Approach is the only way to read section 6225 in a way that is consistent with the other, existing rules of the Code. If this is not what section 6225 means, then this procedural rule will frequently result in tax obligations that differ significantly from those

[1] In order to collect these additional taxes, the Withholding Tax Approach relies upon voluntary compliance by the partners or collection efforts by the IRS. We are mindful of not wanting to reintroduce the collection difficulties the IRS faced under TEFRA, and we think the imputed underpayment mechanism was intended to prevent that. We recommend therefore that the imputed underpayment computation err (within reason) on the side of over-collection in order to minimize the risks to the IRS. In addition, relying upon voluntary compliance and collection for any additional taxes due is preferable to having a collection regime that has the inadvertent impact of making those additional taxes not due at all.

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provided for by the substantive rules of the Code. For the additional reasons detailed in the report, we believe that because the meaning of the statute in this regard is not clear, the Withholding Tax Approach is a reasonable interpretation. As seen throughout the report, many of the difficult issues addressed in the report would be solved if the Withholding Tax Approach is followed. The fact that so many potential issues with the statute are resolved if the Withholding Tax Approach is followed supports our view that this is the correct meaning of section 6225. This being said, we are cognizant of the risk that this interpretation would be challenged and of the negative consequences of adopting an interpretation that is challenged (whether or not it is upheld). Accordingly, we encourage Congress and Treasury to consider a statutory clarification that confirms the Withholding Tax Approach.

If the Withholding Tax Approach is not adopted, then we recommend that the audit adjustments be reflected in the outside bases and capital accounts of the adjustment year partners as an imperfect but "second best" option.

B. Section 6221 and The Scope of the BBA Regime

A threshold question and one of great importance (for reasons we discuss in detail in the report) is what "items" are subject to audit at the partnership level under the BBA (as opposed to subject to audit at the partner level). TEFRA handled this issue by defining the items subject to partnership-level audit as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations…provide that…such item is more appropriately determined at the partnership level than at the partner level" and left it to the Secretary to issue regulations detailing these items. The Secretary's regulations followed the statute's lead with an extensive list of items "more appropriately determined at the partnership level." TEFRA also had another term, "affected item" which was defined as "any item to the extent such item is affected by a partnership item." This term, together with a special rule that extended the partner-level statute of limitations, was used to enable partnership item adjustments (resulting from a TEFRA audit) to be taken into account at the partner level in order to determine the tax (or refund) due based upon how the partnership items interacted with the partner's affected items. Notwithstanding the broad language in the statute and the resulting regulations, there has been extensive litigation over whether a particular item was a partnership item, affected item or neither.

The BBA dispenses with these terms and concepts and instead describes the items subject to partnership-level audit in section 6221(a) as "items of income, gain, loss, deduction, or credit of a partnership." There is no corollary to affected items and no explicit extension of the partner-level statute of limitations.

Looking at the text of the BBA and comparing it to the existing "partnership item" regulations, it is possible to interpret the scope of the BBA audit regime as very limited. We do not believe that such a reading was intended. We believe that the lawmakers were likely reacting to the controversies over the term "partnership item" and "affected item" and believed that eliminating those concepts and using the broad wording in section 6221 would reduce the challenges, not reduce IRS's jurisdiction. We believe that in order for the BBA regime to achieve its goals, the IRS needs to be

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able to adjust in a BBA audit all the items that are more properly audited and determined at the partnership level than the partner level, and that this likely includes all the items defined as "partnership items" in the existing regulations promulgated under TEFRA. However, if the adjustment of some of those items will have no consequences because those adjustments cannot be reflected in the "imputed underpayment" computation (since that computation takes into account only adjustments to items of income, gain, loss, deduction and credits of the partnership), then requiring those items to be adjusted only at the partnership level in a BBA audit means that adjustments to those items will never result in additional taxes being due (or refunds) if the partnership pays under section 6225 (instead of the partners utilizing one of the BBA's two alternative payment).[2]

The Withholding Tax Approach would prevent this inappropriate result (because the results of the audits would flow-through to the partners) and would still permit partnership-level audits of items that are more appropriately audited and adjusted at the partnership level. Therefore, if the Withholding Tax Approach is adopted, we recommend that the scope of BBA audits be the same as that of "partnership items" under TEFRA. If the Withholding Tax Approach is not adopted, then we recommend that the scope of BBA audits be limited to those items which can be taken into account in computing an "imputed underpayment," leaving all the other items for separate partner-level adjustment. However, this will severely affect the IRS's ability to collect taxes and eventually the IRS (and possibly Congress) will need to develop a new regime to address how to adjust all the other types of items that are not adjustable in a BBA audit but which emanate from, or are impacted by items emanating from, a partnership subject to the BBA.

A separate but related question is whether the statute of limitations of the partners should be extended when a BBA audit starts, to ensure that the audit impacts the partners' tax positions in the way the "affected item" rules worked under TEFRA. We strongly favor an approach that facilitates getting as close as possible to Correct Return Position and leaving open the partners' statute of limitations similar to what was done under TEFRA (Pre-BBA section 6229(d)). However, we recognize that the BBA statue does not currently provide for this, so in the absence of a statutory technical correction this could only be achieved through IRS procedures and taxpayer consent.

C. Computing the Imputed Underpayment

The computation of the imputed underpayment raises many complicated issues, including how to reconcile the significant difference between the amount of the imputed underpayment and the amount of taxes that would have been under the Correct Return Position. Resolving these issues in a way that is fair and minimizes distortion is particularly important to seeing the BBA achieve its

[2] We illustrate this in the report with three examples: (i) an audit adjustment to the value and character of an asset distributed by a partnership to a partner, (ii) an audit adjustment to the allocation of partnership liabilities among the partners for purposes of section 752, and (iii) an audit adjustments that changes at the partnership level attributes relevant to the section 199 deduction (which attributes flow through to a partner who has computed the section 199 deduction at the partner level based upon the aggregation of the partner's attributes from all sources).

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goals. If the Withholding Tax Approach is adopted, this difference is reconcilable and we believe that a reasonable over-collection at the stage of the imputed underpayment is justified (however the imputed underpayment needs to be close enough to the actual amount due that partnerships are not incentivized to turn to section 6226). If the Withholding Tax Approach is not adopted, this difference (and all the complications raised in determining how the computations are done) take on even more significance; and the imputed underpayment needs to be such that the partnerships are not incentivized to almost always elect section 6226.

1. Netting Issues

(a) Netting Items of Different Characters

We believe that Treasury and the IRS should use their authority under section 6225(c) to provide that when the adjustments include positive and negative items of different character (which do not offset under the normal tax rules because they are of different character), the negative items can be taken into account in computing the imputed underpayment, provided that the partnership can establish that the reviewed year partners would have been able to utilize the negative items in computing their respective taxes (and then capital losses should only reduce the amount of the imputed underpayment based on the tax rate applicable to capital gains).

(b) Netting Items When the FPA Changes Their Timing

This situation raises similar issues and we believe the same approach should be used. The situation also raises the additional issue of whether section 6225 (and section 6226) are to be applied to each year covered by an FPA separately or all the years taken together, and we respectfully reserve on this issue until some of the other issues we discuss are resolved.

(c) Adjustments That Move Allocations From One Partner to Another

Another netting issue arises when an audit results in the reallocation of an item of income from one partner to another. Section 6225(b)(2) provides that in that case the imputed underpayment is computed by taking into account only the increased income or decreased deduction and by ignoring the decreased income or increased deduction. It is not entirely clear why this rule is in the statute, but we strongly believe that this result is unfair, and has the potential to result in permanent double taxation. We believe there are several ways to address this issue. If the Withholding Tax Approach is adopted, the partner who overpaid taxes in the past should be able to get a refund and thus the regime should collect the right amount. Another approach would be for Treasury and the IRS to use their authority under section 6225(c) to reduce the imputed underpayment to reflect the taxes (proven to have been) paid by the partner who was initially allocated the income. A third approach, which we do not favor, would be to interpret the decrease as a separate "adjustment" and apply to it the rules for adjustments that do not create imputed underpayments. We recognize that there may be other approaches as well. If Treasury and the IRS believe that they do not have authority to implement an approach that resolves this issue, we recommend that a statutory change be sought.

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2. Tax Credits

Section 6225(b)(1)(C) computes the imputed underpayment "by taking into account any adjustments to items of credit as an increase or decrease, as the case may be, in the amount [of the imputed underpayment] determined under [6225(b)(1)A)]." Read literally, this means that additional credits reduce the section 6225(a) imputed underpayment dollar for dollar and a reduction in credits increases the section 6225(a) imputed underpayment dollar for dollar. The Code provides for a number of different credits, with complex (and differing) regimes that often take into account multiple components in computing the allowable credit (or required recapture). Some of these computations are done at the partnership level, others at the partner level, and some at either or both levels. It is not clear how the statutory formula is intended to interact with these regimes.

This is a significant issue because the tax credit regimes reflect policy choices and play a significant role in our tax system. The imputed underpayment mechanism should not supplant them. Moreover, the applicability of these policies should not depend on whether amount of credits were reported correctly on the initial return or determined in an IRS examination. We investigate in detail the application of these rules to the foreign tax credit regime and we also touch on two other credit regimes as illustrations of some of the issues raised

If the Withholding Tax Approach is adopted, the credit issue is far less problematic because the appropriate result can be achieved in the subsequent partner-level proceedings and a literal reading of the statute could be workable. If the Withholding Tax Approach is not adopted, the recommend two options (which may be applied for different credits). First, Treasury and the IRS can use their authority under section 6225(c) to take into account an adjustment to credits but only to the extent that the adjustment would have affected the tax due at the partner level. Second, the imputed underpayment can ignore the credit adjustments and have them tier up to the partners (even if the partnership otherwise is subject to the imputed underpayment).

D. Section 6226(b)(2)(B)—Decreases in Taxes Not Taken Into Account

Section 6226 requires the reviewed year partners to include in their adjustment year taxes an amount equal to the additional taxes they would owe for the reviewed year and all years between the reviewed year and the adjustment year if the FPA adjustments were taken into account by them in the reviewed year (and all corresponding adjustments were made in subsequent years). The statutory formula provides however, that for each of those years, the partner can take into account the impact on the taxes due in that year only if it results in an increase in the taxes due by the partner, not a decrease. This can lead to significant permanent double taxation and we illustrate this in examples. Once Treasury and the IRS have developed the conceptual approach to section 6225, we recommend they consider carefully whether it is appropriate for section 6226 to operate in this way. In particular, we believe that a statutory correction should result in a much more accurate tax collection, but we recognize that there may be policy reasons to keep section 6226 as is in order to encourage taxpayers to use the section 6225 mechanism. If it is determined that this aspect of section 6226 is to stay in place (and not be statutorily corrected), then it is even more important that the rules implementing

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section 6225 be as fair as possible and get all the partners as close as possible to the tax liability they should have had if they had paid their taxes correctly. In addition, this also means that the IRS and Treasury should consider how, if at all, they can add in protections for partners who may be seriously disadvantaged if a partnership representative selects section 6226 rather than proceeding under section 6225.

E. Section 6241(7)

Section 6241(7) provides that, if a partnership "ceases to exist" before a BBA adjustment takes effect, the adjustment shall be "taken into account" by "the former partners." There is no guidance on the meaning of these three terms. In deciding how to interpret these terms and how to implement section 6241(7), it will be important to ensure that the result is both fair and does not create inappropriate incentives for partners to leave partnerships in existence or to cause them to cease to exist.[3] For instance, the amount of the tax payable should not change because the partnership has ceased to exist. Since a partnership that has ceased to exist cannot serve as a "collection point" for the tax liability (which is the paradigm for section 6225), we believe that section 6241(7) should be applied by treating the parties as if the partnership had made a section 6226 election. We also consider whether a partnership and its former partners should have access to the other payment regimes.

F. Partnerships with Insufficient Assets

If the Withholding Tax Approach is not adopted and section 6225 is the final payment for the tax due, then the IRS will not be able to collect the tax due if the partnership is insolvent or does not have sufficient assets to pay the imputed underpayment. This would create a significant risk of abuse. We believe that the IRS could interpret section 6241(7) so that a partnership that does not have sufficient assets to pay the imputed underpayment (and does not make a section 6226 election) will be deemed to have "ceased to exist." Thus, the IRS will be able to rely on section 6241(7) to collect from the reviewed year partners (per Recommendation E immediately above). However, this is an important issue and we believe that it would be better if the statute were clarified.

G. Tiered Partnership Issues and Section 6226

Tiered partnership structures are very common and often involve many tiers, many indirect partners and complex allocations. The difficulties the IRS encountered under TEFRA in auditing and collecting from tiered structures were significant and were one of the main reasons for the enactment of new BBA rules. Under the BBA, if the audited partnership proceeds under section 6225 by paying the imputed underpayment, the existence of complex tiers above that entity should not complicate the IRS's ability to compute and collect that amount (other than with respect to the possible attempt by

[3] The IRS may have access to certain state law remedies if a partnership liquidates with the intent of avoiding a BBA tax liability, for example after a BBA audit has started, but it would be preferable if these rules did not create an incentive for partnerships to take such an action.

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the partnership to reduce the imputed underpayment using section 6225(c)).[4] If instead the audited partnership wants to make a section 6226 election, then the tiers above the partnership become relevant. The text of section 6226 gives no indications as to what should happen in such a case: it merely indicates that the recipient of the section 6226 statement must increase its taxes payable under "chapter 1" to account for the adjustment. We believe that the Secretary has regulatory authority to implement a broad range of different approaches. The BBA Bluebook however has interpreted section 6226 to mean that the push-out stops at the source partnership's direct partners (*i.e.*, it goes up one tier only) and that partners that are themselves partnerships should then pay the tax due with respect to the FPA as if they were an individual. We find this approach problematic, and question if it is authorized by the statute (including because partnerships are not subject to chapter 1 taxes).We discuss these issues in detail, consider a variety and options, and ultimately recommend that the section 6226 election not stop at the first tier above the audited partnership, and that instead each partnership in the chain be permitted to elect to either (i) pay the portion of the audited partnership's imputed underpayment allocated to it (and have the ability to reduce that amount using section 6225(c)) or (ii) elect to apply section 6226 to push the obligation up another tier. We also strongly recommend safeguards to reduce the collection risk for the IRS. First, we recommend that any partnership in the chain that elects to proceed under section 6226 to push out the liability must provide to the audited partnership (or the IRS examination team) either (x) the section 6226(a)(2) data with respect to its partners or (y) an affidavit attesting that its partners have filed the required tax returns and paid the taxes due with respect to their shares of the adjustment. Second, we recommend that there be a maximum period for all the push-outs to occur. We believe that this approach is authorized by the statute. We would be pleased to provide further suggestions on the implementation of this system.

H. Timing and Procedures

The statute raises a series of timing and procedural issues, some of which require technical corrections and others which may be addressed in regulations.

1. Statute of Limitations for IRS Issuance of an Adjustment

There seems to be an inadvertent flaw in the rules governing the last day that the IRS can issue a final partnership adjustment. Specifically, there is no time limit for the issuance of a notice of proposed partnership adjustment, and once a notice of proposed adjustment has been issued, the IRS automatically has additional time to issue the notice of final partnership adjustment. We believe that this should be corrected by requiring that the document finalizing the audit adjustments (but before the application of section 6225(c)) be issued before expiration of the standard 3-year statute of limitations.

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[4] If the Withholding Tax Approach is adopted, the second-stage partner-level refunds and collections would be complicated, but this is why the imputed underpayment should come as close as possible to Correct Return Position, while erring on the side of over-collection rather than under-collection.

2. Providing Documentation Under Section 6225(c)

The partnership should not be required to provide documentation under section 6225(c) before the final, substantive, position of the IRS has been determined and the audit adjustments have been determined. Accordingly, we recommend that the regulations establish that the 270-day period to provide the section 6225(c) information only start after the document finalizing the audit adjustments referenced in recommendation H.1. (immediately above) is issued.

3. Section 6225(c)(2) and Section 6226

Partners should not be required to file amended tax returns under section 6225(c)(2) until the IRS has issued the document finalizing the audit adjustments described in recommendation H.1. above. In addition, because the section 6226 election is only made after the final partnership adjustment is issued, we recommend that partners that want to avail themselves of section 6225(c)(2) file their amended returns (and deposit the tax due) in escrow with the IRS exam team until the partnership makes a section 6226 election (or the statutory period for making such election lapses).

4. Standards for and Review of IRS Decisions In Response to Documentation To Reduce the Imputed Underpayment

We think that the IRS will be best served by specifying what standards will apply to its section 6225(c) evaluations and decisions, providing partnerships with explanation of any denial, and implementing procedures for taxpayers to elevate a denial within exam and then to IRS Appeals.

5. IRS Appeal Process and the BBA

Procedures are needed to establish when the partnership is able to protest the proposed adjustments and the section 6225(c)(2) decisions to IRS Appeals. We consider the options in the report and recommend: (i) that in a first stage, all the proposed adjustments (but not any disagreements over the section 6225(c) decisions) be heard by Appeals and (ii) then, that the case go back to the exam team to review and respond to the section 6225(c) documentation, after which the partnership could go back to Appeals to address those section 6225(c) decisions. The initial imputed underpayment computation (*i.e.*, the application of the section 6225 formula to the adjustments) could be heard in the first Appeals hearing or deferred until the second Appeals hearing (under a policy that applies in all cases or under a flexible policy that allows for either approach in any given case).

6. Section 6226 and Petitioning to Court

Section 6234 needs to be clarified to establish how the partnership's right to go to court interacts with the various payment rules.

7. Timing For IRS Collection Proceedings With Respect to the Imputed Underpayment

The statute is internally inconsistent. Section 6232(b)(1) should be corrected to provide that an assessment of a deficiency and collection proceeding may not commence before the 90th day after

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the due date for the imputed underpayment under section 6232(a) (instead of 90 days after the issuance of the final partnership adjustment).

I. Section 6221 and Electing Out of the BBA

The 100 partner threshold that shuts off a partnership's ability to elect out of the BBA is far higher than the 10-partner threshold that determined the applicability of TEFRA. We recognize that the BBA rules differ from TEFRA, but we have focused on the fact that, if a partnership elects out, the IRS will be able to adjust items arising from the partnership only pursuant to individual partner-level proceedings. To understand what this might be like we have revisited the historic reports of the problems that the IRS (and taxpayers) faced pre-TEFRA (which led Congress to enact TEFRA). We note that the same problems, as well as new problems, may well arise under the BBA's election out, that the problems are likely to be more troubling and that the number of taxpayers and the amount of revenue affected will be significantly larger because the 100 partner number is so high.

While we are troubled by this rule, we hesitate to recommend reducing the number at this time. Instead, we recommend that a reduction be taken up once the BBA has been implemented in a way that irons out the issues and the BBA is operating in a way that is fair and effective.

We appreciate your consideration of our recommendations. If you have any questions or comments on the report, please feel free to contact us and we would be happy to assist in any way.

Respectfully Submitted,

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