

From: Sue Smail saeoil@sssnet.com
Subject: Fwd: Partnership Tax Info
Date: August 16, 2016 at 9:47 PM
To: Jane Marshall citizenjane@me.com

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FYI.

Begin forwarded message:

From: Jim Renacci <jrenacci@gmail.com>
Subject: Partnership Tax Info
Date: August 16, 2016 at 9:24:17 PM EDT
To: Sue Smail <saeoil@sssnet.com>

First point: the partnership audit rules enacted as part of BBA don't go into effect until tax years beginning after 12/31/17, so these rules should not affect current year returns.

Second point: Pre-BBA, there was no statutory provision that exempts small partnerships from filing partnership returns. This is a regulatory issue/exception. A bit of background is necessary to explain.

- Dr. Harl states that the small partnership exception in current Sec. 6231 (not amended by the BBA) relieves small partnerships—those with 10 or fewer members—of the requirement of filing a partnership return.
- This is not accurate. Rather, sec. 6231 pre-BBA only provides a definition of partnership for purposes of assessments. See 6231(a)(1)(B) (“For purposes of this subchapter ... the term ‘partnership’ shall not include any partnership having 10 or fewer partners each of whom is an individual...a C corporation, or an estate of a deceased partner.”). Indeed, section 6231(a)(1)(A) pre-BBA specifically says that, except as provided in 6231(a)(1)(B), “the term ‘partnership’ means any partnership required to file a return under section 6031(a)”. Thus, old section 6231 does NOT provide a small partnership exception to FILING a Form 1065—it only relieves burden of being subject to TEFRA audit regime.
- For purposes of filing a Form 1065, old 6231 says to look to 6031 for the definition of a partnership. And Sec. 6031(a) states that “every partnership (as defined in Section 761(a))” shall file a return for each year. Section 761(a) does NOT provide any so-called small partnership exception. Rather, it broadly defines the term “partnership” to include “a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate.” In other words, there is NO statutory exemption from the obligation for small partnerships to file a partnership tax return—and the BBA did NOT modify 6031(a) or 761(a).
- Section 6698 (unchanged by the BBA) imposes a penalty if any partnership required to file under Section

6031 fails to file a timely return, or files a return that fails to show the information required by the section, unless the failure is due to reasonable cause.

- In 1984, the IRS, through its own guidance (Rev. Proc 84-35), determined that partnerships with 10 or fewer partners and coming within the exceptions outlined in Sec. 6231 (a)(1)(B) will be considered to have met the reasonable cause test and will not be subject to the Sec. 6698 penalty, provided that all partners have fully reported their shares of the income, deductions, and credits of the partnership on their timely filed income tax returns.

This IRS revenue procedure is the only authority I have found that Dr. Harl could rely upon for support that partnerships with 10 or fewer partners don't have to file a Form 1065, if individual partners timely report income on individual returns.

However, this is a regulatory reasonable cause exception to the general statutory rule in Sec. 6031(a) that requires "every partnership (as defined in Section 761(a))" to file a return for each year. And section 761(a) does NOT provide for any small partnership exception to filing.

Bottom line: There was no statutory exemption from partnerships filing a 1065. This was a regulatory exception made by the IRS. For purposes of audit assessments, the BBA actually expanded the scope of the partnerships that can completely avoid the application of "centralized audit" rules from partnerships with less than 10 partners (as was the case under TEFRA) to partnerships with less than 100 partners.

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To "fix" this issue by statute (e.g. provide exemption from filing 1065s for small partnerships), Congress would have to amend 6031(a), which the BBA did not touch.

