May 25, 2021

Ms. Holly Paz
Deputy Commissioner
Large Business & International
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Ms. Holly Porter
Associate Chief Counsel
Passthroughs & Special Industries
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Re: Changes to Simplify and Improve the AAR Process Under the Centralized Partnership Audit Regime and Proposed "AAR-EZ" Process Framework

Dear Ms. Paz and Ms. Porter:

The American Institute of CPAs (AICPA) appreciates the efforts of the Internal Revenue Service (IRS) to continue to develop guidance and program initiatives related to the centralized partnership audit regime ("CPAR") enacted as part of the Bipartisan Budget Act of 2015 (BBA).[1] In light of these ongoing efforts, we are writing to provide recommendations to improve the CPAR's administrative adjustment request (AAR) process. If adopted, these recommendations will help alleviate bottlenecks and resource constraints, streamline the AAR process, increase compliance, and ultimately reduce the system-wide burden the current AAR process imposes on practitioners, taxpayers, and the IRS.

It is administratively cumbersome and time-consuming for partnerships and practitioners to complete and file AARs and for the IRS to process them. In addition, the complexity of the AAR process has made the cost of making minor adjustments to previously filed partnership returns, including those adjustments that are not relevant in determining the tax liability of any partners, unreasonably high. These factors discourage, rather than encourage, partnerships to file AARs to self-correct returns.

The IRS has recognized these issues and has provided past relief to allow BBA partnerships to make corrections outside of the AAR process. However, this relief was temporary. These comments provide recommendations to alleviate the system-wide burden encountered by all parties in properly complying with these new processes. As a continuation of prior discussions, and in response to your request for written comments identifying these changes and alternatives to the AAR process, the AICPA is respectfully submitting the following recommendations to provide solutions, both short term and long term, to simplify and improve the process of self-correcting partnership returns:

[1] P.L. 114-74. All references to "section" are to the Internal Revenue Code of 1986, as amended, and all references to "Reg. §", "Prop. Reg. §", and "regulations" are to U.S. Treasury regulations promulgated thereunder, unless otherwise specified.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Sarah Allen-Anthony, Chair, AICPA Partnership Taxation Technical Resource Panel, at (574) 235-6818, or Sarah.Allen-Anthony@crowe.com; Alexander Scott, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9204, or Alexander.Scott@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

American Institute of CPAs

Changes to Simplify and Improve the AAR Process Under the Centralized Partnership Audit Regime and Proposed "AAR-EZ" Process Framework

May 25, 2021

BACKGROUND

The BBA enacted the CPAR which is generally applicable to partnership tax years after December 31, 2017. The CPAR replaced the longstanding partnership audit and litigation rules enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).[2] The CPAR provides that all adjustments to partnership-related items are determined and any related tax is assessed and collected at the partnership level. The CPAR generally allows the IRS to audit, assess and collect any determined underpayment of tax directly from a partnership, subject to certain available elections. For example, a partnership may elect to "push-out" the adjustments to its reviewed-year partners, in which case the tax attributable to the adjustments is assessed and collected from those partners.[3]

Numerous final regulations, regulation projects, sub-regulatory guidance, and forms have been issued as part of implementing the CPAR.[4] In lieu of filing amended returns, partnerships subject to the CPAR must file an AAR to revise a previously filed tax return. Section 6031(b) generally prohibits filing corrected Schedules K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, except in certain limited situations; however, the provision grants the Secretary authority to set forth additional situations where corrected Schedules K-1 may be filed. Special rules apply to tiered partnership structure adjustments, and the IRS granted a limited time for partnerships to file amended returns for certain 2018 and 2019 tax years to take advantage of retroactive tax benefits enacted by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).[5] Certain small partnerships are eligible to affirmatively elect out of the CPAR.[6]

I. Short-term Simplification Measures Under the Existing AAR Process: Instruction Changes, Clarifications, and Attachments

Overview

The CPAR significantly improves the ability of the IRS to audit, assess, and collect taxes relating to improperly characterized or mis-reported partnership activities or transactions.[7] In addition, the IRS may audit and assess imputed underpayments on partnerships, and the partnership and its

[2] P.L. 97-248. BBA also removed the electing large partnership regime.
[3] Section 6226(a), section 6226(b), Reg. § 301.6226-1.
[4] *See, e.g.*, TD 9844, LB&I-04-0320-0005, Form 1065-X, *Amended Return or Administrative Adjustment Request (AAR)*, Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*.
[5] P.L. 116-136, Rev. Proc. 2020-23.
[6] Section 6221, section 6241(1).
[7] Although the former partnership audit rules under TEFRA allowed the IRS to audit partnerships separately from the partners, the TEFRA Audit Rules were challenging to apply and did not provide a streamlined approach to the assessment and collection of tax.

partners should then generally bear the burden of determining how that amount will be paid, pushed-out (including through tiers), or modified as applicable.

However, the AAR process is overly complicated for partnerships that wish to change an administrative, informational, or similar item to effectively and efficiently comply as it treats all changes to partnership items in a manner similar to audit adjustments. Many partnerships that wish to self-correct a previously filed partnership return have not mis-reported items that could result in a change of tax. In these cases, the corrections partnerships wish to make are primarily informational. For example, a partnership discovers that it inadvertently failed to file a Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations,*[8] but included all of the taxable income from the foreign entity as required on its originally filed return. A similar circumstance exists where a partnership inadvertently omitted a tax accounting method election with its return, but files consistent with making the election. In both cases, there is no change to taxable income of the partnership or any partner. The AAR would merely be filed as a transmittal for a document or election that should have, but was not, included with the originally filed return.

Recommendations

The AICPA recommends that in certain situations involving changes to ministerial or minor administrative items the IRS allow taxpayers to:

1. Attach certain corrected or previously omitted statements or schedules to Form 1065-X, *Amended Return or Administrative Adjustment Request (AAR)*,[9] Form 1065 and Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)* filed as AARs without having to complete the AAR in its entirety;[10] and/or

2. File a corrected Form 1065, *U.S. Return of Partnership Income,* including Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc*., annotated at the top of the form as "Corrected."

A revenue procedure available for updating could define situations eligible for these simplified self-correction filings. The eligible adjustments should be limited to those that correct minor administrative items on a partnership return that do not affect income, gain, loss, deduction or credit or change partner allocations ("Ministerial Items" or "Ministerial Adjustments/Changes," described below).

These short-term recommendations are not intended to involve changes to the forms. Rather, the AICPA suggests that these recommendations be effectuated in the existing AAR framework. Protocols for implementing these changes could be set forth in instruction changes (including the use of cover sheets), clarifications, and the proposed revenue procedure.

[8] As required under section 6038B.

[9] When a Form 1065-X is filed, only the first page of the form should be required to be filed in the case of a Ministerial Item.

[10] In filing AARs, we note that paper filers use Form 1065-X; electronic filers use Form 1065 *and* Form 8082.

Analysis

The AAR process is time intensive for both taxpayers to complete and the IRS to process. Ever increasing reporting requirements beget increasing complexity, and the number of non-intentional, minor errors that cannot be rectified without taxpayers filing and the IRS processing an entire AAR pose a systemic risk to good faith compliance efforts.

For example, if there is a transposition error in a partner's social security number or address on an issued Schedule K-1, the current rules prohibit correcting that error by filing and furnishing a corrected Schedule K-1 to that partner after the filing deadline has passed. A partnership may be required to file Forms 8082 and 1065 or 1065-X, as well as Forms 8985 *Pass-Through Statement-Transmittal/Partnership Adjustment Tracking Report*, and 8986 *Partner's Share of Adjustment(s) to Partnership-Related Item(s)*, to properly report the partner's social security number or address to both the IRS and partner. This is a resource-intensive undertaking for processing basic administrative errors. The AAR format and questions do not lend themselves to fixing errors that do not adjust an item of income, gain, loss, deduction, or credit. Our recommendations suggest a procedure other than correcting these errors using a formal AAR.

Definition of a Ministerial Item or Ministerial Change/Adjustment

Ministerial Items or Ministerial Adjustments/Changes should generally mean items that are not relevant in determining the tax liability of any direct or indirect partner. Examples of Ministerial Items include:

- Missed and/or omitted election statements when the return is filed as if the election was included with the return (*e.g.*, a late section 754 election when the partnership complied as if the section 754 election was made and filed with the return);
- Omitted or changes to informational forms required to be attached to the partnership return (*e.g.*, Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*);
- Changes to items A-K on Page 1 of Form 1065;
- Changes to Schedule B of Form 1065;
- Changes to information on Schedule K-1 Parts I and II with certain exceptions, such as tax basis capital accounts and unrealized 704(c) layers, but excluding Item K liabilities;
- Changes to non-tax amounts reported on Schedule L or financial statement amounts reflected on Schedule M-3 to the extent no amounts on the tax return are changed for U.S. federal income tax purposes;
- Changes to the Schedule K-1 footnote information to the extent the information consists of a breakout of or additional detail for amounts or information already included on Schedule K-1.

Application of Proposed Revenue Procedure to Short-Term Solution

A revenue procedure identifying the list of Ministerial Items that could be corrected via statements, cover sheets, or annotations, attached to an already filed return or issued Schedule K-1, without having to file an AAR, would alleviate the costly and unnecessary administrative burden on the

IRS and partnerships. The revenue procedure should allow the IRS to update the guidance outside of the AAR process – adapting as circumstances change. The revenue procedure also places "guard rails" on this filing procedure process, providing assurances to both taxpayers and the IRS for penalty implications and substantial authority of what Ministerial Items would qualify.

A reissued form or transmittal, subject to an annotation, could also correct Ministerial Items.[11] The mandated use of such an annotation would permit the IRS to route or process corrections in an efficient and effective manner, and the failure to use the prescribed annotation could render the filing ineffective. Allowing corrected filings in this manner would eliminate the burden of filing and processing a complete AAR.

Proposed Streamlined Processes and Form Instruction Changes/Clarifications

Streamlined processes should include specific instructions for preparing, transmitting, and filing Forms 1065-X, 1065, and 8082 due to the difficulty to answer the questions on the forms if the AAR does not involve an adjustment to an item of income, gain, loss, deduction or credit. Specifically, instructions for filing a streamlined AAR for Ministerial Items should be revised to allow partnerships to complete Form 8082 without including a response to questions that are irrelevant, including Part I, B through E and Part II.

II. Long-term AAR Simplification: Proposed "Form AAR-EZ" Process

Overview

Partnerships subject to the CPAR must file Form 1065 and include a Form 8082 if electronic filing or Form 1065-X if paper filing to correct a previously filed return. Additionally, partnerships pushing out adjustments must also file Form 8985 and Form 8986. As discussed, these forms do not lend themselves to fixing Ministerial Items.

Recommendations

The AICPA recommends a long-term solution of an "AAR-EZ" process in order for partnerships to correct Ministerial Items. The AICPA initially proposes two possible solutions of implementing our AAR-EZ model framework.

1. The IRS develops a new Form AAR-EZ specifically for adjusting Ministerial Items described in Part I. The new form could replace the measures described in Part I. Any changes to partnership returns covered under the CPAR outside the scope of Form AAR-EZ procedures would continue to be made using Forms 1065 and 8082 or 1065-X, as appropriate. The revenue procedure described in Part I could be used to identify the Ministerial Items that are eligible to be changed using the Form AAR-EZ; or

2. The addition of a checkbox at the top of Forms 8082 and 1065-X to indicate that the streamlined AAR procedures are being applied. The corresponding instructions would

[11] The revenue procedure could require specific notification similar to "Filed Pursuant to Rev. Proc. 2021-XXX." For example, Rev. Proc. 2013-30 requires such a notification to address S corporation late filing relief.

provide guidance for using the AAR-EZ procedures, similar to the recommendations for these forms in Part I.

Filing an AAR generally extends the statute of limitations with respect to a partnership tax year.[12] The AICPA also recommends that the IRS clarify whether filing a Form AAR-EZ to make changes to Ministerial Items would have the same result of extending the statute. Similarly, the AICPA recommends that the IRS affirmatively state whether a partnership that is filing an "AAR-EZ" to make changes to Ministerial Items may also change the partnership representative on Form AAR-EZ.

Analysis

The proposed new Form AAR-EZ builds from the recommendations and analysis in Part I. The new Form AAR-EZ would be a simplified version of the current AAR forms specifically designed to allow BBA partnerships to correct Ministerial Items without having to file a complete AAR or provide push-out statements to the partners. As an alternative, adding a checkbox to the existing Forms 1065-X and 8082 would simplify the AAR process by providing that only certain portions of those forms require completion.

The advantage of adopting our recommended form changes, rather than changing form instructions as suggested in Part I, is that software developers are less likely to make errors when implementing these changes. Our long-term solutions provide an easy method to identify the types of changes that could be made. Preparing and filing the changes with the IRS would reduce the administrative burden on both taxpayers and the IRS.

The two proposals provide a long-term solution by simplifying the AAR process in cases where adjustments are ministerial in nature and are not relevant in determining the tax liability of ultimate tax paying partners.

III. Deemed Automatic Extension Request(s) Under the Superseding Return Rules

Overview

Under current IRS procedures all taxpayers must affirmatively request an extension of time to file an income tax return. This request for extension is generally automatically granted. However, in conjunction with the recommendations in Part I and Part II, in the case of partnerships subject to the CPAR, the need to make an affirmative request creates a trap for the unwary for unsophisticated taxpayers who file on the original due date without requesting an extension and then discover an error before the extended due date.

Recommendation

The AICPA recommends that the IRS deem a BBA partnership as having filed an automatic extension request if that BBA partnership timely filed its Form 1065 for purposes of the

[12] *See* section 6235(a)(1)(C).

superseding return rules.[13] The automatic extension could be triggered by filing a subsequent return on or before the extended due date, and any number of subsequent superseding returns could be filed at any time prior to the extended due date regardless of whether an extension was actually filed.

Analysis

A superseding return is a return that is filed after a first timely filed return but on or before the due date of the return, including extensions.[14] The superseding return is treated as the original return. Any taxpayer other than a BBA partnership can use an amended return to change any item on a previously filed return after the due date for filing the return (including extensions). After the due date of the original return (including timely filed extensions), a BBA partnership can only change partnership-related items by filing an AAR. An AAR is complex and does not permit the partners to make corresponding adjustments on amended returns. Instead, partners take the adjustments into account in a pro-forma manner and include the corresponding additional reporting year tax as additional income tax on their return for the year the adjustments are pushed out to the partner. If the adjustments result in a reduction of reporting year tax, that reduction is limited to the actual tax liability in the reporting year.

Treating partnerships subject to the CPAR that timely file their return on or before the original due date as having automatically filed an extension removes this trap for the unwary by allowing those partnerships to self-correct errors without filing an AAR within the same filing year. Filing extension requests for BBA partnerships should become more commonplace as more partnerships realize the need to have a contingency plan to avoid filing an AAR for errors discovered shortly after filing the return. However, unsophisticated taxpayers will not be aware of this opportunity and therefore failure to file an extension will be a trap for the unwary. The ability to correct information under the superseding return rules could reduce the number of AARs filed, presumably reducing the burden for practitioners, partnerships and the IRS from processing and filing under the CPAR.

Our recommendation provides taxpayers with a self-help mechanism if an inadvertent error is discovered after the original due date (not extended), without filing a complete AAR (or even an AAR-EZ). Tax software and familiarity with the superseding return rules further encourage self-correction in the filing year and increasing proper compliance, as opposed to the cumbersome and in many cases, cost-prohibitive AAR process.

Any concerns regarding allowing this procedure should be outweighed as partnerships subject to the CPAR are prohibited from filing amended returns. Partnerships filing by the original due date should not be disadvantaged relative to partnerships that file for an automatic extension. If a deemed extension is not provided, tax preparers may adopt a procedure to extend all partnership returns soon after year-end as a best practice. The AICPA also looks at this opportunity to increase IRS-taxpayer-practitioner benefits without significant financial outlays.

[13] Described in Rev. Proc. 2019-32.
[14] *See* Rev. Proc. 2019-32.

IV. Limited Amended Partnership Returns in the Case of Retroactive Tax Changes

Overview

The IRS exercised its authority through Rev. Proc. 2020-23, including authority under section 6031(b)(4), to allow BBA partnerships to file amended partnership returns and Schedules K-1 for a limited time in lieu of filing an AAR. The procedure was allowed to claim retroactive tax benefits enacted under the CARES Act as well as any other tax attributes to which the partnership was entitled by law. BBA partnerships had until September 29, 2020 to file amended returns under Rev. Proc. 2020-23. Unless a partnership used the special amended return procedures, the general AAR procedures applied.

This exercise of IRS authority rightly recognized that the AAR process would defer and, in some cases, deny taxpayers from realizing the CARES Act benefits Congress intended. The added significant burden and cost would have undermined the positive effect the CARES Act intended to have on the economy and taxpayers.

The complexity, burden, and cost of filing AARs did not disappear on September 29, 2020. Rather, taxpayers and their advisors who are only now tackling AARs are experiencing how difficult, time-consuming, and expensive the AAR is to file.

Recommendation

The AICPA recommends that when a wide range of partnerships are affected by a retroactive change in or interpretation of tax law, the IRS allow BBA partnerships to file an amended partnership return.

Analysis

The IRS exercised its authority in Rev. Proc. 2020-23 to allow a BBA partnership to file an amended partnership return and issue amended Schedules K-1 to claim retroactive tax benefits enacted by the CARES Act as well as any other tax attributes entitled by law.

The AAR process is extraordinarily resource intensive and can be punitive in certain instances. This includes the time needed to complete and process Forms 8985 and 8986 if there is a push out (i.e., in cases where the adjustments are taxpayer favorable or to ensure the adjustments are taken into account by the partners who were originally allocated the incorrect item/amount). More importantly, a partner subject to the AAR process can have tax consequences that are substantially different from a similarly situated partner merely needing to amend the return due to the receipt of an amended Schedule K-1. For instance, if a refund is due to a partner in the reviewed year, the partner could lose the benefit of that refund, or the refund could by limited, by the amount of the partner's tax liability in the reporting year. Other differences negatively affecting a partner subject to the AAR process include the calculation of interest, penalties, and the time for reporting. In situations in which there are retroactive tax changes, retroactive relief from such hardships should be provided by means of a limited exception to file amended returns.