Changes to the Calculation of a Partner's Basis in a Partnership – Tax Cuts and Jobs Act of 2017

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Large Business & International

Objectives

- Review basis limitation rules for charitable contributions and foreign taxes paid and accrued before and after the Tax Cuts and Jobs Act of 2017 (TCJA).

Review of Ordering Rules - Basis

Losses/deductions limited to basis.

Review of ordering rules for basis:

1. Increased by positive basis adjustments (cash, property contributions, income/gain) IRC § 705(a)(1).
2. Decreased by current-year distributions.
   - Cash distributions first – IRC § 732(a)(2).
3. Decreased (not below zero) by the partner’s share of all items of partnership losses for the year, including carryovers form prior years (Reg. 1.704-1(d)(2)).

Review of Ordering Rules – Basis (cont'd)

Limited to basis:

- If a partner's losses are limited by outside basis, the partner can deduct a pro-rata portion of each separately stated partnership item making up the loss, including prior year carryovers limited by prior year basis.
- The balance of the loss is suspended and deducted in subsequent years when the partner has sufficient basis. (Reg. 1.704-1(d)(2)).
- Note: This regulation has not yet been updated for charitable contributions and foreign taxes paid or accrued, but we expect this change will be made.

TCJA and IRC § 704(d)

- Section 13503 of the Tax Cuts and Jobs Act of 2017 (TCJA) modifies the IRC § 704(d) basis limitation on partner losses.
- This new provision requires that the limitation takes into account a partner's distributive share of:
  - charitable contributions (as defined in IRC §170(c)), and
  - taxes (as defined in IRC §901) paid or accrued to foreign countries and to possessions of the United States.

Before Sec. 13503 of TCJA

- How did charitable contributions impact outside basis before the TCJA?
  - The partner reduced outside basis in the partnership by the partner's share of the adjusted basis of contributed property, but not below zero. For example, if a partner's outside basis was $10, but a partner's share of the adjusted basis of contributed property was $20, the partner's basis would be reduced by $10 for that contribution.
    - This resulted in giving partners with a zero basis a share of a partnership charitable contribution of property without any reduction in partnership basis, whereas partners with a positive basis had to reduce outside basis for the same item.

Polling question 1

- Were charitable contributions limited to basis prior to the TCJA of 2018?
  - ☐ Yes
  - ☐ No

Before Sec. 13503 of TCJA

- How did foreign taxes impact outside basis before the TCJA?
  - The IRC § 704(d) regulations also did not take into account the partner’s share of foreign taxes paid or accrued in applying basis imitations.
  - For example, if a partner’s outside basis was $10, and the foreign taxes paid by the partnership was $20, the partner would reduce his outside basis by $10 to zero. The partner would still be able to deduct the total $20 amount of the taxes foreign taxes paid.

After Sec. 13503 of TCJA

- How does this change outside basis computations for tax years beginning after 12/31/2017?
  - A partner must reduce outside basis by the partner's share of:
    - foreign taxes.
    - the adjusted basis in the partnership's donated property.
  - in determining the partner's allowable share of partnership losses under revised IRC § 704(d).

After Sec. 13503 of TCJA

- Impact of the partnership donating appreciated property.
  - If the value of the partnership's donated property exceeds its tax basis, then the partner reduces outside basis only by his share of the partnership's **tax basis** in the property, ***NOT*** by the appreciation in the property's value.

Polling question 2

- After TCJA of 2017, the partner's share of the adjusted basis of the charitable contribution is limited to the partner's outside basis

☐ True

☐ False

After Sec. 13503 of TCJA

- Partner’s deduction when the partnership contributes appreciated property (FMV>Basis).
  - The partnership allocates to the partner a deduction equal to his share of the property’s tax basis. This property basis deduction ***is limited to his outside basis.***
  - In addition, the partner may separately deduct his share of the excess of the FMV of the property over the tax basis of the property (appreciation), subject to IRC § 170(b) limitations.

After Sec. 13503 of TCJA – Example – Tax Year 2018

Jerry and George, 50/50 partners in J&G, each have an adjusted basis in their partnership interest of $20 immediately after deducting distributions and before other items of loss and deductions.

- ❖ The partnership has an ordinary loss of $60 before deducting charitable contributions.
- ❖ The partnership made a charitable contribution of property with a FMV of 300, adjusted basis of $150.

After Sec. 13503 of TCJA – Example Charitable Contribution of Property

- How much can Jerry and George deduct on their personal returns, and what is the effect of the charitable contribution on basis?
  - Assume that Reg. § 1.704-1(d)(2) is revised to include charitable contributions and foreign taxes paid or accrued.

A. Compute pro-rata basis contribution reduction

	Total	PR share (50%)	% of total loss	Reduction to Basis	
Basis after all distributions and before deductions					**$20**
Ordinary business loss	(60)	(30)	29%	(6)	
Charitable contributions					
AB Property Subtotal	(150)	(75)	71%	(14)	
Partner basis	(210)	(105)	100%	**(20)**	(20)
					0

B. Compute allowable contribution deduction limited by basis

The taxpayer may deduct the following for charitable contributions:

	FMV	AB	Excess	**Deduction**
Excess of FMV over Adjusted Basis	300	150	150	**75**
Allowable adjusted basis from above				**14**
Deduction subject to 170 limitations				**89**

C. Compute charitable contribution carryover

Distributive share of basis	75
Less: Deduction allowed against basis	<u>14</u>
	<u>61</u>
Charitable contribution carryover	

Polling question 3

- After TCJA of 2017, the partner's share of the excess of the FMV over the adjusted basis of the charitable contribution is limited to the partner's outside basis

☐ True

☐ False

Before TCJA – Example Charitable Contribution of Property – Tax Year 2017

- Assume the same facts as above for J&G except that Jerry and George each have an adjusted basis in their partnership interest of $50 immediately after deducting distributions and before other items of loss and deductions.

- How much of the charitable contribution is deductible?

A. Compute outside basis after deducting allocable share of losses

Outside Basis	50
Less allocable share of:	
Loss	(30)
Adjusted basis of charitable contribution	(20)
Ending Outside Basis	0

B. Determine deductible charitable contribution

- Jerry and George would still need to reduce basis to zero for their allocable share of the adjusted basis of the charitable contribution.
- However, their charitable deduction would not be limited to outside basis.
- Assuming there was no IRC §170(b) limitation, they could deduct their entire distributive share of the FMV of the property of $150.

Summary

- Reg.§ 1.704-1(d)(2) does not take into account charitable contributions and foreign taxes paid/accrued in applying basis limitations.
- The TCJA in IRC § 704(d) provides that charitable contributions and foreign taxes paid or accrued are now taken into account in applying the basis limitations.
- The order that these two items reduce basis has not yet been added to Reg. §1.704-1(d)(2). National Office is currently reviewing this issue.