Law Over Improvision: A Call to Reform the Culture of Partnership Tax

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Andrea Monroe, *Making Tax Law Work: Improvisation and Forgotten Taxpayers in Partnership Tax*, 55 **U. Mich. J. L. Reform** (forthcoming), available on SSRN.

Andrea Monroe's article, Making Tax Law Work: Improvisation and Forgotten Taxpayers in Partnership Tax, boldly calls on partnership tax experts to understand their role in normalizing dysfunction within partnership tax law and to support reform that is mindful of all partnerships.

Although millions of business entities are taxed as partnerships, assets and income are concentrated in a small number of them. As Monroe notes, drawing on IRS data from 2018, "less than 1 percent of partnerships held greater than 76 percent of partnership assets, and approximately 73 percent of partnerships held roughly 1 percent of partnership assets." This suggests great differences among tax partnerships, yet, as partnership income and deductions are taxed to the partners and not the partnership, all tax partnerships must allocate their income and deductions to their owners.

Because Congress prized economic flexibility, the statutory framework allows partners to decide by agreement how to allocate the partnership's income and deduction items. This flexibility is constrained by the requirement that such allocations have "substantial economic effect," and if they lack such substantial economic effect, the allocations must conform to the "partner's interest in the partnership." Regulations provide detailed allocation rules implementing these concepts.

As Monroe notes, the regulatory allocation rules are at the core of the partnership tax regime. Yet, as Monroe argues, these allocation rules are dysfunctional both for elite partnerships and for "forgotten" partnerships. (Indeed, these rules are so difficult that even a superficial description would put this review well over the allotted space; please see Monroe's article for an excellent overview.)

Monroe identifies as "forgotten" partnerships those entities that lack the resources to acquire the expertise necessary to engage meaningfully with the allocation rules and concepts. As Monroe highlights, and has written about more extensively elsewhere, IRS publications currently do not provide adequate assistance in navigating the allocation rules.

Monroe compellingly argues that because the law is functionally illegible to a large number of taxpayers, such taxpayers are consigned to rely on intuition, chance, and instinct, instead of on law. Monroe points out that tax experts often simply do not think about these taxpayers (hence, "forgotten"), or, less benignly, tax experts normalize the forgotten partnerships' situations by assuming, or even arguing, that for less economically complex partnerships, instinct will often be good enough for compliance.

Monroe argues with compassion and eloquence that even if the tax returns of forgotten partnerships end up largely where they would have if technical partnership tax law had been accessible, that does not mean there is no harm. Instead, there is great harm to the impacted taxpayers' dignity as well as to their trust in and access to the tax system. These taxpayers are forced to improvise and to do so without an understanding of the technical rules around which the improvision is taking place, which means that the process will almost certainly be more stressful, more unequal, and less nuanced.

With respect to elite partnerships, Monroe points to growing anecdotal evidence that such partnerships also do not rely on the allocation rules, but not because they are illegible to such partnerships. Instead, it is because the rules fail to reflect the economic priorities of elite partnerships.

With their resources and access to expertise, elite partnerships are, however, able to interact creatively with the allocation rules by creating workarounds in the form of allocations designed to yield greater certainty about economic distributions. They also have the capacity to assume the risk that such workarounds may technically fail to comply with the rules.

Thus, as Monroe explains, the allocation rules are also dysfunctional for elite partnerships, but in a completely different way. That is, like forgotten partnerships, elite partnerships also improvise, but they do so by choice and with expert guidance on how their improvision harmonizes (or clashes) with the allocation rules.

Monroe's article calls out partnership tax experts who, with understandable pride in their intellectual and technical abilities in navigating partnership tax, embrace complexity and use it to benefit their clients without considering how what is often a rewarding and engaging puzzle for them is instead a meaningless pile of jargon to so many others. As Monroe indicates, dividing partnerships into "elite" and "forgotten" is a "blunt" categorization, but that does not detract from her overall message, which is a sharp and insightful critique of the "normal" practice of partnership tax.

In a nod to political realities, Monroe does not urge abandonment of the central flexibility of the partnership tax system, although she notes that "[i]f one were writing on a clean slate, reimagining partnership allocations entirely would surely be an intriguing option." Monroe does present two concrete proposals for reform: she proposes that small partnerships have a more streamlined regime and that the Treasury add a safe harbor for target allocations. As she acknowledges, these two proposals, at least in their broad outlines, build on the work of other tax scholars.

More importantly, she issues a call to tax experts that they critically examine their role in the current dysfunction and that they apply their expertise not only to helping elite partnerships but also to using their creativity and insight to transform partnership tax law so that forgotten partnerships are able to engage fully with the tax system.

The dual-track reform examples offered in the article highlight that Monroe is not saying all partnerships need the same rules. Instead, she emphasizes that all entities organized as partnerships should be able to rely on law that is intelligible and that does not require improvisation.

Andrea Monroe's article is a critical and timely reminder that the tax system, including the highly difficult portion applicable to tax partnerships, "only works if the vast majority of [taxpayers]—whether rich or poor, forgotten or elite—can participate."

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