TAX SECTION
State Bar of Texas

March 19, 2018

Via Federal eRulemaking Portal
at www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG-120232-17, REG-120233-17)

Room 5207
Internal Revenue Service
P.O. Box 5604
Ben Franklin Station
Washington, D.C. 20044

RE: Comments on Proposed Regulations Regarding Centralized Partnership Audit Regime: Rules for Election under Sections 6226 and 6227, Including Rules for Tiered Partnership Structures, and Administrative and Procedural Provisions

Dear Ladies and Gentlemen:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Department of the Treasury ("Treasury") and Internal Revenue Service (the "IRS" or "Service") in the Notice of Proposed Rulemaking (REG-120232-17, REG-120233-17) issued on December 19, 2017 (the "Proposed Regulations"). The Proposed Regulations provide rules concerning the certain aspects of the centralized partnership audit regime (the "Centralized Audit Regime"). The Proposed Regulations provide rules for election under Sections 6226 and 6227, including rules for elections by tiered partnership structures, and administrative and procedural provisions. The Centralized Audit Regime was enacted by section 1101 of the Bipartisan Budget Act of 2015, as corrected and clarified by the Protecting Americans from Tax Hikes Act of 2015.

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THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW. THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend Treasury and the Service for the time and thought that has been put into preparing the Proposed Regulations, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

Stephanie M. Schroepfer

Stephanie M. Schroepfer, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED REGULATIONS REGARDING CENTRALIZED PARTNERSHIP AUDIT REGIME: RULES FOR ELECTION UNDER SECTIONS 6226 AND 6227 INCLUDING RULES FOR TIERED PARTNERSHIP STRUCTURES, AND ADMINISTRATIVE AND PROCEDURAL PROVISIONS

These comments on the Proposed Regulations (the "Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafters of these Comments were Richard L. Hunn, Co-Chair of the Tax Controversy Committee, and Leonora S. Meyercord, Vice Chair of the Partnership and Real Estate Tax Committee. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Jeffry M. Blair, Co-Chair of COGS, reviewed these Comments. Mary A. McNulty, reviewed the Comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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INTRODUCTION

These Comments are provided in response to Treasury's and the IRS's request for comments on the Proposed Regulations regarding the Centralized Audit Regime, specifically, rules for election under Sections 6226 and 6227, including rules for tiered partnership structures, and administrative and procedural provisions. The Centralized Audit Regime was enacted into law on November 2, 2015 by section 1101 of the Bipartisan Budget Act of 2015, Pub. L. No. 114-74 (the "BBA"), as corrected and clarified by the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q (the "PATH Act"). The BBA repealed the prior rules governing partnership audits under the Tax Equity and Fiscal Responsibility Act ("TEFRA"), for taxable years beginning after December 31, 2017. The BBA replaced those rules with a centralized audit regime that generally provides for assessment and collection of tax at the partnership level rather than the partner level. The Proposed Regulations were issued to provide rules addressing how partnerships and their partners take into account partnership adjustments under the Centralized Audit Regime, as well as rules regarding administrative and procedural matters. We appreciate the opportunity to comment on the Proposed Regulations.

FINAL REGULATIONS SHOULD INCLUDE CERTAIN CLARIFICATIONS WITH RESPECT TO THE CALCULATION OF INTEREST ON TAX AND ON PENALTIES AND ADDITIONS TO TAX

Section 6226[1] provides that, after the Service has issued a notice of final partnership adjustment, the partnership may, instead of paying an imputed underpayment pursuant to Section 6225, elect to push out the adjustments to the reviewed-year partners. Where the partnership elects to make a push-out election, each reviewed-year partner is responsible for paying any increase in tax resulting from the adjustments to that reviewed year and any increase in tax resulting from adjustments to tax attributes for interim years between that reviewed year and the year the statement is issued.[2] Partners are required to pay the additional taxes in the taxable year that a statement of the adjustments is sent to each such partner.[3]

Section 6226(c)(2) imposes underpayment interest on each partner with respect to such partner's increase in tax, in pertinent part as follows:

> (2) INTEREST.—In the case of an imputed underpayment with respect to which the application of this section is elected, interest shall be determined—
>
> . . .
>
> (B) from the due date of the return for the taxable year to which the increase is attributable ...

Section 6226(c)(2) is silent as to whether the due date of the return for this purpose is determined with or without regard to any extension of time for filing. In addition, Section 6226(c)(2) does

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1 Unless otherwise indicated, all "Section" or "§" references are to the Internal Revenue Code of 1986, as amended (including amendments enacted under the BBA and the PATH Act).

2 I.R.C. §6226(b).

3 *Id.*

not differentiate between interest on tax and interest on penalties and additions to tax. Nor does it provide separately for interest on penalties and additions to tax.

Where the partnership has not elected to push out the imputed underpayment to the reviewed year partners but instead pays the imputed underpayment and any associated penalties and additions to tax, Section 6233(a)(2) is similarly silent regarding whether interest is calculated from the due date of the return with or without regard to any extension of time for filing. Section 6233(a)(2) also does not on its face differentiate between interest on tax and interest on penalties and additions to tax. Section 6233(a)(2) simply states:

> The interest computed under this paragraph with respect to any partnership adjustment is the interest which would be determined under chapter 67 for the period beginning on the day after the return due date for the reviewed year . . .

The Proposed Regulations take the position that in the case of a push-out election, interest on any taxes and on penalties and additions to tax with respect to each partner should be calculated from the due date (*without extension*) of the reviewed-year partner's return.[4] The Proposed Regulations take that same position with respect to the calculation of interest on any underpayment of tax for a partnership that has not elected to push out an imputed underpayment. The Proposed Regulations do not include any separate provisions for interest on penalties or additions to tax with respect to a partnership has not elected to push out an imputed underpayment, providing in Proposed Regulations section 301.6223(a)-1(b) that:

> The interest imposed on an imputed underpayment resulting from partnership adjustments for the reviewed year is the interest that would be imposed under chapter 67 of the Internal Revenue Code (Code) if the imputed underpayment were treated as an underpayment of tax for the reviewed year. The interest imposed on an imputed underpayment under this paragraph (b)(1) begins on the day after the *due date of the partnership return (without regard to extension)* for the reviewed year . . . [emphasis added]

The approach in the Proposed Regulations is inconsistent with the calculation of interest on penalties and additions to tax outside of the partnership context. In a non-partnership context, interest on penalties and additions to tax other than assessable penalties (which are not owed until notice and demand for payment) is calculated under Section 6601(e)(2)(B) from the due date of the return, including any extension of time to file, until paid, as follows:

> Interest shall be imposed under this section with respect to any addition to tax imposed by section 6651(a)(1) or 6653 or under part II of subchapter A of chapter 68 for the period which—
>
> (i) begins on the date on which the return of the tax with respect to which such addition to tax is imposed *is required to be filed (including any extensions)*, and
>
> (ii) ends on the date of payment of such addition to tax.

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[4] *See* Prop. Reg. §§301.6226-3(d)(1); 301.6226-3(d)(3).

[Emphasis added.]

In a non-partnership context, the calculation of interest on penalties and additions to tax differs from the calculation of interest on an underpayment of tax. Under Sections 6601(a) and (b) and 6151(a), interest on an underpayment of tax is calculated from the time fixed for filing the return, which is "determined *without regard to any extension of time for filing* the return [emphasis added]."[5]

Thus, in a non-partnership context, Congress expressly provided for a bifurcated approach: interest on an underpayment of tax is determined *without regard* to any extension of time for filing, whereas interest on penalties and additions to tax (other than assessable penalties) is determined *with regard* to any extension of time for filing. By contrast, in the partnership context under the Centralized Audit Regime, Sections 6226(c)(2) and 6233(a)(2) are silent and ambiguous about whether interest is calculated with or without regard to any extension of time for filing. We were unable to find anything in the legislative history of the Centralized Audit Regime that addresses this point and, in particular, evidences an intent that interest on penalties be determined differently in the partnership context than in the non-partnership context.[6]

Because Sections 6226(c)(2) and 6233(a)(2) are silent and ambiguous as to whether interest is calculated from the due date of the return with or without regard to any extension of time for filing, it is appropriate for Treasury and the Service to address this issue in connection with the Proposed Regulations. Under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984), when a statute is silent or ambiguous with respect to the specific issue at hand, in keeping with the long recognized principle of deference to administrative interpretations, courts will defer to the agency's construction of the statute, so long as it is a permissible one, even when there is more than one permissible construction of the statute.

We respectfully recommend that Treasury and the Service adopt the same approach for interest on penalties and additions to tax in the partnership context as in the non-partnership context and thus provide for interest to run on penalties and additions to tax from the due date of the return including any extension. This can be accomplished as follows:

- Change the parenthetical in Proposed Regulations section 301.6226-3(d)(3) from "(without extension)" to "(including any extension)"

- Add a new second sentence in Proposed Regulations section 301.6233(a)-1(c): "The interest imposed on a penalty or addition to tax under this paragraph (b)(1) begins on the day after the due date of the partnership return (including any extension) for the reviewed year and ends on the earlier of the dates set forth in § 301.6233(a)-1(b) for interest imposed on an imputed underpayment."

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5 I.R.C. § 6151(a).

6 *See* Staff of Joint Comm. on Taxation, General Explanation of Tax Legislation Enacted in 2015, 69, 74 (Comm. Print 2016).

FINALITY OF PARTNERSHIP ADJUSTMENTS

We respectfully submit that there is a recurring error in Proposed Regulations section 301.6226-3(g), Examples 2, 3, 4, 6, 7, 8, 9. The error is with respect to the date that adjustments become final when a partnership fails to file a petition with a court within the 90-day period from the notice of final partnership adjustment ("FPA"). In these Examples, the partnership has 90 days from the date of mailing of the FPA to file a petition.[7] If a petition is not filed within the 90 day period, the adjustments become final on the 91st day. The current description in these examples inaccurately states that the partnership adjustments become finally determined on the last filing day rather than the day after the last filing day. In addition, in what appears to be simply a typographical error, the language in some of these examples erroneously refers to Proposed Regulations section 301.6226-1(b), instead of -2(b).

Examples 2, 3, and 4

The pertinent language in Examples 2, 3, and 4 currently reads as follows:

The time to file a petition expires on August 30, 2023. Pursuant to § 301.6226-2(b), the partnership adjustments become finally determined on August 30, 2023.

We recommend that the language be revised to read as follows:

The last day to file a petition is August 30, 2023. Pursuant to § 301.6226-2(b), the partnership adjustments become finally determined on August 31, 2023.

Examples 6, 7, and 8

The pertinent language in Examples 6, 7, and 8 currently reads as follows:

The time to file a petition expires on August 30, 2023. Pursuant to § 301.6226-1(b), the partnership adjustments become finally determined on August 30, 2023.

We recommend that the language be revised to read as follows:

The last day to file a petition is August 30, 2023. Pursuant to § 301.6226-2(b), the partnership adjustments become finally determined on August 31, 2023.

Example 9

The pertinent language in Example 9 currently reads as follows:

The time to file a petition expires on May 28, 2024. Pursuant to § 301.6226-1(b), the partnership adjustments become finally determined on May 28, 2024.

We recommend that the language be revised to read as follows:

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7 I.R.C. § 6234(a).

The last day to file a petition is May 28, 2024. Pursuant to § 301.6226-2(b), the partnership adjustments become finally determined on May 29, 2024.

EXAMPLE REGARDING MODIFICATION PROCEDURE

In Example 5 of Proposed Regulations section 301.6226-3(g), a partner (referred to as "F" in the example; referred to herein as the "partner") utilized the amended return modification procedure to reflect adjustments to a partnership's 2020 taxable year that were proposed by the IRS in a notice of proposed partnership adjustment. The partner filed amended returns for 2020, 2021, and 2022 reflecting the modification and paid the additional tax and interest for all three years. No other taxable years of the partner are affected by the IRS's adjustments, and the IRS approved the modification. The IRS issues an FPA reflecting the adjustments to the partnership's 2020 taxable year as well as the modification to the imputed underpayment based on the amended returns filed by the partner. The partnership then elects to push out the modified imputed tax to the reviewed-year partners pursuant to Section 6226 and contests the FPA in the Tax Court. The IRS adjustments are sustained in the Tax Court and become final in 2025. In 2026, the partnership issues the statements described in Proposed Regulations section 301.6226-2(b), including a statement to the partner reflecting the partner's share of the adjustments and explaining that the partner's share of the adjustments was taken into account by the partner as part of the amended return modification.

The example provides that the partner then computes its correction amounts for 2020 and the intervening years through 2026 and that it "computes any additional chapter 1 tax for those years using the returns for the 2020, 2021, and 2022 taxable years as amended during the modification process." We respectfully submit that this quoted language is ambiguous. The partner has already made the modification, filed amended returns, and paid the additional tax with interest, and no other years were affected by the adjustments. Therefore, we believe this example is intended to show that the partner will not owe any additional tax because the modification pursuant to the amended returns will be taken into account when the partner calculates its tax resulting from the push-out election. Accordingly, we respectfully recommend that Example 5 be clarified by revising the last sentence of the example to read as follows:

> Accordingly, in accordance with paragraph (b) of this section, when F computes its correction amounts for the first affected year (the 2020 taxable year) and the intervening years (the 2021 through 2026 taxable years), F's computation will take into account the additional chapter 1 tax that F reported and paid pursuant to the modification process on amended returns for the 2020, 2021, and 2022 taxable years.

WITHDRAWAL OF NAP AND STATUTE OF LIMITATIONS CONCERNS

Proposed Regulations section 301.6231-1(f) provides that the IRS may, without consent of the partnership, withdraw a notice of administrative proceeding ("NAP") or a notice of proposed partnership adjustment ("NOPPA"), and that a withdrawn NAP or NOPPA has no effect for purposes of the Centralized Audit Regime. Subsection (g) in turn provides that the IRS may rescind an FPA with consent of the partnership, and the partnership may not then bring a proceeding in court under Section 6234.

The authorizing statute, Section 6231(c), provides that the IRS "may, with the consent of the partnership, rescind any notice of a partnership adjustment." The statute does not address withdrawal or rescission of NAPs, with or without consent. Our concern is that providing separately in the regulations that the IRS has the authority to withdraw a NAP without consent of the partnership may have unintended consequences in circumstances where the partnership has not filed an administrative adjustment request ("AAR") under Section 6227(a) before the IRS has mailed a NAP to the partnership.

If the IRS issues a NAP before the partnership has filed an AAR, the partnership is prohibited from filing an AAR under Section 6227(c). Proposed Regulations section 301.6231-1(f) provides that if a NAP is withdrawn with respect to a partnership taxable year, "the prohibition under Section 6227(c) on filing an AAR after the mailing of a NAP no longer applies with respect to such taxable year." While the partnership is no longer prohibited from filing an AAR, the lifting of the prohibition is meaningless if the three-year period of limitations for the partnership to file an AAR under Section 6227(c) has expired.

One possible solution to this problem would be to provide that the period of limitations for filing an AAR is suspended while a NAP is outstanding. We recommend Proposed Regulations section 301.6227-1(b) be revised to provide that the period of limitations for filing an AAR is suspended during the period while the NAP is outstanding by adding the following sentence at the end:

> The period of limitations for filing an AAR under section 6227(c) is suspended during the period that the partnership is prohibited from filing an AAR under section 6227(c) until the date that the notice of administrative proceeding is withdrawn (if withdrawn) under § 301.6231-1(f).

We further recommend that the second sentence of Proposed Regulations section 301.6231-1(f) be revised to read as follows:

> A NAP or NOPPA that has been withdrawn by the IRS has no effect for purposes of subchapter C of chapter 63, except for suspension of the period of limitations under section 6227(c) as provided in § 301.6227-1(b).

TREATMENT OF NEGATIVE ADJUSTMENTS IN PENALTY CALCULATION

Section 6233(a)(3) provides that any penalty is "determined at the partnership level as if such partnership had been an individual subject to tax under chapter 1 for the reviewed year and the imputed underpayment were an actual underpayment (or understatement) for such year." Proposed Regulations section 301.6233(a)-1(c) provides rules for determining the portion of the imputed underpayment to which a penalty applies. Proposed Regulations section 301.6233(a)-1(c)(2)(ii)(D) and (E) provide that negative adjustments (*i.e.*, a taxpayer favorable adjustment that increases an item of loss, deduction or credit or decreases an item of income or gain) are applied first to adjustments to which no penalties have been imposed and then to adjustments subject to the lowest penalty. Thus, the negative adjustments are applied in a manner that maximizes penalties.

Example 3 in Proposed Regulations section 301.6233(a)-1(c)(3) illustrates the impact of the treatment of negative adjustments. In that example, there is a $100 increase to ordinary income subject to a 20% accuracy-related penalty, a $50 decrease to ordinary income (*i.e.*, a negative adjustment), and a $300 increase to capital gain that is not subject to any penalty.[8] For purposes of calculating the penalty, the $50 negative adjustment is grouped with the $300 increase to capital gain and does not reduce the $100 increase to ordinary income that is subject to the 20% penalty. As a result, the imputed underpayment to which the 20% accuracy-related penalty applies is $40 ($100 x 40%), rather than $20 ($50 x 40%), and the penalty is $8 ($40 x 20%), rather than $4 ($20 x 20%).

The statute does not require such a taxpayer-unfavorable result. The statute requires only that the penalty be calculated as if the taxpayer is an individual. Treasury Regulations section 1.6664-3 provides the penalty calculation rules applicable to individuals and is silent on the treatment of negative adjustments.[9] Absent any explicit language in the Treasury Regulations, the implication is that negative adjustments are grouped by character, consistent with other provisions of the Code.[10] Further, grouping negative adjustments by character is consistent with the grouping rules for computing the imputed underpayment in Proposed Regulations section 301.6225-1. Therefore, we recommend the Proposed Regulations be revised to group negative adjustments by character for purposes of calculating the portion of the imputed underpayment subject to penalty.

CONCLUSION

We greatly appreciate the opportunity to work with Treasury and the Service on these significant tax issues and hope these comments provide helpful analysis for your review. Thank you for your consideration.

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8 The Example also includes a $10 adjustment to credits, which is ignored for purposes of this discussion.

9 Treas. Reg. § 1.6664-3(b), (d). The adjustments in Example 1 of Treasury Regulations section 1.6664-3(d) either reflect netted amounts or do not involve negative adjustments.

10 *See, e.g.*, I.R.C. §§ 1222(5) – (8) (grouping short-term capital gains with short-term capital losses and long-term capital gains with long-term capital losses).