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The Real Estate Roundtable

November 18, 2019

The Honorable David J. Kautter
Assistant Secretary of Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Michael Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Draft 2019 Form 1065 and Schedule K-1

Dear Assistant Secretary Kautter and Chief Counsel Desmond:

On behalf of The Real Estate Roundtable, I am writing regarding the recently released 2019 Draft Form 1065 and Draft Schedule K-1 and Instructions ("Draft Documents"). Some of the proposed reporting requirements are generating significant taxpayer uncertainty, may lead taxpayers to adopt inconsistent approaches to computing information, and could do more harm than good with respect to overall tax compliance. The Roundtable respectfully requests that the Department of Treasury and Internal Revenue Service postpone certain requirements while taking the additional time to seek input from stakeholders and provide further guidance and clarification regarding specific, reportable items.

Real estate partnerships represent nearly half of the 3.7 million partnerships in the United States. They include a wide variety of arrangements that range from two friends who purchase, improve, and lease a modest rental property to a large private real estate fund that raises capital from sophisticated institutional investors to develop large, mixed-use structures requiring years, if not decades, to plan, permit, and construct. In 2015, significant changes were made to the partnership audit rules, in response to widespread government concerns with the challenges of administering partnership tax rules. The Roundtable actively contributed to the development and modification of partnership audit reform legislation. The Roundtable continues to believe the new regime, if properly and fairly implemented, will address longstanding problems associated with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), while preserving the fundamental precepts of entity choice and passthrough taxation that give root to American entrepreneurship and capital formation.

We encourage the Department of Treasury and Internal Revenue Service to postpone certain proposed reporting requirements included in the Draft Documents. While many of the proposed reporting changes are intended to facilitate implementation of the Tax Cuts and Jobs Act, there are several proposed changes that implicate other areas of tax law that would benefit from input from stakeholders and further guidance and clarification from the government. These proposed reporting changes in some circumstances request information that has not regularly been maintained by taxpayers in the manner that the Draft Documents are now requiring.

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The Roundtable is concerned that the proposed reporting changes, which are proposed to be effective for the 2019 tax year, would create significant costs and administrative burdens to partnerships and their partners. The haste with which the reporting changes are proposed to be implemented raises uncertainty in the tax community as to how to comply with the changes. Absent a more comprehensive explanation of how certain information required to be reported is to be computed, it is likely that taxpayers will adopt varying approaches in determining the information required to be reported on the Draft Documents, raising questions about the utility of the information being reported.

Although there are many changes proposed to the reporting requirements included in the Draft Documents, there are certain changes in particular that will likely cause the most difficulty in compliance.

The first relates to tax capital account balances. At present, the current Schedule K-1 requires reporting capital account balances on either a tax, 704(b) or GAAP basis. As a result, many taxpayers do not report tax capital and in many instances, as tax capital is most relevant at the partner level, do not have all of the information necessary to compute this amount, even assuming that there was a clear definition of what is intended by "tax capital account balance." At present there is no statutory or regulatory definition of tax basis capital account. The time frames in which taxpayers and preparers are expected to gather necessary information to timely report out on Schedule K-1s poses an undue burden on the system. Most partnerships compute partner tax basis information only when specifically required and for certain partnerships, partner tax capital is not shared in proportion to the partners' ownership of partnership interests. Partnerships that have been in existence for years frequently lack sufficient records to reconstruct a partner's tax capital account, when this information has not previously been required to be calculated by the partnership. Guidance as to how partnerships are to compute tax basis capital accounts under various factual scenarios, including possible safe harbor mechanics, would be needed immediately in order to implement this requirement for 2019 filings and gather any meaningful information from taxpayers.

While true *partners* may have always been required to maintain their tax bases in an interest in a partnership, partnerships may not have maintained that information on outside basis. It is outside basis, which is relevant to computing partner's taxable income when the partner, receives a distribution that is in excess of the partner's basis, an allocation of loss in excess of basis limited by section 704(d), or disposes of its partnership interest in a sale or exchange. In addition, there may be differences between a partner's outside basis (relevant for these situations) and the partnership's inside basis. The aggregate tax capital accounts of all partners reported on Schedule K-1, if reported on outside tax basis, may not equal, in total, the partnership's total assets net of total liabilities. It is unclear and probably impossible for a partnership to reconcile the difference.

The second relates to the Section 465 reporting regarding multiple activities. Section 465 applies at the partner level and accordingly, partnerships have not generally prepared separate accounting for each activity, although they have maintained at-risk information where relevant. The draft instructions for the 2019 Form 1065 require more detailed activity reporting than previously required. Each property held in a partnership is arguably treated as a separate "activity" for purposes of section 465 (unless a statutorily mandated aggregation rule applies). Reporting separate items (and distributions) from each property held in a partnership that is arguably treated as a separate "activity" for purposes of Section 465 is extremely onerous. We believe that additional time is appropriate for stakeholders to explore additional possible reporting alternatives, including possible aggregation reporting where appropriate.

The third area relates to Section 704(c) built-in gains or losses. While most partnerships are able to compute a partner's section 704(c) net built-in gain or loss, methodologies used in computing these amounts vary taxpayer by taxpayer because of purposeful regulatory flexibility in the Section 704(c) regulations but also due to the lack of guidance on how to compute section 704(c) gain or loss in many frequent situations. In Notice 2009-70, the IRS set forth a series of unanswered issues raised by section 704(c), and many of those issues, yet to be answered are implicated by the new reporting requirements. The varying approaches to addressing those and other issues will invariably create disparate reporting based on different approaches being taken by different taxpayers and their preparers where there is insufficient guidance from the government as to how and what is intended to be reported. In particular, it is unclear whether the reporting requirements include "reverse" section 704(c) gain or loss, and whether section 704(c) items in different "layers" and with respect to different assets should be netted or separately tracked, among others. In the interest of obtaining consistently reported information from taxpayers, it would be beneficial for the Internal Revenue Service to provide instructions that address these open issues. In that regard, again, we believe that including stakeholders' participation in the guidance process would ensure that the new section 704(c) gain or loss reported information is presented consistently across taxpayers.

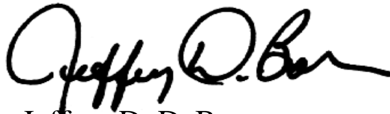
Lastly, we note that questions or requests for information, other than items that directly affect a reported amount of income, deduction, or other item that affect the current year's tax liability of a taxpayer, occupy an uncertain area of tax administration, further suggesting that the Internal Revenue Service should be very deliberate in introducing any new questions or requests that are arguably unclear, or require information not known to be readily available to the taxpayer.

Under Section 6662 and related provisions, there are clear penalty rules and defenses that apply to errors of fact or law that would understate a taxpayer's actual tax liability if not corrected. If the answer to a question might provide useful information to the Internal Revenue Service, but does not alter the taxpayer's tax liability for the year, it appears that the main potential sanction for an incorrect or omitted answer would be a refusal to treat the return as filed, which would appear to be an excessive, counterproductive and unlikely response. If new questions or information requests are included on a form, and it appears that taxpayers and their preparers do not fully understand exactly what is being asked for, and even if the request were clear would not have the information readily available, rushing to put the question or request on a form without adequate public review and comment is likely to lead to a combination of inaccurate or unusable information where answers are given, and substantial amounts of non-compliance for which an appropriate sanction is not readily available. The latter cannot be helpful in maintaining confidence in a tax system that relies so heavily on self-reporting by taxpayers.

In light of these concerns, The Real Estate Roundtable respectfully requests that the new reporting requirements be delayed in order to permit an adequate notice and comment period as to the new requirements and to provide necessary time for both taxpayers to gather the information, and the government to issue much needed clarification as to permissible methodologies for computing and presenting the required information. We therefore request that the Treasury Department and the Internal Revenue Service postpone implementing these specific changes to Form 1065 and Schedule K-1 until 2020 at the earliest, and to provide for a full public review and comment process.

The Real Estate Roundtable looks forward to working with you as you consider the many issues arising in the implementation of changes to the Form 1065 and Schedule K-1. Please do not hesitate to contact me or Ryan McCormick, Real Estate Roundtable Senior Vice President and Counsel, at (202) 639-8400 with any questions or requests for additional information.

Sincerely,



Jeffrey D. DeBoer
President and Chief Executive Officer