Testimony on Proposed Regulations (REG-136118-15)
Regarding the Centralized Partnership Audit Regime
Presented at Public Hearing – October 9, 2018

Good morning. My name is Michael Greenwald and I am a partner at Friedman LLP. I am testifying today on behalf of the American Institute of CPAs. I am currently the chair of the AICPA Partnership Tax Technical Resource Panel.

The AICPA has submitted a series of comments to the IRS on the Centralized Partnership Audit Regime and the proposed regulations, including our latest letter issued this morning. My testimony will focus on the proposed regulations on Partner-Level Penalty Defenses, as well as two areas **not** covered by any guidance issued to date - an audited partnership's access to the Office of Appeals and the impact of the provisions under the Tax Cuts and Jobs Act (commonly referred to as TCJA) on the Regime.

The Regime significantly changes the way adjustments made by the IRS during an exam are assessed and paid. By default, a partnership is liable for **any** imputed underpayment. The underpayment is potentially reduced through requested modifications (such as, the filing of amended returns by partners). Alternatively, a partnership may elect to "push-out" an adjustment to its partners, who must then prepare and file "adjustment statements" for the audited and affected tax years.

First, let's talk about penalties and the process for raising a defense to a penalty. Under the Regime, the IRS determines and assesses penalties at the ***partnership-level***. However, the actual calculation and ability to raise a defense occurs at the ***partner-level***. We have suggestions on how to reconcile and streamline this process.

Under the proposed regulations, a partner can **only** assert a penalty defense (such as, reasonable cause or good faith) if the partner first pays the tax and penalty due and then files a claim for refund of the penalty. This process will result in the needless expenditure of additional resources by the taxpayer and the IRS, while further extending the length of time until final resolution of the case.

Instead, we recommend allowing partnerships to submit defenses on behalf of the partners (both direct and indirect) **during the modification period**. In the case of a partnership electing the "push-out" procedures, the IRS should allow the direct and

indirect partners to submit a statement supporting a partner-level defense. They could submit it with their reporting year return.
It is both fair and **more efficient** for the IRS to consider the validity of any partner-level defense early in the process. Otherwise, the agency would force some partners to unnecessarily pay the proposed penalties.

Penalties can represent a sizable dollar amount and the requirement that taxpayers must provide ***advance*** payment of penalties, even in cases where they have a valid penalty defense, has the potential of imposing a significant economic burden. Partners no longer have the ability to participate in the actual exam, or challenge IRS determinations regarding items reported on the partnership return. They have lost **all ability** to challenge the actual assessment of additional tax determined by the IRS. To impose additional, unreasonable restrictions on their ability to timely raise legitimate penalty defenses, is contrary to the goal of a fair, equitable and transparent tax system. It is also important to note that requiring the prepayment of penalties and then having to file a claim for refund is inconsistent with the procedures in place for other scenarios involving amended returns and audit adjustments.

Next……. I would like to address our concern that there is no reference in the preamble, the proposed regulations or any other guidance related to the Regime to an audited partnership's right to challenge, with Appeals. The appeals process is a vital option for taxpayers to resolve an issue without having to go to Tax Court.

The Regime creates a significant number of new elections which apply to partnerships under examination. Further, the Regime establishes new procedures and **stringent statutory deadlines**. Together these changes will create issues for taxpayers wishing to challenge IRS decisions under the Regime.

In our comment letter submitted this morning, we have identified eight specific actions or determinations by the IRS that taxpayers should, at a minimum, be able to challenge.

For example, taxpayers need the ability to appeal a decision on the validity of an opt-out election, a denial of a requested modification or the proposed audit adjustments among other issues.

In general, they should have the right to appeal any decision by the IRS which directly affects the proposed audit adjustments, the calculation of imputed underpayment, or the ability of a partnership to make any valid election under the Regime.

It is also important that the Appeals process is both fair and equitable.

- For example, a partnership should have the right to appeal the determinations under sections 6221 and 6241 within 60 days of receiving a determination;

- Next, it is important that the IRS establish a single unified appeals process for a partnership to challenge both the underlying adjustments and any denial of requested modifications.

    a. We recommend that if a partnership has ***not*** submitted a request for modification, then it should have 270 days after issuance of the NOPPA to challenge with Appeals.
    b. If a partnership ***has filed*** a request for modification, then its right to challenge IRS decisions should extend until the latter of 270 days after the NOPPA ***or*** 45 days after the IRS has responded.
    c. The IRS should ***not*** have the ability to issue a Final Partnership Adjustment until at least 30 days after a final decision is made by Appeals.

The partnership's right to challenge a decision with Appeals is an **important step** that we need to preserve. Under the Regime, the IRS has the authority to invalidate partnership elections, refuse requested modifications to the adjustments and overrule partnership decisions without explanation. The stringent statutory deadlines established for certain actions **will not provide sufficient time** for a partnership to properly review and challenge the decisions made by the IRS.

Such absolute authority, mainly invested in **one IRS employee** (the examiner assigned to the audit), is contrary to good tax policy. It violates the IRS's own Taxpayer's Bill of Rights. In the interest of fairness, the IRS should **explicitly identify** those decisions which a taxpayer may challenge with Appeals, the

timeframes for taking such actions, and the effect of such challenges on the various new deadlines.

Finally, taxpayers and their tax preparers need guidance on the impact of the new partnership-related provisions of TCJA to the Regime. The TCJA contains several new provisions which impact partnerships and the distributive shares of income and expenses to their partners. In particular, section 163(j) concerning interest expense limitations, section 199A for the Qualified Business Income deduction, and section 954A on GILTI, all contain substantial new partnership reporting and calculation elements.

These new reporting and calculation procedures for partnerships will present significant challenges for taxpayers. A key issue is that in some cases partnership items are now treated under both the entity and aggregate concepts at the same time. As an example, questions have been raised as to whether the 199A QBI deduction might be allowed as a modification item. The treatment of partner level carryforwards for disallowed interest under section 163(j) is another example. The challenge of integrating these new TCJA provisions into adjustments under the Regime exist regardless of whether a partnership elects to pay an imputed underpayment (both with and without any modification requests) or issues "push-out" statements.

We need guidance as soon as possible, including examples of how the Regime's adjustments to partnership items and tax attributes specific to these new provisions are treated under sections 6225 and 6226 by partnerships and their partners.

The AICPA appreciates the opportunity to testify today. We hope Treasury and the IRS will consider these thoughts and our comment letters as you move forward in developing the final regulations, forms and procedures necessary to implement the Centralized Partnership Audit Regime. Thank you.