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December 13, 2016

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Assistant Secretary for Tax Policy, Mark J. Mazur

Re: Comments on Eligibility of Trusts to Participate in an Election Out of the Partnership Audit Rules under New Section 6221

Dear Sir:

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit the enclosed comments on Proposed Regulations to section 6221 of the Internal Revenue Code of 1986, as amended, which was added by Section 1101 of the Bipartisan Budget Act of 2015. This new consolidated or centralized system for audit, adjustment and collection of income tax will apply to partnerships for partnership taxable years beginning after 2017. ACTEC recommends that the government authorize trusts to be eligible partners when determining a partnership's eligibility to opt out of the new rules.

ACTEC is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

If you or your staff would like to discuss ACTEC's recommendations, please contact Steve Gorin, who led the task force drafting these comments, at (314) 552-6151 or by email at sgorin@thompsoncoburn.com, Beth Kaufman, Chair of ACTEC's Washington Affairs Committee, at (202) 862-5062 or by email at bkaufman@capdale.com, or Leah Weatherspoon, ACTEC Communications Director, at (202) 688-0271 or by email at lweatherspoon@actec.org.

Respectfully submitted,

Cynda C. Ottaway, President

COMMENTS OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL (ACTEC)
ON ELIGIBILITY OF TRUSTS TO PARTICIPATE IN AN
ELECTION OUT OF THE PARTNERSHIP AUDIT RULES
UNDER NEW SECTION 6221

These comments of The American College of Trust and Estate Counsel (ACTEC) address the Treasury and the Internal Revenue Service's authority under section 6221(b)(2)(C)[1] to add trusts and other pass-through entities as "Qualified Partners" who are allowed to elect out of the new partnership audit rules. The Bluebook (described below) suggested that trusts and other pass-through entities be included in the class of Qualified Partners. ACTEC appreciates the opportunity to submit these comments about trusts for consideration by Treasury and the Internal Revenue Service.

Background. Section 1101 of the Bipartisan Budget Act of 2015 (the Budget Act) provides a new consolidated or centralized system for audit, adjustment, and collection of income tax with respect to partnerships. This new system will apply to all partnerships for partnership taxable years beginning after 2017. Generally, the system provides for adjustments at the partnership level, instead of at the partner level. That system also does not allow for adjustments to take into consideration a partner's own tax situation, overriding fundamental precepts of Subchapter K in the interests of facilitating otherwise unwieldy collection from large partnerships. This override also could shift tax burdens from partners properly taxable under Subchapter K to other partners.

Election Out. Under section 6221(b), a partnership may elect out of the new centralized system if it meets certain eligibility requirements. The election is required to be made annually. Where a partnership properly elects-out for a particular taxable year, each partner will be audited at the partner level (under pre-TEFRA rules) and will take into account adjustments to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year on the partner's own return.

To elect out, two key requirements must be satisfied: (1) the partnership must furnish 100 or fewer statements under section 6031(b) (Schedules K-1) with respect to partners; and (2) each partner must be an individual, C corporation, a foreign entity that would be a C corporation under U.S. tax law, an S corporation (provided special rules are met) or an estate of a deceased partner (a "Qualified Partner"). In addition, the partnership must make an annual election with a timely filed partnership tax return that includes the name and taxpayer identification number of each partner (or Schedule K-1 recipient) in the partnership and must notify each partner of the partnership election with respect to such taxable year.

Permissive Expansion to include Trusts as Qualified Partners under Current Law. Section 6221(b)(1)(C), authorizes the Treasury and Internal Revenue Service to promulgate regulations expanding the types of partners that are Qualified Partners under section 6221(b)(1)(C).

Bluebook. The report prepared by the Staff of the Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in 2015," JCS-1-16 (March 2016), the "Bluebook," recites the guidance set forth under section 6122(b)(2)(C) under the Budget Act that regulations or similar guidance from the Treasury may extend the types of partners that can qualify for being part of the election-out rule. The Bluebook (on page 60) provides the following example in which a trust as a partner may be permitted to make the election-out:

[1] Unless otherwise stated, references herein to "section" are to sections of the Internal Revenue Code of 1986, as amended, as if the amendments added by section 1101 of the Bipartisan Budget Act of 2015. P.L. No. 114-74, were now in effect.

> "As another example, such guidance may provide that a partnership with a trust as a partner can make the election if the partnership includes (in the manner prescribed by the Secretary) a disclosure of the name and taxpayer identification number of the trustee, each person who is or is deemed to be an owner of the trust, and any other person that the Secretary determines to be necessary and appropriate, and each one of such persons is taken into account as if each were a statement recipient in determining whether the 100-or-fewer-statements criterion is met. Similar guidance may be provided with respect to a partnership with a partner that is a grantor trust, a former grantor trust that continues in existence for the two-year period following the death of the deemed owner, or a trust receiving property from a decedent's estate for a two-year period."

Two additional examples in the Bluebook suggest that "other partners" could include disregarded entities such as a single member limited liability company, or tiered partnerships where a partnership is the Qualified Partner.

Greenbook. In February 2015, the Administration published the "General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals" (the "Greenbook"). The Greenbook includes the Administration's proposal to **Streamline Audit and Adjustment Procedures for Large Partnerships**. The Greenbook notes that the new partnership audit rules (simplified partnership procedures (SPP)) would apply to any partnership that has 100 or more direct partners in the aggregate during the taxable year to which the adjustment relates (i.e., partnerships that file 100 or more Schedules K-1 for the taxable year), or that has at least one partner that is another partnership, estate, trust, S corporation, nominee, or similar person ("pass-through partner") at any time during the taxable year to which the adjustment relates.

However, the Greenbook (on page 235) recognizes that "[a] partnership subject to the SPP regime because it has at least one pass-through partner can elect out of the SPP regime if the partnership can demonstrate that the total number of direct and indirect partners is less than 100 in the aggregate during the taxable year to which the adjustment relates, in which case each partner would be subject to separate deficiency proceedings."

Tax Policy Considerations. The new partnership audit rules are designed to streamline audit and adjustment procedures for large partnerships by allowing collection at the partnership level rather than at the individual level for partnerships with more than 100 partners. As noted above, the Greenbook recognized that partnerships with fewer than 100 direct and indirect partners should be allowed to elect out of the new partnership audit rules even if such a partnership has pass-through partners, so long as the partnership can demonstrate that the total number of direct and indirect partners is less than 100, and provided that the partnership discloses the name and taxpayer identification number for each indirect partner. Section 6221(b)(2)(C) specifically allows one type of pass-through entity, an S corporation, as a Qualified Partner. As a tax policy matter the purpose of section 6221 is not undermined by allowing other types of pass-through entities to be treated as Qualified Partners as long as the total number of persons reporting partnership tax items, using look through rules, is not more than 100. The ability to elect out of the new partnership audit rules should not be restricted in situations where the rules are otherwise satisfied and the name and taxpayer identification number for each indirect partner is available to the partnership and the Service.

Trusts as Qualified Partners. ACTEC respectfully requests that Treasury and the Internal Revenue Service include trusts as Qualified Partners by regulation pursuant to its authority under section 6122(b)(2)(C) and that trusts and other pass-through entities be treated as Qualified Partners.

Extending Qualified Partner treatment to trusts and other pass-through entities is consistent with the description of the new partnership audit rules in both the Bluebook and the Greenbook.

More specifically, ACTEC recommends that the regulations permit a single member limited liability company, a qualified subchapter S subsidiary owned by an S corporation, and the grantor of a grantor trust to each fall within the scope of a Qualified Partner.

In determining the number of Qualified Partners in connection with each trust, ACTEC recommends the following rules:

1) The deemed owner of a wholly grantor trust should be counted as a single statement recipient under the 100-or-fewer statement rule.

2) For grantor trusts with multiple grantors, each grantor who is a deemed owner (and not the trust) would be counted as a statement recipient.

3) A non-grantor trust and each Schedule K-1 recipient of the trust whose return is affected by the partnership's tax items should be counted as a statement recipient.

4) When an electing small business trust ("ESBT"), as defined under section 1361(e) and taxed under section 641(c) and Reg. §1.641(c)-1, holds stock in an S corporation that is a partner:

    a. If and to the extent that the S portion is a nongrantor trust, the partnership items that flow through the S corporation will be taxed to the trust, without regard to any distributions made to the trust's beneficiaries. To that extent, the trust should be counted as a statement recipient, and the beneficiaries would not be counted as statement recipients.

    b. If and to the extent that the S portion is a grantor trust, the partnership items that flow through the S corporation will be taxed to the deemed owner(s), and the grantor trust rules described above would apply.

The trustee of the trust should be required to provide the name and taxpayer identification number of each deemed owner of a grantor trust or each trust beneficiary of a non-grantor trust who receives a Schedule K-1 from the trust that is affected by the partnership's tax items in the tax year subject to the election to the partnership to enable the partnership to file this information with the annual election-out.

If an individual holds partnership interests in the same partnership directly and indirectly, such individual should be counted as one statement recipient. For example, if a person owns a partnership interest in *ABC Partnership* directly and a partnership interest in *ABC Partnership* indirectly through a trust, he or she should be counted as one statement recipient for purposes of the 100 statement recipient limitation. Further, the treatment of an individual receiving more than one K-1 as the same partner should not turn on whether the trust is a nongrantor trust issuing a K-1 to that person, a grantor trust using the partner's social security number pursuant to Reg. §1.671-4(b)(2)(i)(A), or a grantor trust using its own taxpayer identification number and filing a Form 1041 with a separate statement attached pursuant to Reg. §1.671-4(a).

Conclusion. Millions of taxpayers use trusts in connection with their estate planning to help them provide for family members and to accomplish a wide spectrum of planning goals. Providing a method for small partnerships with trusts as partners to elect out of the new partnership audit rules would provide welcome relief and the proper application of subchapter K to numerous small partnerships. Thank you for the opportunity to comment on these rules.