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Subject: CONFUSION WITH INSTRUCTIONS TO PARTNERSHIP RETURN AND INAPPROPRIATE USE OF FAQs

This morning, in Tax Notes Today Federal, there is a news story relating to the draft instructions to the 2019 form 1065 issued recently. (See Eric Yauch, *Draft Partnership Instructions With TCJA Changes Raise Questions,* Tax Notes Today Federal, Oct. 31, 2019, for the news story and Tax Analysis doc 2019-41371 for the draft instructions). In accordance with the news story, it appears that a question has been raised as to whether the draft instructions to form 1065 alter the position of the Chief Counsel set forth in certain FAQs, relating to computing tax basis capital accounts, that section 743(b) adjustments are counted in making that determination.

This is not the first time that I, or others as well, have pointed out to you (and others) that FAQs (in this case, see Tax Analysts doc 2019-13509) are not “authority” as set forth at regulation §1.6662-4(d)(3)(iii). Nowhere in the income tax regulations is there a similar requirement about how to compute and determine partners’ tax basis capital accounts for purposes of disclosure on a tax return. In fact, the term “tax basis capital account” is not a term of art in subchapter K of the Code and the regulations thereunder. The term is solely a creature of the FAQs and the form 1065. As such, a requirement to follow the FAQs to prepare a true and accurate return seems to be inconsistent with the regulations under section 6011 (see below) and would be invalid as a matter of law.

Even if the draft form 1065 instructions referenced the FAQs, which they do not, such disclosure would not satisfy the income tax regulations which state at regulation §1.6011-1(a) that “the return [under chapter 1 of the Code] shall include therein the information required by the applicable regulations or forms”. Nowhere are FAQs mentioned and FAQs are not “regulations or forms”.

Notice 2019-20 provided penalty relief for the failure to include the required return disclosure for tax years beginning after 2017 and before 2019. This was appropriate under section 6011 because the return itself, the form 1065 schedule K-1, required the disclosure.

The FAQs, posted on the IRS.gov website, were issued on April 5, 2019.

I am not writing here to debate the wisdom of including or not including section 743(b) adjustments in the computation itself, or whether the Chief Counsel and the IRS have had a change of heart on the section 743(b) issue. What I am writing about is the continued and inappropriate use of FAQs in lieu of recognized tax guidance under the section 6662 regulations, at least in cases where a new tax term of art is being introduced into the tax return disclosure process for which penalties for noncompliance could be asserted by the IRS on exam.

First, as to needing to follow the FAQs, the regulations under section 6011, cited earlier, only allow “regulations or forms” to require tax return disclosure. FAQs are insufficient. Perhaps if the return instructions contained a reference to the FAQs that would be sufficient for purposes of tax return disclosure, but even that would not be clear without repeating the entire set of FAQs in the return instructions. Not everyone uses electronic copies of forms and instructions and so an internet link to the FAQs would not satisfy this failure to incorporate the FAQs into the tax return instructions. Thus, there can be no penalty for failure to comply with the FAQs relating to the filing of a true and accurate tax return.

Second, although the FAQs appear to be drafted so that they can be relied on by taxpayers (they have a “safe harbor” and so the assumption must be that the FAQs can be relied on by taxpayers), the FAQs are not “authority” under the section 6662 regulations cited earlier. Although one would not think that an IRS exam agent could or would impose penalties based on complying or not complying with the FAQs in filing the form 1065, as a matter of law that would be possible.

Third, to force taxpayers and their advisors to find the FAQs on the IRS.gov website is extremely poor tax policy. As noted earlier, although partnership tax practitioners understand the significance and general computation of what is known as “negative tax capital accounts”, the term of art used by the tax form and the FAQs is not a creature of either the Code or the regulations. It is inappropriate to introduce a new tax term of art in FAQs.

If the Chief Counsel and the IRS want the FAQs to have the force of law to any extent, they must be issued as regulations (or, in the interests of time, a notice describing those regulations could be issued followed by the regulations). Taking any other path would be inappropriate as a matter of law.