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October 2, 1995

The Honorable Bill Archer
Chairman, Committee on Ways and Means
House of Representatives
1236 Longworth House Office Building
Washington, D.C. 20515-6348

Re: Large Partnership Simplification Proposal

Dear Mr. Chairman:

I am writing on behalf of the Tax Section of the New York State Bar Association to convey our continued opposition to two provisions of the large partnership simplification rules (the "Proposed Rules") contained in the proposed Tax Simplification Act of 1995, included in the Budget Reconciliation Recommendations reported out of the Committee on Ways and Means on September 19, 1995.* This letter supplements our December 16, 1994 report (the "Report") on the large partnership provisions of H.R. 3419, the Tax Simplification Bill of 1993, a copy of which is enclosed.

As the Report explains in greater detail, we generally support simplified flow-through treatment of income and loss and simplified reporting by large partnerships, and we agree that the Proposed Rules should enable the Internal Revenue Service to match partnership and partner tax returns more efficiently,

* This letter was prepared with substantial assistance from Linda Z. Swartz.

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October 2, 1995

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and thus better collect the taxes due on partnership income. Nevertheless, we continue to strongly oppose two particular provisions of the proposed legislative changes, the "current partner liability rule," and the simplified reporting rule that denies otherwise allowable deductions to corporate partners in large partnerships. The reasons for our opposition to these two provisions are summarized below.

Under the Proposed Rules, liability for tax on partnership adjustments would be imposed on the persons who are partners of the partnership in the year an adjustment is finalized (or on the partnership, if it elects to pay), rather than on the persons who were partners in the year to which the adjustment relates. (The "current partner liability rule.") We strongly believe that the liability for tax adjustments should remain with the persons who were partners in the year to which the adjustment relates, as under current law. We do not believe the proposed change to current law is justified by difficulties with audits and collections under current law; and certainly this proposal is much more than mere simplification.

The reasons for our strong objection to the current partner liability rule are detailed in our Report. Certain fundamental problems with the proposal bear repeating, however. First, the proposal is fundamentally inconsistent with the pass-through nature of partnerships. The bedrock principle of partnership taxation is that the partners are subject to tax, on a current basis, on the income of the partnership. While other aspects of the Proposed Rules cut back on the pass-through nature of partnerships, none goes nearly so far as this. We do not believe that taxpayers should be required to forfeit the ability to apply classic pass-through treatment for the imposition of tax liability solely because a partnership has 250 or more partners.

Furthermore, even if the current partner liability rule results in simplified audit and tax collection procedures, at the same time this rule will create new and complicated issues. For example, in order to determine basis, book capital accounts, and tax capital accounts, it will become necessary to allocate partnership audit adjustments among the current partners. The allocation of tax liabilities of

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former partners among the then-current partners seems certain to create significant complexities and uncertainties, and we do not believe the current collection difficulties warrant this across-the-board complication of partnership agreements and returns.

We also note that the bifurcation of tax responsibility that results under the proposal will create considerable business complexities for large partnerships and their partners. For example, imposing personal liability on limited partners for tax liabilities of their predecessors completely undercuts the assumption that limited partners have no personal exposure for partnership debts, and in fact places a limited partner in a worse position than a purchaser of stock in a corporation. It may be that undercutting the marketability of large partnerships is an intended consequence of the simplification proposal. The current partner liability rule is, however, a rather convoluted means of attacking the viability of large partnerships.

Finally, we are concerned that the current partner liability rule creates considerable opportunities for tax abuse, first because of discontinuities that stem from the fact that former partners enjoy the results of earlier tax positions while current partners are liable for the tax on audit adjustments thereto, and because adjustments to prior years' income are taxed at current year rates. There is a clear risk that the introduction of the current partner liability rule may, over time, hinder tax collection rather than enhance it. Encouraging tax planning to avoid payment of audit adjustments is undesirable in and of itself, and seems particularly unappealing as a side effect of partnership simplification. Combating audit "planning" will, however, likely require the development of complex anti-abuse rules, which is inconsistent with the desired simplification and may not, in any event, suffice to overcome the problems this proposal creates.

For all of these reasons, we strongly believe that existing law concerning partner liability should be retained.

We also reiterate our opposition to the disallowance of 70% of partners' deductions for

October 2, 1995

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The Honorable Daniel P. Moynihan
United States Senate
Committee on Finance
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December 16, 1994

MEMORANDUM

Large Partnership Provisions of the Tax Simplification Bill

Enclosed is a Report by the New York State Bar Association Tax Section concerning the large partnership provisions of H.R. 3419, the Tax Simplification and Technical Corrections Bill of 1993. The relevant provisions of the Bill are intended to simplify the pass-through treatment, tax reporting and audit procedures for partnerships with at least 250 partners. The Bill passed the House of Representatives in May of 1994 but was not acted on by the Senate.

The Report takes the following positions, among others:

1. We generally support a simplified tax regime for large partnerships. However, we believe a number of modifications to the Bill are necessary.

2. While we generally support the simplified flow-through treatment of partnership items, we recommend an expansion of the items that specifically flow through to partners, as under current law, to include investment expenses, dividend income and short-term capital gains.

3. We strongly oppose the provision in the Bill imposing liability for tax for partnership audit adjustments on persons who are partners in the year the audit is concluded, as opposed to persons who were partners in the year under audit. We believe the proposed rule is fundamentally inconsistent with the nature of partnerships, will create new and complex issues, will complicate trading and

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discourage investment in large partnerships, and will create new (and in many cases abusive) tax planning opportunities for partners.

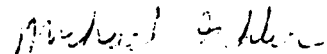
4. We believe the Bill goes too far in reducing notice and participation rights of partners in partnership audits.

5. Guidance should be provided on a number of issues prior to the effective date of the new rules, and a delayed effective date should be provided to allow for adjustment to the new rules.

The Report also makes a number of more technical comments on the Bill, and comments on certain technical corrections to the existing partnership audit rules that are also contained in the Bill.

The Tax Section, as always, strongly supports simplification of the partnership and other provisions of the Code. Please let me know if we can be of further help in the development of simplified rules for large partnerships or in any other efforts at simplification.

Sincerely yours,



Michael L. Schler
Chair, Tax Section