Wyden renews call for partnership tax reform

Senate Finance Committee Chairman Ron Wyden, D-Ore., this week renewed his longstanding call for an overhaul of the tax rules for partnerships as Congress contemplates possible changes to the tax code next year in light of the scheduled expiration of significant portions of the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97).
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Speaking at a September 25 forum on modernizing partnership taxation that was co-sponsored by the Brookings Institution and the New York University Tax Law Center, Wyden noted that lawmakers tend to be overly focused on issues such as the corporate tax rate and the top marginal tax rate for individuals and, as a result, have paid less attention to partnership issues—including the proliferation of large, complex partnerships and the “serious tax dodging” that occurs among some of these entities.

Wyden cast the issue of modernizing the tax treatment of partnerships as a matter of fairness, arguing that the wealthiest taxpayers, with the help of “armies of lawyers and accountants,” are able to use partnership structures to reduce their tax liability in ways that “the average person” cannot.

As lawmakers consider how to address the pending sunset in 2025 of temporary TCJA provisions affecting individuals, passthrough entities, and estates, they will have an opportunity to close various “loopholes” in the tax code and “bring some common sense” to the partnership tax rules,” Wyden said, adding that “it would be legislative malpractice to punt on that issue.”

Revisiting prior proposals?

The Finance Committee chairman did not discuss specific reforms to the partnership rules at the Brookings event. It’s worth noting, though, that Wyden released a discussion draft (text, Finance Committee staff summary) in 2021 of a proposal that would significantly modify the tax treatment of partnerships by, among other things:
URL: https://www.finance.senate.gov/imo/media/doc/Pass-through%20Changes%20Discussion%20Draft%20Legislative%20Text.pdf
URL: https://www.finance.senate.gov/imo/media/doc/Wyden%20Pass-through%20Reform%20Section%20by%20Section.pdf

1. Tightening the rules for allocating partnership income and losses among partners (generally requiring pro rata allocations),
2. Requiring that all debt be shared between partners in accordance with profits, subject to limited exceptions,
3. Repealing the exception from corporate tax treatment for publicly traded partnerships,
4. Requiring mandatory basis adjustments in the case of transfers and distributions, and
5. Requiring revaluations of partnership property.

Also in 2021, Wyden introduced the Small Business Tax Fairness Act (text, summary), which would reform the TCJA's 20 percent deduction for passthrough business income by, among other things, eliminating the "specified trade or business" concept that partially determines eligibility for the deduction, streamlining the formulas and limitations that determine the size of a qualifying taxpayer's deduction, and—to help finance these changes and raise additional revenue—phasing out the deduction for individuals earning more than $400,000. (Under the proposed phase-out schedule, taxpayers with earnings above $500,000 would be ineligible for any 199A deduction.)
URL: https://www.finance.senate.gov/imo/media/doc/7.19.21%20Small%20Business%20Tax%20Fairness%20Act.pdf
URL: https://www.finance.senate.gov/download/small-business-tax-fairness-act-one-pager

Tighter rules linked to stepped-up enforcement

In his remarks at the Brookings event, Wyden also emphasized the importance of providing the Internal Revenue Service with the resources it needs to maintain robust enforcement and compliance operations, noting that some of the largest partnership entities may feel emboldened to look for ways to avoid—or even evade—tax if they perceive that the risk of a possible audit is low.

Without strong enforcement by the IRS, he said, "tax dodging becomes part of the business model."

The IRS received a special mandatory funding allocation of $80 billion (through 2032) under the Inflation Reduction Act of 2022 (P.L. 117-169) to enhance its compliance and enforcement efforts, modernize its business systems, and improve its taxpayer services operations, although that amount was trimmed by $20 billion on a bipartisan basis in the fiscal year 2024 government funding law. The Biden administration's budget blueprint for fiscal year 2025 proposes to backfill that reduction and extend the revenue stream through 2034—a proposal the Democrats are likely to pursue next year if they win control of the White House and both chambers of Congress in this November's elections.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

The White House this week also emphasized the importance of fully funding the IRS's discretionary budget for fiscal year 2025 in a statement announcing its support for a stopgap spending measure that for the most part continues funding the government at current levels through December 20 and averts a shutdown of federal operations that otherwise would have occurred when fiscal year 2025 begins on October 1. (See related story in this issue for details.)

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