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TEFRA: No Fix Possible, Just Get Rid of It!

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To the Editor:

I commend N. Jerold Cohen and William E. Sheumaker for their special report "When It's Broke, Fix It! It's Time for TEFRA Reform" (*Tax Notes*, Aug. 13, 2012, p. 815, *Doc 2012-15153, 2012 TNT 157-2*). However, I believe their proposal is too timid. The TEFRA unified partnership audit and litigation rules are indeed broken. So much so that they should be repealed outright, rather than modified in the piecemeal fashion Messrs. Cohen and Sheumaker propose.

The authors' special report documents some of the bizarre, uncertain, and inefficient results that obtain in TEFRA cases. They address issues arising as to statute of limitations, refund actions, and judicial inefficiency, with the latter divided into dimensions involving partner-level penalty defenses, penalties and basis overstatements, partnership or affected items, and substantive or computational items. Coming from commentators of such experience and sophistication, the exploration of these problems of TEFRA (these problems do not exhaust the catalog of TEFRA's problems) is welcome, and their indictment of the present system is convincing.

In regard to one level of the analysis, the authors exclaim: "What a mess!" This could be said of the TEFRA rules generally and would be fitting for the epitaph when, I hope, we are able soon to bury this procedural folly.

The problem with the special report is that it urges a gradualist path of piecemeal reforms when root-and-branch extirpation of the TEFRA regime is needed. The authors propose over a half-dozen changes to particular TEFRA rules but add, "Undoubtedly, there are many corrections to TEFRA that could be made and are not covered in this report." One does not relish slogging along such a long road.

In contrast, the short and direct highway is simply to repeal the TEFRA rules, returning us to the partner-level audit and litigation regime that existed before 1982. It would be safe to do so because the landscape has changed radically since 1982 — the conditions that prompted enactment of the TEFRA rules no longer exist. As Cohen and Sheumaker point out, many tax shelters of the earlier era had scores or hundreds of "investor" partners. The IRS had difficulty locating and auditing them all within the statute of limitations period. Those days are gone. As a result of section 469 and other changes, the mass marketed "cast of thousands" shelters are extinct. Current shelters typically have only a few partners each. To the extent the TEFRA rules were ever needed, they are not needed now.

Several points in this regard. First, section 6231(a)(1)(B)(i) represents Congress's judgment that the TEFRA rules are not needed for partnerships with 10 or fewer partners (when the partners are citizens, resident aliens, C corporations, and decedents' estates). Virtually no current shelters have more than 10 partners. Second, in exceptional cases, the better approach is to adjust the limitations period, not to animate the TEFRA Frankenstein. For example, if a partnership has another partnership as a partner, we could take a page from section 6901(c) and add a year to the limitations period (up to a cap) for each extra level of passthrough. Third, we once had TEFRA-like rules to govern audits of S corporations. The abolition of that regime was accomplished without a ripple in tax administration. Fourth, very large partnerships — so-called master partnerships or publicly traded partnerships — are under their own regime (treated as corporations) under section 7704.

In short there no longer is a compelling need for the hybrid entity-partner approach of TEFRA. In the current changed environment, we can safely return to the pre-1982 approach of audits purely at the partner level (with a few collateral changes for exceptional circumstances if warranted). We can dispense with the TEFRA rules entirely and thus with the long, slow path of piecemeal reform.

I commend Cohen and Sheumaker for their cogent critique of some of TEFRA's problems. By keeping the spotlight on these problems, we may be able to achieve genuine reform — preferably complete abolition of the TEFRA rules. For more extended analysis of complete abolition, see my article, "The E.L. Wiegand Lecture: Administrability-Based Tax Simplification," 4 *Nev. L.J.* 573, 596-602 (2004), and Peter A. Prescott, "Jumping the Shark: The Case for Repealing the TEFRA Partnership Audit Rules," 6 *Fla. Tax Rev.* 503 (2011).

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