

October 3, 2016

Members of the Joint Committee on Taxation (Orrin Hatch, Chair; Paul Ryan, Chair; Kevin Brady, Mike Crapo, Charles Grassley, Sam Johnson, Sander Levin, Charles Rangel, Debbie Stabenow, Ron Wyden)

502 Ford House Office Building

Washington, D.C. 20515

Dear Members of the Joint Committee:

When I contacted the office of Senator Grassley in late March of this year, I anticipated that he would find the facts surrounding the totally unexpected repeal of the “small partnership” exception (authorized by I.R.C. § 6231(a)(1)(B)(i)) in the Bipartisan Budget Act of 2015 so repulsive that he would help to clear the way for reinstatement of the provision enacted in 1982. As the events since late March now demonstrate, his interest in trying to assure that the “small partnership” exception would be able to survive and to provide a simplified way to report the federal income tax annually by small farmers, ranchers and other small businesses has been disappointing. The initial response was favorable but as the staff of the Joint Committee on Taxation, to which he steered the problem of reinstatement of the repealed provision, weighed in with its withering criticism of the idea of reinstatement (principally on the grounds that “. . . there was no such thing . . .” as a “small partnership” exception) the Senator and his staff backed away from openly supporting the necessary steps to reinstatement. We argued for three months in April through June, facing an incomprehensible set of objections by the JCT staff. The Senator had required that the problem of reinstatement had to be approved by that group.

I have served on about a half dozen federal task forces, committees and commissions, including a 1967 task force organized by the Department of the Treasury and IRS to recommend solutions to the problems of “tax sheltering” which was a predecessor of the “get tough” policies in TEFRA passed in 1982 and which gave rise to the “small partnership” exception; the IRS Commissioner’s Advisory Group (1979-1980); the Advisory Committee of the Office of Technology Assessment (from 1987 through 1995) and served as president of that group in 1993-1994; the Advisory Committee on Agricultural Biotechnology (2000 to 2002); and the Congressionally appointed Committee on Payment Limitations in 2003. My experiences were uniformly favorable in all of those instances. However, what I have faced since March of this year is beyond belief. If someone had told me what would transpire, I would have accused them of high fiction.

The “small partnership” exception was offered as an amendment to TEFRA in the belief of the sponsors that the legislation being considered to crack down on partnerships would make it difficult for many small business owners, particularly farmers and ranchers.

The discussion with the staff of JCT began on April 7 in a telephonic hook-up between my office and a Joint Committee office in Washington with an almost immediate assertion by one staff member (later identified as Cecily Rock) that

“there is no such thing” as the “small partnership” exception. The heat of the rhetoric reached a peak an hour later with Rock yelling at the microphone that “I told you in the beginning of this session that there was no such thing.” The Chief of Staff of the Joint Committee on Taxation intervened and asked that each of us prepare a position paper and exchange them before the next meeting. I dutifully complied and e-mailed my position paper that evening. Nothing was received from JCT until they sent a response to my memorandum. This continued for three months with me methodically knocking down the long list of objections they raised including their persistence in asserting that if there was such a thing, I.R.C. § 6698(a) penalties would apply for failure to file a partnership tax return. As patiently as I could, I explained that the “small partnership” exception states, in I.R.C. § 6231(a)(1)(B)(i), that “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.” Thus, any entity that meets the requirements in that subsection *is not considered a partnership*. That point was argued over and over again with staunch objections voiced by the JCT staff person doing most of the talking (Rock). After three months of that, I gave up. We had not even begun to discuss how to get a bill introduced that would reinstate the “small partnership” exception.

In their insistence that there was no such thing as a “small partnership” exception their focus was voiced on the fact that “except for you, who believes all of this?” My article published in Tax Notes on August 15, 2016, a copy of which is enclosed, discusses the evidence that there is and has been since 1982 use made of the concept. The staff (at least one staff member, Rock) kept insisting on proof that there is a “small partnership” exception. As the Tax Notes article explains, in addition to the statutory provision, I.R.C. § 6231(a)(1)(B), and the regulations thereunder, there have been 21 litigated cases involving “small partnerships,” the January 2016 edition of the IRS publication *Partnerships* at page 13 recites the requirements to be a “small partnership,” a Chief Counsel’s Advice in 2012 had stated that a tenancy by the entirety does not preclude the “small partnership” exception from being used, Revenue Procedure 84-35 is devoted totally to the concept and the Internal Revenue Service has reproduced that publication in its Internal Revenue Manual (IRM § 20.1.2.3.3.1), just to mention the major pieces of evidence that the concept has been embraced widely.

The “small partnership” exception authority in I.R.C. § 6231(a)(1)(B)(i) was repealed in the Bipartisan Budget Act of 2015, § 1101(a), without a hearing, without notice and inserted deeply in a budget bill where it would be less likely to be spotted and objections made to repeal. Because a larger segment of the Internal Revenue Code was involved in the repeal than the nine lines providing authority for the “small partnership” exception, the camouflage was even more complete. The repeal was engineered by Rep. James Renacci of the 16th District in Ohio who is a member of the House Ways and Means Committee at the behest of a group of tax practitioners who had been complaining about the adverse effect on their bottom lines (the tax filing was so simple in many instances the taxpayer can file the return without assistance; a Form 1065 is not required). Repeal will add \$2,000 to \$3,000 in costs to hire a tax practitioner to prepare the Form 1065 and its schedules, not to mention the heavy penalties for even minor omissions in the return (currently \$195 per month for each partner for up to 12 months with inflation adjustments beginning in 2016)

It is my considered view that it is utterly ridiculous, as the staff of JCT has insisted, that “there is no such thing as a “small partnership” exception.

The repeal cries out for intervention. Apart for the focus on the need to reinstate the concept before 2018, when the repeal becomes effective, it is my considered view that the role of the Staff of the Joint Committee on Taxation is to advise and consult, not to block language in an arbitrary manner that has already been passed by Congress and was signed by the President in 1982.

My plea to the Committee is to look into this matter and to support the reinstatement of the “small partnership” exception. The provision is, in my view, one of the most significant tax simplification measures enacted in recent years. If the repeal remains in effect, farm and ranch entities (and other small businesses using the provision) will be forced to file a Form 1065 annually which is extremely complicated, entails stiff penalties if not done correctly and is expensive for taxpayers who, with the “small partnership” exception, would, in many cases, be able to file their Form 1040 (including the business income, losses and credits) without costly assistance.

Sincerely and respectfully yours,

Neil E. Harl

ADDENDUM:

For the benefit of those who are not familiar with me, I am the author of the 15-volume treatise, [Agricultural Law](#) and the two-volume, [Farm Income Tax Manual](#), both published by LexisNexis, as well as author or co-author of three Tax Management Portfolios, and about a dozen other books.

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