Response to Rep. Renacci's Email dated August 16, 2016 at 9:24:17 PM EDT drafted by: Dr. Neil E. Harl and Jane Marshall, OFRW Agriculture Committee Co-Chair

Point one – we agree that the effective date of the 2015 amendment in the Bipartisan Budget Act of 2015 is January 1, 2018. However, it is ambiguous as to whether 2017 calendar year returns can be filed in 2018 under the "small partnership" exception. We would urge that 2017 returns be allowed to be filed in 2018 if the provision in question (Rev. Rul. § 6231(a)(1)(B)) is not restored as we are arguing should be done.

Point two – you state that before the repeal of the "small partnership" exception 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.

Response we are very familiar with the statute, regulations, rulings and cases in this area. We are of the firm belief that the Point Two statement is unsupported by the applicable law and that has been crystal clear for 34 years, since enactment of the "small partnership" exception as part of the Tax Equity and Fiscal Responsibility Act of 1982. Moreover, we believe that re-enactment of the provision in Rev. Rul. § 6231(a)(1)(B) is a matter of tax simplification, believed by us to be the most dramatic tax simplification move in a half century or longer, with significant savings in tax return filing for eligible taxpayers (up to $2,500 per year or more) and at no cost to the federal treasury.

That is because the statute, in question which has been in place since 1982, states as follows in I.R.C. § 6231(a)(1)(B)(i)—

"(A) IN GENERAL.—*Except as provided in subparagraph (B),* the term "partnership" means any partnership required to file a return under § 6031(a).

"(B) EXCEPTION FOR SMALL PARTNERSHIPS.—

(i) IN GENERAL.—The term "partnership" shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a

deceased partner. For purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner.

(ii) ELECTION TO HAVE SUBCHAPTER APPLY.- A partnership (within the meaning of subparagraph (A)) may for any taxable year elect to have clause (i) not apply. Such election shall apply for such taxable year and all subsequent taxable years unless revoked with the consent of the Secretary.

The above provision is clear and unequivocal – there is a "small partnership" exception. Moreover, it is based on statutory enactment, not a regulation, not a ruling, not a litigated case but based on a statute duly enacted by the Congress of the United States and duly signed by the President of the United States in 1982. Further, it has been used by countless taxpayers in good faith who believed that the language meant what it states – there is a legitimate way to file a tax return in a highly simplified manner and have done so.

To adopt your position, which has no basis in law or in fact, would mean that I.R.C. § 6231(a)(1)(B) would be a nullity. It would mean that law was being made out of no more than thin air to counter a statutory provision, duly enacted and signed by the President of the United States the consequences of which have been backed by more than 20 litigated cases. That could *never* have been the intent of the Congress of the United States. The language is clear and unambiguous with no question as to what the Congress intended. To disregard what was the clear intent of Congress is completely unacceptable in our system of government.

If there were ambiguous words or passages, which do not exist in our view, the accepted approach is to interpret words or phrases in a way that carries out Congressional intent. But we stress, in this instance, there is no question of Congressional intent and it is confirmed by the committee reports of the era. The message is clear – that the "small partnership" exception, for those who are eligible and meet the requirements, is not a "partnership." The resulting entity *is not a partnership.*

Point three – the document available to us states that the idea of the "small

partnership" exception allowing for an exception to filing a partnership return "is not accurate. Rather, § 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, § 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 § 6031(a)". Thus, old § 6231 does NOT provide a small partnership exception to FILING a Form 1065—it only relieves burden of being subject to TEFRA audit regime. "

Response -- We believe, as worded, the nine lines of text for the authority giving rise to the "small partnership" exception constitute a unique entity that is not subject to "partnership" rules.

Therefore, it is absolutely wrong to state ". . . there is no statutory provision that exempts small partnerships from filing partnership returns." It is not a "regulatory issue/exception." Whoever dreamed that up is not familiar with I.R.C. § 6231(a)(1)(B). Our position is also supported by Rev. Proc. 84-35, 1984-1 C.B. 509, which was included, word-for-word, and is still there in IRM 20.1.2.3.3.1 many years ago.

That, by the way, is the internal guidance for employees of the Internal Revenue Service. The matter was also supported by the last case to be litigated involving the "small partnership" exception, *Battle Flat, LLC v. United States, 2015-2 U.S.T.C. ¶ 50,490 (D. S.D. 2015).* That case, in a clear statement, recites that a "small partnership" exception, which meets the requirements of I.R.C. § 6231(a)(1)(B)(i) " . . . is considered to have met the reasonable cause test and will not be subject to the penalty imposed by § 6698 for the failure to file a complete or timely partnership return. . . " provided that the partnership, or any of its partners, if so requested by the Internal Revenue Service, have fully reported their shares of the income, and credits of the partnership on their timely-filed income tax returns. Other cases include: Harrell v. Commissioner, 91 T.C. 242 (1988) (IRS was not required to issue a notice of final partnership administrative adjustment because the partnership was excepted from the partnership audit rules as a "small partnership"); Davis v. Commissioner, T.C. Memo. 1997-80, aff'd, 98-2 U.S.T.C. ¶ 50,600 (10th Cir. 1998) (similar to Harrell); McKnight v.

Commissioner, T.C. Memo. 1991-514, aff'd, 7 F.3d 447 (5th Cir. 1993) (the "small partnership" exception was valid; it harmonized the plain language, organization and purpose of Code § 6231(a)(1)); Buchsbaum v. Commissioner, T.C. Memo. 2002-138 (partnership qualified for the "small partnership" exception and thus did not fall within the TEFRA audit and litigation provisions).

You state "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 § 6231 (a)(1)(B) will be considered to have met the reasonable cause test and will not be subject to the § 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." The only words we quarrel with are "through its own guidance." The IRS did this because of the tax simplification that is in I.R.C. § 6231(a)(1)(B). This statement makes our point exactly. Do you think that this will stay after 2017 when I.R.C. § 6231(a)(1)(B) is no longer in effect? Surely this provision will be applicable for the tax year 2017 regardless. Look at the date this was written 1984, just two years after I.R.C. § 6231(a)(1)(B) was passed by Congress. Are we really supposed to believe these two things are not connected?

Point four – I.R.C.§ 6698 penalties. The email states that § 6698 imposes a penalty for failure to file a timely return.

Response --That is discussed above pointing out that "small partnerships" are not subject to the penalties. However, there is another *reason why § 6698 penalties do not apply for "small partnerships. "That is I.R.C. § 6698(a) states – "In addition to the penalty imposed by § 7203 (relating* to willful failure to file return, supply information, or pay tax), if any *partnership* required to file a return under § 6031 for any taxable year . . ." First of all, a "small partnership" by virtue of I.R.C. § 6231(a)(1)(B)(i) *is not a partnership.* That is by virtue of a *statute.* § 6698 has no involvement with "small partnerships" by virtue of the statutory language.

Bottom line—the statement is made that "there was no statutory exemption from partnerships from filing a 1065."

Response -- Whoever wrote this is absolutely wrong. There is a statutory exemption that has been in place and honored for 34 years. The statement about the 100 partner exception for audit rules is completely irrelevant to a discussion

about the “small partnership” as it now exists which is why we are pushing for reenactment of the provision without hearings, without notice and parked in the Budget bill where it would be less likely to be spotted.

The message from Rep. Renacci states that to fix this issue by statute would require an amendment to § 6031(a). That is completely untrue. I.R.C. § 6031(a) has no connection to I.R.C. § 6231(a)(1)(B). An amendment would merely have to reinstate the language in I.R.C. § 6231(a)(1)(B) in total.

Finally – all of this was hashed out in a three month period with the Joint Committee on Taxation and is discussed in the August 15, 2016, issue of Tax Notes which is provided for those who may not have seen the article.