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"TREATMENT OF SPECIAL ENFORCEMENT MATTERS"

[REG-123652-18]

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PROCEEDINGS

(10:00 a.m.)

OPERATOR: Welcome and thank you for joining the public hearing for REG 12365218. To minimize the background noise on this call please make sure your audio devices are muted. With that, I'll turn the call over to Jenny. Please go ahead.

MS. BLACK: Good morning, thank you. Good morning everyone. I'd like to thank you for attending. We are here today for the public hearing regarding proposed regulations under Part 3301 of 26 C.F.R. The proposed regulations concern the regulations implementing the special enforcement provisions of the Centralized Partnership Audit Regime which was enacted by the bipartisan Budget Act of 2015 as amended by the Protecting American From Tax Heights Act of 2015, that Technical Corrections Act of 2018. Regulations Project number is REG-123652-18.

I want to start off first today by having all the panel members gathered here today introduce themselves. To start off, my name is Jenny Black. I'm a senior counsel in the office of Chief Counsel Teacher and Administration. Richard.

MR. GOLDMAN: Good morning everyone. I am Richard Goldman. I am a deputy associate chief counsel in the Office of Procedure and Administration in the Office of Chief Counsel IRS.

MS. BLACK: Natasha.

MS. GOLDBUG: Good morning. This is Natasha Goldblack and I am an attorney-advisor with the Tax Budget Legislative Counsel in the Office of Tax Policy at the Treasury Department.

MS. BLACK: Emily.

MS. LESNIACK: Hi, I'm Emily Lesniack. I'm the senior level counsel in the Office of Chief Counsel of Procedures and Administration.

MS. BLACK: Thank you. Our schedule today includes two speakers. The list of speakers has been posted on regulations.gov. Each speaker will have 10 minutes to present. The operator will monitor each speaker's time. The panel members may then pose questions to the speaker. Let's move forward with the presentation by the speakers. We will go first with Jackson Oliver from Thompson & Knight LLP.

MR. OLIVER: Thank you for that introduction. As she just stated, I'm Jackson Oliver with the law firm of Thompson & Knight, but I'm appearing here today on behalf of the State Bar of Texas tax section. I'm also here with my colleague Lee Meyercord, who is also with Thompson Knight and here on behalf of the State Bar of Texas Tax Section as well. Just to start off I'd like to make notice that these comments are being presented on behalf of the tax section of the State Bar of Texas. They 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. These comments are being made as a result of the approval of the Committee of Government Commissions of the Tax Section in the State Bar of Texas and pursuant to the procedures of the counsel of that section, which is the governing body.

No approval or disapproval of the general membership of the tax section of the State Bar of Texas has been obtained and the comments represent only the views of the members of that section be comparative. So, attributing my comments, my comments are going focus on the proposed special enforcement regulation that involves controlled partnerships in the extension of the partner's tax limitations.

Proposed Regulation Section 301.62.1-7F, which is the regulation here at issue, allows the IRS to make partial adjustments after the partnership level statute of limitations to expire. If the partner's statute limitation is (inaudible) and either the partner has control of the partnership or the partner has extended the partner's statute of limitation and the extension expressly states the Department will be

extending the times to adjust in the statute any tax attributable to partnership related items for that taxable year. So, my comments are going to be focused on three aspects of the proposed regulation.

Our first comment is based on the principal that statute of limitations are strictly construed and the statute of limitations for partnership adjustments should not be extended beyond what was promised at the prescribed-in-statute. So, basically this puts forward that the tax of Section 6235 to analyze what tax limitations Congress has provided for. In looking at the statute, there is a detailed limitation timeframe that is provided that partnership adjustments can be made only during this time period. In looking on in the statute there are multiple exceptions to the general period of limitations. So, for example, when a taxpayer files a false return the statute of limitations on adjustment is extended three years, or if the taxpayer doesn't file a return at all, adjustments can be made at any time. So there, you know, are explicit carve-outs to the general limitations period that allow the IRS to make adjustments under certain circumstances that Congress recognize deserve extra time for IRS to definitely make adjustments.

None of the adjustments provided in the Texas statutes include whether controlling partner's statute limitation is open or whether the partner has agreed to extend this statute of limitation. There is reference to the extended period of limitation and the partner has agreed to extend it but is not necessarily looking to the partner's extended statute of limitation like what we see in a special enforcement regulation. So, in analyzing Section 6235 as a whole, we believe that it clearly demonstrates that our Congress had a clear directive to determine the statute of limitation for partnership adjustment exclusively at the partnership level. This conclusion is backed up by Congress' multiple opportunities to provide a special limitation period based on the partners statute of limitation being open.

The context surrounding the enactment as a BDA showed there are multiple issues that kept raising in determining which statute of limitation was applicable, whether it was the partner's statute of limitation, or the partnership statute of limitation. There is considerable litigation over these issues and we believe that Congress enacted the BDA to ameliorate some of these issues and make it clear that the only focus should be based on the partnership statute of limitation taking an entity based approach.

There are also two sets of technical corrections where Congress made changes to the bill and in one of those sections in 2019 Congress specifically took up an issue of the statute of limitation which would allow the IRS to issue (inaudible) to revise an otherwise closed statute of limitation. So, Congress recognized that as an issue, a special statute of limitation that needed to be fixed, so they took care of it in 2018.

They also took care of the — they addressed the special statute of limitation for a taxes imposed by a chapter other than Chapter One, notably that chapter — Congress' act during the 2018 technical directions for this specific provision is provided in the same statute that the special enforcement consideration is provided for.

So, despite Congress focusing on special limitation issues and technical directions, they chose not to enact any provision that would alter the general rule that statute of limitation to partnership adjustments should be determined exclusively at the partnership level. So, the legislative history and the tax limitation statute indicate that as a partner, the partnership statute of limitation really should be irrelevant as to when partnership adjustments should be made.

The third focus of our comment is just based on the actual use of the term, control, and the extent that the term control would be used in applying the special enforcement consideration by the IRS.

So the application of the control partnership prepared regulation would extend beyond the tiered partnership structures discussion which the Treasury used in the preamble to discuss the need to have a provision that allows in situations where the partner's statutory of limitation is open and under audit, but the partnership has been closed, the IRS determined that the special enforcement matter was necessary to provide for efficient resources within use of the IRS. But, the proposed need doesn't just apply, you know, for tiered partnership structures based on the definition of the term control. It would extend out much further and apply to any partnership adjustments involving direct or indirect partners whether they extended their statute of limitations and is generally when a partner controls the partnership rather than is involved in multiple tier entities.

We do recognize the IRS' concern with multi-tiered structures and sometimes there are administrative difficulties in determining partner and partnership information, but we knew that Congress recognized those issues and decided to simplify the tasking, determine everything directly at the partnership level, so we believe the special enforcement regulation is not necessary, especially based on the tax in the statute, the context that this statute is enacted and the legislative issue. Thank you.

So, while we respect the IRS' concern, limitation periods are, they can be arbitrary and sometimes it will favor the government and sometimes it will favor the taxpayer, but they are necessary for the practical administration of income tax policy and the enforcement code.

As several courts have noted, the statute of limitation frequently involved some hardship and they are by definition arbitrary and if there is an issue, the statute of limitations, they think that hardship should be a matter of policy for Congress. So, based on all these principles the state bar of Texas recommended that the propose regulation be amended to strike proposed regulation Section 301.6241-7F.

Those are all the points that I chose to make and if anybody has any questions I'll be happy to answer if I can.

MS. BLACK: Thanks. I do have a question. Do you think that when 6211 says, the secretary may prescribe rules under which CBA or a portion of it does not apply to partnership related items, that this means that the partners 6501 period now applies to those items, because if CBA doesn't apply, which then 6235, which is part of CBA, no longer applies?

MR. OLIVER: So, your question by allowing for the secretary to prescribe regulation —

MS. BLACK: So, CBA no longer applies to those items —

MR. OLIVER: Right —

MS. BLACK: — but that would mean 6235 no longer applies to those items?

MR. OLIVER: No, we think 6532 applies to any item within the BDO including for the time period for when partnership adjustments should be made. The statute clearly is based on the actions of the partnership and the partnership statutes that the partners —

MS. BLACK: So, you think that 6235 would still apply even when, under the 6241.11, the IRS has prescribed regulations under which this subchapter, or any portion thereof does not apply to such items?

MR. OLIVER: Right, that the regulations are determining, you know, what applies when, you know. So, the regulations are allowing the IRS the, you know, ultimate authority to decide whether it applies or not. So, it's our position that to decide whether to still apply in those circumstances because dealing with a special limitation issue which should be determined just based on the tax rule and the congressional intent behind it. I do believe that this conclusion is determined at the partnership level based on the strict interpretation of the code.

MS. BLACK: All right, just to clarify, you don't — you think that even though we have the ability, the actual ability to turn off DBA, that they do not have the ability to turn off all of DBA, because they cannot turn off SEC. 6235, is that my understanding you correctly?

MR. OLIVER: Well, what we did the special enforcement consideration is not warranted to take this out of DBA. So, we recognize that Secretary was allowed to make, you know, regulations for special enforcement matters that would be more practical to be determined outside the BDA, but we viewed this matter, which is specifically based on, you know, limitations period, which very clear — there is a clear framework designed by Congress in 6235 that that still applies based on the purpose by the enactment of the DBA in determining the partnership being addressed solely at the partnership level.

MS. BLACK: Thank you. Does anybody else have any questions?

MR. GOLDMAN: No, I do not.

MS. GOLDVUG: No questions for me Jenny.

MS. MEYERCORD: No questions for me either.

MS. BLACK: So thank you Mr. Oliver for your time. Now our next speaker is Lee Meyercord from, also from Thompson and Knight. Lee.

MS. MEYERCORD: Thanks Jenny. Yes, as Jenny said, I am Lee Meyercord. I'm a partner with Thompson & Knight in Dallas. Thank you all for giving us the opportunity to testify today. We appreciate it and we appreciate the thoughtfulness and time that the IRS and Treasury put in to drafting these proposed regulations. I know from being on panels with Jenny that she puts a lot of thoughtfulness. It's rare that I raise a concern or question that she hasn't already considered. So, we appreciate the deliberation behind — in this process. I'm a little surprised that there aren't more people testifying. I participated in the EPA conference and the contract questions generated lively discussions.

On this question that Jenny just raised to Jackson, just one additional point. You know, I understand Jenny's point that the act Congress has given Treasury and the IRS the authority to turn off DBA and certain special enforcement matters and I think our position is just that it's not appropriate to turn off in the circumstances described in that provision, the controlled partnerships. You know, I think the preamble discusses the tiers of the enforcement considerations and issues that arrive in that tiered partnership context and I'd just like to note that those tiered partnership were one of the reasons that the DBA was enacted because of the problems in auditing them and physically facing through the adjustment tract to the ultimate partners to assess and collect the tax.

I'm going to focus my time on two other provisions in the proposed regulations. One being the special enforcement provision and the other being the treatment of non-income adjustments.

All right, so let's start with the special enforcement matter which is the ability to make partnership adjustments and a partner level audit. So, as Jenny mentioned at the outset, we are here talking about the specialized audit regime enacted by the BBA and the general rule under that attachment to partnership items and, you know, partnership audits, you know, our special enforcement audits an distinct option added the special enforcement rules that are in the proposed regulations 301-6221-7B. It allows partnerships and adjustments at a partner level. So, that's not typically put into a physical audit. The deductions related to a partner level adjustment and the partnership treatment and is based in whole or in part on information provided by the partner. I'm paraphrasing here because what I'm relating to is not actually precise, as I'm sure, I'm sure our government panel has immediately picked up on. But, and the rationale given in the preamble, it makes a lot of sense for this rule, okay. So, if a partner contributes an asset to the partnership in exchange for partnership interest, and so the preamble argues, okay, in this situation, the partner has all the information regarding that the partnership basis is in the asset because of course, the partnership

just took a carry over basis from the partner. And so, it could be more efficient and appropriate their understandable objective, and I think you know, we can appreciate that it might be more efficient. And that the partner might appreciate the opportunity to participate, and fully control that audit. We still think it conflicts with Congress' general directive in that enacting the BBA Regime.

A partnership adjustment should be made in a partnership level audit. And as I am sure, and Jenny would be quick to point out, that there is the authority, right, in 6241 to make exceptions to this rule, but we think the special enforcement consideration should be narrowly prescribed. And so there has to be a compelling reason for departing from this directive, and to exercise that authority in the statute. And the reason has to be more than I think can lend (phonetic) efficiency, or convenience.

So, we would recommend that this rule be withdrawn. If it's not withdrawn, we have a couple of clarifications to the example. So, the example addresses the sale of a partnership entrance (phonetic) by A to B, and A originally acquired its partnership interest by contributing in asset to the partnership. And then in auditing A, the IRS adjusts the basis of the partnership aspect.

So, we have two comments on this example, and the first is it was unclear to us why the partnership adjustment is made in the example. Proposed Regulation Section 301.6241-7H2 provides that any partnership adjustments that are made outside of a partnership level audit, which would be the adjustment to the partnership's basis in the assets. And the issues here (phonetic) are not binding on any person that is not a party to that proceeding.

So, in the example, only A was a party to that partner level audit, and A is no longer a partner in the partnership. So, therefore, there is no one left in the partnership, in our view, that could be bound by the partnership adjustment.

And so we weren't clear why the partnership was made.

The second clarification, it really goes to just how these rules interact with Subchapter K provisions, specifically, a Section 754 election. So, the example doesn't explain how this partnership, the adjustment to the partnership assets' basis would interact if the partnership had a Section 754 election

in place. So, if a Section 754 election was in effect let's say, when A sold its interest to B, B shares that partnership space, and the asset would have been adjusted at fair market value. And this adjustment recognizes that A was already taxed on the gain of its partnership interest, and that B should not be taxed again. And it's our view that the IRS should not undo that Section 754 election in an audit of A.

One possibility to adjust the rules to really take into account these two considerations would be to add an example that doesn't involve the sale of A's partnership interest, because of course, then in that situation, you do have a party to the proceeding that would still be a partner in the partnership, so you could show how that partnership adjustment, and the impact of that partnership adjustment is limited to A. And then also, of course, without the sale, there is no 754 election issue.

The second provision I'd like to briefly touch on is the treatment of non-income adjustments. Of course, non-income adjustments are adjustments to things like the partnership's basis and asset, a partner share, a partnership liability, and the partners' tax capital account. So, Proposed Regulation Section 301.6225-3B8 provides that non-income adjustments do not result in an imputed (phonetic) underpayment are taken into account are taken into account by adjusting the item on the partnership's adjustment year return. And the proposed regulation's joint example, where the IRS conducts an audit in 2022 of a partnership's 2020 tax year and adjusts the basis of the partnership asset by \$10. And then the example includes the basis adjustment as a positive adjustment determining whether an imputed underpayment results.

Now, we do not think that — this brings us to our first comment, we have two comments on this, this provision, is that we don't think non-income items should be treated as a positive adjustment in computing the imputed underpayment, because this could result in a recognition of gain on an asset, before the asset has been sold or disposed of. Which of course, is inconsistent with general federal income tax principles, right? Where you know, we wouldn't realize, or recognize gain before there is actually a realization and recognition event.

And not only do we think that the correct result under general federal income tax principles, but we also think this treatment might be better for the efficiency of an audit, because non-income adjustments that could result in an imputed underpayment are much more likely to be aggressively challenged by the partnership when they may not have otherwise been.

We have recognized that there's other guidance that suggests that non-income adjustments should be treated as positive adjustments. And so, you know, of course there is the ECA (phonetic) liability example, and the Treasury Regulations, and their results are noted as 2021-13. So, the IRS and the Treasury may have think that the ship has sailed on this point, but we thought it was important enough of an issue to urge the IRS and the Treasury to reconsider.

Regardless on that point, we recommend that if the provision is retained, then the example by revised to make clearer that the adjustment, in the adjustment year, does not result in tax. So, if it does, this would be the situation, once it doesn't cause an imputed underpayment, and then the adjustment is then made in the adjustment year, the partnership only corrects, you know, in the —

SPEAKER: Sorry, I need to — I need to interrupt you, Lee, but there is one more minute remaining.

MS. MEYERCORD: Thank you very much. Appreciate that. So, that is perfect timing because I am almost done.

So, this is the partnership in the example, would only correct the assets' basis in 2022, and wouldn't realize a recognized gain on that \$10 basis adjustment in 2022. And that's it for my comments. I am happy to take questions. And again, I appreciate the opportunity to speak with everybody today.

MS. BLACK: Thanks, Lee. As you can imagine, I have the same questions for you that I did for Mr. Oliver, in that —

MS. MEYERCORD: Mm-hmm.

MS. BLACK: — when you are talking about adjusting things at the partner level, and how that was inconsistent with BBA, which is a partnership level determination. I was wondering what you thought about 5241-11's provision that allows us to turn off portions of BBA? And if when we are turning off either BBA, or a portion of BBA, does that mean that we then adjust the item at the partner level? And if so, does that speak to Congress' intent with respect to special enforcement and determining items at the partner level?

MS. MEYERCORD: Hmm, can you repeat that? Do you mind, Jenny?

MS. BLACK: Sorry, yes, it was 6241-11 says that as you know, as we talked about with Mr. Oliver, the —

MS. MEYERCORD: Mm-hmm.

MS. BLACK: — the Secretary has the authority to prescribe regulations under which partnership related items, BBA does not apply to them, or does not — a portion of BBA does not apply to them. So, if BBA doesn't apply to a particular item, is that item adjusted at the partner level? Because BBA no longer applies, and if it is determined at the partner level, because BBA no longer applies, is that — how does that make it inconsistent with Congress' directive that items be determined at the partnership level?

MS. MEYERCORD: Yeah, thanks, Jenny. I think that's a great question. So I think we agree with your first point. Like if you turn off BBA, which the statute certainly gives IRS and Treasury the authority to, then you make the adjustment at the partner level. So, I think my response is similar to how I would respond to the statute of limitations question in that the ability to turn off BBA should be very narrowly prescribed so that in general, that Congress' directive of these items should be determined at the partnership level that that's respected, right?

Because if they are — if Congress' directive is we should determine partnership related items at the partnership level, and then the IRS and Treasury says well, we can turn off whenever we want and we are going to turn it off 100 percent of the time, I mean, we have rendered the statute meaningless, right? So, I think our thought is that it should be in very limited circumstances, that we turn off BBA. And we shouldn't turn it off for convenience or efficiency. We should turn it off for something that really resents a really unique special enforcement consideration.

Which, like the ones identified in the statute, right? Like a criminal investigation, or a foreign partner, or partnership, I think those are really an issue of the type of circumstances that might warrant turning off the BBA.

MS. BLACK: Thank you. Let's have another question.

MS. MEYERCORD: Mm-hmm.

MS. BLACK: You mentioned in your outline Section 301.6241-7H2, which is a provision that says that if we adjust items outside of BBA, that the adjustments are not binding on the partnership, or the other partners, unless those persons are parties to the proceedings.

MS. MEYERCORD: Mm-hmm.

MS. BLACK: I think the exact wording is any final decision with respect to a partnership related item adjusted in a proceeding not under Chapter C — or Chapter 6, is not binding on any person that is not a party to the proceeding. I was wondering how you thought that provision works?

MS. MEYERCORD: Well, so that's another one that we certainly have a question mark. In fact, we thought that that meant for example, and perhaps we are wrong about this, right? But we thought that that provision meant that in the example of a partner level audit, where there is an adjustment to the partnership's basis, that that adjustment to the partnership's basis would only bind that partner. It would only bind A.

MS. BLACK: Right.

MS. MEYERCORD: And so therefore the other partners in the partnership, would not be bound by this new basis. But then you know, of course then we had a question, because then it didn't make sense for us in the example for the 7B rule, the example there, to make the partnership adjustment. Because A is no longer a partner in the partnership and so we really weren't sure who would be bound by that partnership adjustment or why that partnership adjustment would be made.

MS. BLACK: In the example, do you think that we, the IRS, did not need to make the adjustment to the contribution in order to adjust A's outside basis in partnership that he sold?

MS. MEYERCORD: Ah, yes, that is actually how I read that, is that they did not need to adjust the partnership spaces in the assets to be able to adjust a basis in the partnership.

MS. BLACK: Why do you think that?

MS. MEYERCORD: And you are saying because the basis, of course, is a partnership item, so therefore, the basis should be adjusted in a partnership proceeding?

MS. BLACK: I believe the example says that — let me read it, I believe it says the contribution in this one. So, I'm just because it says that to determine the aid is just basis and asset and immediately prior to the contribution should have been \$20 less. A's basis and asset — and then it says A's adjusted basis and A's interest in partnership is reduced. So, how far does —

MS. MEYERCORD: Okay, so that's interesting, so you're — I see, so you guys think okay, this is helpful, so the example, the partnership adjustment, you all recognize number 7H2, it doesn't apply to anyone else. But the reason the partnership adjustment is being made in the example and correct me if I am misstating. I am just trying to understand, so the reason that a partnership adjustment is made, is because it's necessary to adjust a basis in the partnership? Is that — is that what I'm understanding?

MS. BLACK: It's these things that — that would need to be done.

MS. MEYERCORD: With or without this special provision that allows you know partner adjustments in a partner level audit?

MS. BLACK: I mean, I guess, either.

MS. MEYERCORD: Okay, so with this provision, I think no, right? You could — you are able to make this what you know, could be considered a partnership adjustment to A's basis in the partnership. Without this example, I think you make a good point, I mean, without this provision. But you could not, the IRS could not adjust a basis in the partnership in a partner level audit. So, you would need this provision to do that — make that adjustment in a partner level audit.

MS. BLACK: Those were my only questions. Does anybody else have any questions?

MR. GOLDMAN: No.

MS. LESNIACK: No, I don't have any.

MS. BLACK: Okay, hearing no additional questions from the panelists, I would like to, if we could, open up the attendee line and see if there is anyone else who would like to present — present, sorry, present oral comments who has not previously done so we would like to provide people the opportunity now.

OPERATOR: To ask a question on the phone, please press #2 on your telephone keypad to enter the question queue. You will hear a notification when your line is unmuted. At that time, please state your name and question. Once again, pressing #2 will indicate you wish to ask a question.

I do not see any questions in the phone, as of now.

MS. BLACK: Okay, I see that there are no additional comments or questions that would like to be made in this hearing. I will conclude our hearing today. I would like to thank everyone for attending, especially our speakers who took the time today to make their presentations and answer questions and I greatly appreciate their comments and their input. So, thank you.

OPERATOR: That concludes our conference. Thank you for using AT&T Event Services.

(Whereupon, at 10:36 a.m., the PROCEEDINGS were adjourned.)