NATIONAL TAXPAYERS UNION

122 C Street N.W., Suite 700, Washington, DC 20001

August 19, 2024

Internal Revenue Service
Attn: CC:PA:LPD:PR
Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments on IRS REG-124593-23, "Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest," and Related Guidance

On behalf of the National Taxpayers Union (NTU), the nation's oldest taxpayer advocacy organization, I write with this submission on your notice and request for public comments regarding Internal Revenue Service (IRS) REG-124593-23. Given recent IRS public communications that this proposed rule is intricately linked with other guidance elements such as Notice 2024-54 and Revenue Ruling 2024-14, please consider the following comments to be applicable to the totality of guidance described in FS-2024-21.[1]

Introduction

NTU is the nation's oldest taxpayer advocacy organization, founded in 1969. For nearly as long, our experts and advocates have engaged federal policymakers on important questions surrounding tax administration, taxpayer rights, and IRS services. NTU served on the National Commission on Restructuring the IRS in 1996 and 1997, which later became the basis for the 1998 IRS Restructuring and Reform Act (RRA). More recently, we provided technical assistance to Congress for what became the Taxpayer First Act (TFA) of 2019 and worked with stakeholders across government to ensure its enactment into law.

[1] "New IRS, Treasury Guidance Focuses on 'Basis Shifting' Transactions Used by Partnerships," June 17, 2024, available at https://www.irs.gov/newsroom/new-irs-treasury-guidance-focuses-on-basis-shifting-transactions-used-by-partnerships.

Last year, our research affiliate, National Taxpayers Union Foundation, initiated the Taxpayers for IRS Transformation (Taxpayers FIRST) project, which draws on experts from government, academia, and the private sector to "assist IRS officials and policymakers so that the new funding is spent effectively, improves taxpayer services, upgrades outdated technology, and helps efficiently reduce the tax gap while respecting and strengthening taxpayer rights and due process."[2]

Comments

Cursory Mentions of Compliance Burdens Notwithstanding, REG-124593-23 and Related Guidance Would Impose Major New Requirements on Heretofore Unsuspecting Segments of the Filing Population.

In the Federal Register document accompanying REG-124593-23,[3] the Service's Paperwork Reduction Act (PRA) statement indicates:

> The reporting requirements contained in the proposed regulations would be met by completing Forms 8886 and 8918. These forms have been approved by OMB under control numbers 1545-1800 and 1545-0865, respectively. Accordingly, the proposed regulations would not be creating new collection of information requirements or changing the collection of information requirements already contained in the burden associated with the control numbers for Forms 8886 and 8918.

The Regulatory Flexibility Act (RFA) statement which follows this assessment contends:

> The estimated burden for any taxpayer required to file Form 8886 is approximately 10 hours, 16 minutes for recordkeeping, 4 hours, 50 minutes for learning about the law or the form, and 6 hours, 25 minutes for preparing, copying, assembling, and sending the form to the IRS. RAAS estimates that the appropriate wage rate for complying with the proposed regulations is $102.00 (2022 dollars) per hour. Thus, it is estimated that persons required to comply with the proposed regulations would incur costs totaling $2,194.70 per filing. This amount is small in comparison to the $5 million or more of basis increase in a Partnership Related-Party Basis Adjustment Transaction identified as a transaction of interest.

In our view, the assumptions behind these statements could prove unfounded.

For one, neither the PRA nor the RFA statement mentions that each proposed "transaction of interest" covered by REG-124593-23 could easily entail dozens of parties. Partnerships are, by definition, business arrangements among multiple individuals with varying levels of interest and involvement. "Material Advisors," also named in REG-124593-23 as falling under the new filing

[2] For additional information, see: https://www.taxpayers-first.org/.

[3] See: https://www.federalregister.gov/documents/2024/06/18/2024-13282/certain-partnership-related-party-basis-adjustment-transactions-as-transactions-of-interest.

requirements for Forms 8886 and 8918, are generally defined in this area of law as anyone "providing material aid, assistance, or advice with respect to the organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction." Others affected by REG-124593-23 can, under certain circumstances, include unrelated partners, transferees, and tax-indifferent parties as defined in the rule.

With no "reasonable cause" exception for noncompliance, it is not difficult to imagine a host of unsuspecting individuals being required to submit Forms 8886 or 8918 under the new regulation but being snared by penalties for unintentionally failing to do so. As IRS points out, those penalties are quite heavy, at 75 percent of the reduced tax associated with the reportable transaction.

Furthermore, because REG-124593-23 and other associated guidance is drafted in an expansive and sometimes vague manner, IRS could be triggering many more filings than anticipated. An analysis from EY is typical of the concerns that have arisen:

> Given their broad scope, the Proposed TOI [transaction of interest] Regulations could apply to many ordinary-course business transactions where the parties entered into the arrangement for commercial reasons wholly unrelated to basis adjustments under Subchapter K. For example, the types of transactions previously described as potentially subject to the Notice would potentially also be subject to reporting under the Proposed TOI Regulations. It is likely that the 'substantially similar' transactions that the IRS identified in the Proposed TOI Regulations will have surprising consequences.[4]

EY goes on to provide example transactions involving unrelated partners that are *facilitated* by a "tax-indifferent" party as triggering the new reporting obligations, or how one unrelated partner's perfectly normal net operating loss or capital loss carryforward could set the new rules into motion "*even if the other partners were not aware of those tax attributes* (emphasis added)."

It is no wonder then, that the tax practitioner community is sounding an alarm to clients who believe they are "in the clear" from REG-124593-23, but may not be. As a bulletin to clients from Holland and Knight put it, '[t]he proposed reporting requirements are extremely broad in scope and would impose compliance burdens on taxpayers that could result in significant penalties or potential tolling of the statute of limitations on assessment."[5]

Thus, whether one accepts the IRS's "$2,194.70 per filing" figure or a higher amount, it is problematic for the document accompanying REG-124593-23 to justify this sum by juxtaposing it against the $5 million basis increase threshold the rule establishes for a transaction of interest. With conceivably 10, 20, or even 50 "filings" on one transaction, the holistic compliance burden at stake with reporting each transaction falling under the rule is much heavier.

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[4] See the analysis at https://taxnews.ey.com/news/2024-1273-treasury-and-irs-issue-guidance-on-certain-partnership-related-party-basis-adjustment-transactions.

[5] See IRS Cracking Down on "Basis-Shifting" in Related-Party Partnership Transactions | Insights | Holland & Knight (hklaw.com).

Furthermore, that $2.194.20 calculation of compliance cost associated with the additional requirements of REG-124593-23 is, in itself, probably low. While the Service is following standard operating procedure in reporting the average wage associated with form compliance at $102 per hour, we must once again point out that this figure does not reflect the reality of the tax advice community.[6] According to the most current survey data from the National Society of Accountants, the average hourly fee for the preparation of a partnership tax return was $177.29.[7] Since not every partnership tax scenario involves reportable transactions, this figure is still likely to err on the side of caution because, in many cases, higher-priced "specialists" in the partnership tax field would need to be called upon for assistance. The typical fee of a tax attorney, who might oversee or give final approval for the preparation of forms, could be twice this amount, while a senior attorney who could very well be involved in reviewing the final form could require three or four times this amount.

There are other considerations that would drive up compliance costs. Given the massive penalties involved for failure to comply (75 percent or a minimum of $5,000 for a "natural person"/$10,000 for an entity), due diligence on the part of virtually any taxpayer or material advisor involved with Forms 8886 and 8918 must be as close to perfect as possible. Given also the organic complexities surrounding many partnerships as well as the untested provisions of REG-124593-23, it is hardly likely that any conscientious taxpayer would skimp on the quality of tax advice, much less fill out the forms themselves. Many individuals and entities who would be —or might be —subject to this new partnership guidance would be motivated to seek the "best of the best" to protect themselves from harsh government enforcement, even if they are innocent of any wrongdoing.

As many commenters from the practitioner community are likely to agree, both the complexity and compliance burdens of REG124593-23 and associated guidance —as currently proposed — are being underestimated in government documents.[8]

While Formally Described as Prospective, as a Practical Matter the Regulatory Approach of 2024-2028 Would in Many Cases be Retroactive.

As stated in the Federal Register notice outlining REG-124593-23, the regulation "would apply to identify certain partnership related-party basis adjustment transactions described in proposed § 1.6011-18(c) and substantially similar transactions as transactions of interest effective as of the date of publication in the Federal Register of a Treasury decision adopting these regulations as final regulations."

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[6] For an early example, see our comments on IRS REG–108060–15 at: https://www.ntu.org/publications/detail/ntus-pete-sepp-outlines-tax-reform.

[7] See: https://connect.nsacct.org/nsacctwww/knowledgecenter/income-fees-survey.

[8] This is a tendency we have observed with other statutory and regulatory acts in tax administration. See, for example: https://www.ntu.org/foundation/tax-page/tax-complexity-how-long-and-how-much-do-income-taxes-cost and https://www.ntu.org/foundation/detail/new-irs-data-still-vastly-underestimates-the-increasing-1099-k-burden-on-taxpayers.

This statement would seem to indicate that the proposed regulation is, in theory, prospective. Unfortunately, the actual compliance obligation facing those affected by the proposed rule can be retroactive, in some cases extremely so. An eloquent explanation of how this is possible comes from experts at EY:

> [T]he Proposed TOI [transaction of interest] Regulations also provide that a Participating Partner, Participating Partnership, or Related Subsequent Transferee participates in a transaction in any year in which the participant's tax return reflects the U.S. federal income tax consequences of the basis increase (*e.g.*, claiming amortization or depreciation deductions). Therefore, even if the transaction that resulted in the positive adjustment occurred in the early 2010s, it is possible that the participant would have to attach a Form 8886 to its tax return once the Proposed TOI Regulations become final in the 2020s.

A yawning period of de facto retroactivity such as this is not a simple matter with which practitioners and taxpayers can contend. It could entail time-consuming and expensive reviews of records dating back more than a decade to determine compliance with the new rules and avoid onerous penalties (see previous comment above and text below). Moreover, the records themselves may not necessarily be dispositive in establishing full compliance, because with REG-124593-23 and other Notices and Revenue Rulings linked to it, the definitions of transactions of interest and participants in them are changing as well (also see above and below).

It is one thing to search past tax returns for basis increases that occurred under laws and rules understood to be standard then as well as now. After all, this is the heart of tax audit procedures. A taxpayer is expected to keep extensive records and provide substantiation for any positions claimed on returns going back several years.

It is quite another thing, however, to force taxpayers to examine whether the actions of unrelated partners or tax-indifferent parties might impact the need to file Forms 8886 and 8918 going forward. Quite suddenly, those with only tenuous connections to a given partnership might be recategorized as liable for filing Form 8886 or Form 8918. This process could mean much higher degrees of forensic financial analysis.

The practical burdens of retroactivity on taxpayers aside, there are also systemic, negative impacts. As my colleague Joe Bishop-Henchman, Executive Vice President of National Taxpayers Union Foundation, wrote:

> Retroactive taxes violate the fundamental principles of transparency and stability. Retroactive tax increases undermine certainty in the law and the ability of taxpayers to plan their affairs by relying on the law today, not based on what legislators in the future decide the law *was*.
>
> Retroactivity also undermines public respect for the law and belief that the system is fair. Where retroactive tax obligations have been imposed on taxpayers in the past, they have avoided substantial public and legal backlash largely because they are usually narrowly imposed on small subsets of people or businesses, and because of a general lack of public

> awareness that the imposition of retroactive taxes is even possible, much less that it happens.[9]

Although Henchman focused his argument on statutory law, similar precepts can and should apply to regulatory actions. And while the permissible boundaries of retroactivity in the tax realm may yet see more judicial scrutiny,[10] recent activity in the courts suggests that REG-124593-23 and, especially, its related guidance could already be in legal jeopardy (see below).

The Approaches toward the Economic Substance Doctrine Contemplated in the Related Guidance Are Built on a Foundation that Could Collapse Depending on the Resolution of Current Litigation … and Existentially Endanger REG-124593-23.

As these comments noted at their beginning, the IRS acknowledges that REG-124593-23 is part of a coordinated guidance effort aimed at curbing what it calls "basis shifting" among certain partnership operations. An integral part of this guidance is Revenue Ruling 2024-14, which explains the Service's new position that it will wield the statutorily codified economic substance doctrine (ESD) against three defined "basis shifting" transactions among related parties, across its entire spectrum of examination and enforcement powers.

This is a controversial position, as explained in a publication from Skadden:

> Notably, the IRS relies on IRC section 7701(o) and not Treasury Regulation section 1.701-2, the partnership anti-abuse rules. This reflects a broader and questionable trend by the IRS to expand the application of IRC section 7701(o) in contexts not traditionally considered to be subject to the economic substance doctrine or where another anti-abuse

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[9] See: https://www.ntu.org/foundation/detail/proposed-biden-retroactive-capital-gains-tax-could-be-challenged-on-constitutional-grounds#ftnt23.

[10] According to Henchman:

> The U.S. Supreme Court has never directly addressed the question of the constitutionality of retroactive taxes, though it did come close in *United States v. Carlton* (1994).[23] That case dealt with a new estate tax deduction for selling stock in employee stock ownership plans that was included in the tax reform law passed in October 1986. In January 1987, the IRS announced that the deduction had a loophole in not requiring that the taxpayer own the stock before dying, and that it would seek legislation to fix it. That legislation was introduced in February 1987 and passed in December 1987 with retroactive effect to the 1986 law.
>
> The Supreme Court declined to strike down the 14 months of retroactive application, specifically citing that the period of retroactivity was "modest," the IRS had given quick notice that it would seek a legislative fix, and that the law essentially reverted an unintended change.[24] Left unsaid was whether a similar change without notice and with much more than one year of retroactivity would be permissible. Justice Sandra Day O'Connor concurred separately to warn that anything more than one year would probably violate the Due Process Clause, while Justices Antonin Scalia and Clarence Thomas agreed with her, dubbing retroactive taxation to be "bait-and-switch taxation."[25]

NTU Foundation is actively seeking "opportunities to defend taxpayers from retroactive taxes all the way to the U.S. Supreme Court."

> provision or doctrine already exists. Additionally, Revenue Ruling 2024-14 applies the economic substance doctrine without any consideration of its relevancy to the transactions at issue.[11]

Holland and Knight concurs, noting that:

> The Ruling fails to address whether the codified economic substance doctrine, as an initial matter, is relevant to the facts at issue, as required under the statute. This issue is currently on appeal to the U.S. Court of Appeals for the Tenth Circuit in *Liberty Global*. Instead, the IRS wants to chill these transactions and will assert a strict liability penalty because a transaction lacks economic substance.[12]

The Taxpayer Defense Center, a project of NTU's research arm, has filed an amicus brief in the *Liberty Global* case. While not professing expertise in, or affinity toward, the particular tax controversy involving Liberty Global (nor the tax controversies that may arise under Revenue Ruling 2024-14), the IRS's apparently coordinated attempt to apply the ESD in exotic new ways is of great concern to all taxpayers. As our brief explains:

> The Economic Substance Doctrine is a dangerous tool to give the government and thus must be used rarely and only when a threshold determination that it [is] "relevant" to use [has been made]. Congress recognized the danger when it wrote 26 U.S.C. § 7701(o)—explicitly calling for its use only when the doctrine is "relevant." See 26 U.S.C. § 7701(o) ("[i]n the case of any transaction to which the economic substance doctrine is relevant"). Determining how to reconcile pre-enactment case law with the § 7701(o) "relevant" standard is no easy task, but this case affords this Court the opportunity to do so. This is vitally important, for not only did the District Court reject a threshold determination of relevancy, its gloss on § 7701(o) holds that merely seeking "tax benefits" is enough for a court to set aside a transaction as lacking economic substance. See, e.g., Add.16. Not only is seeking tax-advantageous results perfectly proper under long-established case law, Congress uses tax incentives to engineer economic outcomes. For example, Congress favors small businesses with the 26 U.S.C. § 199A deduction, encourages environmental and historical investments with tax benefits, and promotes home buying with significant tax advantages via the mortgage interest deduction. That a taxpayer engages in many of these activities precisely because they provide tax benefits does not mean they lack economic substance.[13]

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[11] See The IRS Takes Aim at Basis Adjustments in Partnership Transactions | Insights | Skadden, Arps, Slate, Meagher & Flom LLP.

[12] See IRS Cracking Down on "Basis-Shifting" in Related-Party Partnership Transactions | Insights | Holland & Knight (hklaw.com)

[13] The full brief may be accessed via Taxpayer Defense Center Urges Narrow Application of Economic Substance Doctrine in Liberty Global Inc. v. United States - Foundation - National Taxpayers Union (ntu.org)

NTU hastens to add that, regardless of the outcome in *Liberty Global*, other litigation underway will afford additional opportunities for courts to weigh in on the limits of the Service's ESD prerogatives in light of an explicit statute.[14]

It is far from clear that the IRS's position in either case will be sustained. Also, based on the U.S. Supreme Court's *Loper Bright* decision,[15] issued subsequent to both Revenue Ruling 2024-14 and REG-124593-23, the Service's avenue of expanding its ESD powers through the regulatory realm could likewise be endangered. Should this portion of the infrastructure that the IRS is hoping to build around enforcement against partnerships fail, the entire enterprise will need to be reconsidered.

Recommendations and Conclusion

Based on the foregoing comments, NTU recommends that REG-124593-23, Notice 2024-54, and Revenue Ruling 2024-14 be withdrawn. Knowing that the Service will be disinclined toward such a course of action, we offer the following alternatives.

Finalization of REG-124593-23 Should be Suspended Until Major Legal Cases Surrounding the Economic Substance Doctrine Are Decided.

To reiterate, since Revenue Ruling 2024-14 is so integral to the operation of REG-124593-23, it is sensible from a cost-benefit standpoint for both stakeholders inside and outside of government to pause making further guidance in this area final.

[14] See, for example, *Patel v. Commissioner*, Docket No. 24344-17, 11352-18, 25268-18. Kat Lucero of Law360 summarizes the importance of the case as follows:

> In an order July 19, Judge Courtney D. Jones sought input from the Internal Revenue Service and the couple who brought the case, Sunil S. Patel and Laurie McAnally-Patel, about whether the doctrine requires an initial analysis to determine its relevance in a scrutinized transaction under Internal Revenue Code Section 7701. The judge also asked for nonparties to submit amicus briefs by Aug. 23 since the case will wade into territory that is novel to the Tax Court.

The Taxpayer Defense Center, a project of NTU's research affiliate, will be among the amici in the case. The full article may be accessed at: https://www.law360.com/tax-authority/international/articles/1863413?nl_pk=32ccd375-0163-48c1-be80-60f16e748cb9&utm_source=newsletter&utm_medium=email&utm_campaign=tax-authority/international&utm_content=2024-08-08&read_main=1&nlsidx=0&nlaidx=0.

[15] See analysis at: https://www.ntu.org/foundation/detail/ntuf-applauds-the-loper-bright-decision-and-end-of-chevron-deference.

The Compliance and Complexity Burdens Surrounding REG-124593-23 and Related Guidance Merit Much More Comprehensive and Systemic Analysis.

Although the Federal Register notice accompanying REG-124593-23 correctly notes, "tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended," and "[t]herefore, a regulatory impact assessment is not required." But this should not preclude all stakeholders from engaging in a more robust, and structured discussion of that impact.

In December of 2023, NTU responded to the Service's request for comments on Notice 2023-26, the 2023-2024 Priority Guidance Plan.[16] Among our suggestions for measuring "the impact of guidance on compliance and paperwork burdens more carefully and consistently" was greater facilitation of such discussion led by entities such as the National Taxpayer Advocate and the IRS Advisory Council. REG-124593-23 affords an ideal opportunity to put this suggestion to work.

Consider a Regulatory Sandbox.

The collaboration described above could, and should, extend beyond compliance and complexity burden analysis, to the crafting of guidance itself. Recently, NTU's research affiliate proposed this framework to the Internal Revenue Service for developing tax regulations governing cryptocurrency. As NTU Foundation Attorney Lindsey Carpenter explained in comments to the IRS:

> Under this sandbox method, the IRS would recruit cryptocurrency experts from outside the IRS. These experts should represent all areas of cryptocurrency: Regulatory, taxation, trading platforms, cybersecurity, investors, brokers, sellers, etc. Then, in a controlled environment, the IRS should foster allowing for the free flow of ideas about cryptocurrency and how to properly tax such.[17]

REG-124593-23 and Related Guidance Should be Substantially Clarified in Scope with Safe Harbors that Address Who Is Impacted, Which Situations Trigger Compliance and Enforcement, and When Obligations Exist for Lookbacks.

If REG-124593-23 is to live up to its stated effective date of Treasury's finalization, it could be made prospective for any partnership operating after that date. Or, the regulation could state that the effective date is prospective for returns reporting a basis increase with tax consequences. At the very least, the regulation could define "participants" more carefully to exclude unrelated partners or tax-indifferent parties from transaction of interest reporting obligations when a basis

[16] See https://www.ntu.org/publications/detail/ntu-comments-on-irs-priority-guidance-plan.
[17] See comments at https://www.ntu.org/foundation/detail/ntufs-comments-on-irs-cryptocurrency-regulations.

adjustment occurred on a return from prior to 2024 (or even a less distant year such as 2021). At the same time, the regulation could be modified to narrow what a “substantially similar” transaction is, thereby ameliorating concerns that ordinary business transactions might fall under Schedule K-related basis adjustments that must be reported on Form 8886 or Form 8918.

Strategic ambiguity may have utility for statecraft, but in the realm of tax law enforcement, such a position serves neither taxpayers nor the government.

Thank you for your consideration, and we are at your service for any questions you may have.

Sincerely,

Pete Sepp, President