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TAX REFORM AND PARTNERSHIPS: WHAT YOU NEED TO KNOW

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The new tax law contains a number of provisions that will have a significant impact on partnerships and their partners.

While businesses across many different industries are structured as partnerships, the structure is particularly common in the real estate and private equity sectors. The following discussion outlines several key partnership-related provisions and highlights several consequences these provisions may have on partners both in terms of annual operations as well as future capital transactions. The specific partnership-related tax reform provisions include:

- Deduction for Qualified Business Income of Pass-Through Entities (Section 199A);
- Recharacterization of Certain Long-Term Capital Gains (Sections 1061 and 83);
- Taxation of Gain on the Sale of Partnership Interest by a Foreign Person (Sections 864(c) and 1446);
- Repeal of Technical Termination Rules under Section 708(b)(1)(B);
- Modification of the Definition of Substantial Built-in Loss in the Case of a Transfer of a Partnership Interest (Section 743(d));
- Charitable Contributions and Foreign Taxes Taken into Account in Determining Basis Limitation (Section 704(d)); and
- Like-Kind Exchanges of Real Property under Section 1031.

RELATED CONTENT

Tax Reform and Section 199A Deduction of Qualified Business Income of Pass-Through Entities

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DEDUCTION FOR QUALIFIED BUSINESS INCOME OF PASS-THROUGH ENTITIES (SECTION 199A)

General Rule

An individual partner's distributive share of ordinary business income is generally subject to tax at the individual's applicable income tax rate. Under the new tax law, the highest individual income tax rate is 37 percent. The law can effectively reduce the income tax rate applicable to an individual partner's distributive share of qualified trade or business income to a maximum rate of 29.6 percent. This rate reduction is achieved by providing taxpayers other than corporations a deduction for each taxable year equal to the sum of:

1. The lesser of (A) the taxpayer's "combined qualified business income amount" or (B) 20 percent of the excess of the taxpayer's taxable income for the taxable year over any net capital gain plus the aggregate amount of qualified cooperative dividends, plus
2. The lesser of (A) 20 percent of the aggregate amount of the qualified cooperative dividends of the taxpayer for the taxable year or (B) the taxpayer's taxable income (reduced by the net capital gain).

A taxpayer's combined qualified business income amount is generally equal to the sum of (A) 20 percent of the taxpayer's qualified business income (QBI) with respect to each qualified trade or business plus (B) 20 percent of the aggregate amount of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

Limitation Based on Wages & Capital

The portion of the deduction attributable to 20 percent of the taxpayer's QBI cannot exceed the greater of (1) 50 percent of their share of W-2 Wages paid with respect to the QBI or (2) the sum of 25 percent of their share of W-2 Wages plus 2.5 percent of the unadjusted basis of qualified property determined immediately after its acquisition of such qualified property. This limitation does not apply to taxpayers with taxable income not exceeding $315,000 (joint filers) or $157,500 (other filers). The limitation is phased-in for taxpayers with taxable income exceeding these amounts over ranges of $100,000 and $50,000, respectively.

The term W-2 Wages is defined to mean the sum of total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer. W-2 Wages do not include any such amount that is not properly allocable to qualified business income.

Definition of Qualified Property

The term qualified property is generally defined to mean, with respect to any qualified trade or business, tangible property of a character subject to depreciation under section 167 that is (i) held by and available for use in the qualified trade or business at the close of the taxable year, (ii) used at any point during the taxable year in the production of QBI, and (iii) the depreciable period for which has not ended before the close of the taxable year. Importantly, the new tax law defines the term "depreciable period" to mean the later of 10 years from the original placed in-service date or the last day of the last full year in the applicable recovery period determined under section 168.

Illustration of W-2 Wages & Capital Limitation

Assume a taxpayer (who files a joint tax return and has taxable income of more than $415,000) operates a widget-making business. The business buys a widget-making machine for $100,000 and places it in service in 2020. The business has no employees in 2020. Further, assume the taxpayer generates $20,000 of QBI resulting in a QBI deduction amount of $4,000.

The Section 199A(b)(2)(B) limitation is the greater of (a) 50 percent of W-2 wages, or $0, or (b) the sum of 25 percent of W-2 wages ($0) plus 2.5 percent of the unadjusted basis of the machine immediately after its acquisition ($100,000 * 2.5 percent = $2,500). The amount of the W-2 Wages & Capital Limitation for the year is $2,500. Therefore, the taxpayer would be entitled to a Section 199A deduction equal to $2,500 (the lesser of $4,000 or $2,500).

If the taxpayer's taxable income for the year is $375,000 (an amount above the $315,000 threshold but below $415,000), the Section 199A(b)(2)(B) limitation is subject to phase-in. The phase-in occurs over $100,000 for joint filing taxpayers, resulting in a phase-in percentage equal to 60 percent (($375,000 – $315,000)/$100,000). Under Section 199A(b)(3)(B)(iii), the taxpayer's allowable deduction is $3,100 ($4,000 – (($4,000 – $2,500) * 60 percent)).

As a general rule, the phase-in percentage of taxpayers filing a joint return will be one percent per $1,000 of taxable income in excess of $315,000. For other taxpayers, the phase-in percentage is two percent per $1,000 of taxable income in excess of $157,500.

Definition of Qualified Business Income

QBI includes the net domestic business taxable income, gain, deduction, and loss with respect to any qualified trade or business. QBI specifically excludes the following items of income, gain, deduction, or loss: (1) Investment-type income such as dividends, investment interest income, short-term & long-term capital gains, commodities gains, foreign currency gains, and similar items; (2) Any Section 707(c) guaranteed payments paid in compensation for services performed by the partner to the partnership; (3) Section 707(a) payments for services rendered with respect to the trade or business; or (4) Qualified REIT dividends, qualified cooperative dividends, or qualified PTP income.

Carryover of Losses

The new tax law provides rules regarding the treatment of losses generated in connection with a taxpayer's qualified trades or businesses. Under these rules, if the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year. In practice, this will mean that a taxpayer's net loss generated in Year 1 will be carried forward and reduce the subsequent year's section 199A deduction.

For example, assume a taxpayer generates a $1,000 loss from a qualified trade or business during the year-ended December 31, 2018. During the year-ended December 31, 2019, the taxpayer generates $1,500 of qualified business income. Under the carryover loss rule, and ignoring other limitations, the taxpayer would calculate a Section 199A deduction of $100 as follows:

Section 199A Deduction	Amount	Deduction Percentage	Allowable Deduction
Qualified Business Income	$1,500	20%	$300
Carryover Loss Amount	($1,000)	20%	($200)
Total Section 199A Deduction			**$100**

Definition of Qualified Trade or Business

A qualified trade or business includes any trade or business other than a "specified service trade or business" or the trade or business of performing services as an employee. A specified service trade or business includes any business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, and investing and investment management, trade, or dealing in securities, partnership interests, or commodities. The specified service trade or business exclusion does not apply to the extent the taxpayer's taxable income does not exceed certain thresholds: $415,000 (joint filers) and $207,500 (other filers). Application of this exclusion is phased-in for income exceeding $315,000 and $157,500, respectively.

Illustration of Specified Services Exception Calculation

Assume the taxpayer has taxable income of $375,000, of which $200,000 is attributable to a specified services trade or business. Under Section 199A(d)(3), the taxpayer has an applicable percentage of 40 percent (1 – (($375,000 – $315,000) / $100,000)). Therefore, in determining includible QBI the taxpayer takes into account only $80,000 ($200,000 * 40 percent).

Special Rules for Partnerships & S Corporations

The new tax law provides that the Section 199A deduction is to be applied at the partner or shareholder level. Consequently, each partner or shareholder is required to take into account each person's allocable share of QBI. Additionally, each partner or shareholder is treated as having W-2 wages and qualified property in an amount equal to such person's allocable share of the W-2 wages and qualified property of the partnership or S Corporation.

Comprehensive Example

Taxpayer "A" files a joint return reporting taxable income of $375,000 (determined without regard to any potential Section 199A deduction). A is allocated business income, W-2 Wages, and unadjusted basis of qualified property, respectively, from the three separate business activities summarized in Table 1:

TABLE 1 SUMMARY DATA	Activity #1	Activity #2	Activity #3
Business Income	150,000	35,000	30,000
W-2 Wages	100,000	10,000	10,000
Qualified Property	1,500,000	75,000	100,000

Activities #1 and #2 meet the definition of a qualified trade or business under Section 199A(d)(1). Activity #3, however, is a specified services business within the meaning of Section 199A(d)(2). Additionally, during the year, A received qualified REIT dividends ($25,000), qualified PTP income ($35,000), and net capital gains ($15,000). Finally, A has a net carryover qualified business loss of $100,000. Based on these facts, A will be entitled to a Section 199A deduction in the amount of $29,960. The calculation of this deduction pursuant to Section 199A(a) is illustrated in Table 2.

TABLE 2 CALCULATION OF SECTION A QUALIFIED BUSINESS INCOME DEDUCTION		Deduction Amount
Sum of:		
(1) Lesser of (A) or (B)		
(A) Combined QBI (see Table 3)	$29,960	
(B) 20% of Excess T.I. over Capital Gain plus Qual. Coop. Div.	$72,000	$29,960
(1) Lesser of (A) or (B)		
(A) 20% of Qualified Coop. Div.	$0	
(B) Taxable Income (reduced by net capital gain)	$360,000	$0
Section 199A Deduction (sum of lesser of (1) or (2))		**$29,960**

TABLE 3 COMBINED QBI AMOUNT	
Qualified trade or business amount – Activity 1	$30,000
Qualified trade or business amount – Activity 2	5,800
Qualified trade or business amount – Activity 3	2,160
Qualified trade or business amount – Carryover Loss	(20,000)
Net qualified trade or business amount (see Table 4)	$17,960
Qualified REIT dividends	5,000
Qualified PTP income	7,000
Section 199A(a) Combined QBI Amount	**$29,960**

TABLE 4 DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS	Activity #1	Activity #2	Activity #3	Carryover QBL	Total
Net Qualified Business Income per Qualified Trade or Business	150,000	35,000	30,000	-100,000	115,000
Reduction for Specified Services Trade or Business Income*	0	0	-18,000	0	-18,000
Allowable Qualified Business Income per Qualified Trade or Business	150,000	35,000	12,000	-100,000	97,000
Deduction Percentage	20%	20%	20%	20%	20%
Qualified Trade or Business Amount (Pre-Wages and Capital Limitation)	30,000	7,000	2,400	-20,000	19,400
Limitation Based on Wages & Capital	0	-1,200	-240	0	-1,440
Qualified Trade or Business Amount	**30,000**	**5,800**	**2,160**	**-20,000**	**17,960**

**Application of the applicable percentage with respect to a specified service business is being illustrated as a reduction in QBI*

Discussion of Relevant Components in Illustrative Example

20 Percent of Qualified REIT Dividends & Qualified PTP Income

A generated $25,000 of qualified REIT dividends and $35,000 of qualified PTP income. Pursuant to Section 199A(b)(1)(B), combined QBI includes 20 percent of the aggregate amount of qualified REIT dividends and qualified PTP income of the taxpayer for the taxable year. Consequently, A's combined QBI will be increased by $12,000 (($25,000 + $35,000) * 20 percent).

Qualified Trade or Business Amount – Activity 1

A's QBI from Activity 1 is $150,000, 20 percent of which is $30,000 ($150,000 * 20 percent). A's allocable share of W-2 Wages paid with respect to Activity 1 is $100,000, 50 percent of which is $50,000 ($100,000 * 50 percent). Further, 25 percent of the W-2 Wages plus 2.5 percent of A's allocable share of the unadjusted basis in qualified property is $62,500 (($100,000 * 25 percent) + ($1,500,000 * 2.5 percent)). As A's taxable income is above the threshold amount of $315,000 but not above the $415,000 threshold amount over which the limitation would apply fully, application of the wage limitation for Activity 1 is subject to phase in. However, since the Section 199A(b)(2)(B) limitation amount of $62,500 (the greater of $50,000 or $62,500, calculated above) exceeds the QBI amount of $30,000, calculation of the phase-in amount is unnecessary. A will be entitled to include the entire $30,000 in determining his overall Section 199A(a) deduction.

Qualified Trade or Business Amount – Activity 2

A's QBI and W-2 Wages from Activity 2 are $35,000 and $10,000, respectively. 20 percent of the QBI for Activity 2 is $7,000 ($35,000 * 20 percent). 50 percent of the W-2 Wages allocated to A during the year is $5,000 ($10,000 * 50 percent); 25 percent of W-2 wages allocated to A plus 2.5 percent of A's allocable share of the unadjusted basis in qualified property is $4,375 (($10,000 * 25 percent) + ($75,000 * 2.5 percent)). As A's taxable income is above the threshold amount of $315,000, application of the wage limitation for Activity 2 is subject to phase in. Since the applicable limitation amount of $5,000 is less than the QBI amount, A's Section 199A deduction will be limited. Accordingly, the $7,000 amount is reduced by 60 percent of the difference between $7,000 and $5,000 (the greater of the wage limitation amounts calculated above), or $1,200 resulting in a deductible amount for Activity 2 of $5,800.

Qualified Trade or Business Amount – Activity 3

A's QBI and W-2 Wages from Activity 3 are $30,000 and $10,000, respectively. Because Activity 3 is a specified services business the general rule provides that no portion of A's allocable share of income is generated from a qualified trade or business. Therefore,

none of the income would generally be considered QBI. However, because A's taxable income is above the threshold amount of $315,000 but below the phase out limit of $415,000, a portion of the income allocated from Activity 3 will be treated as QBI. For purposes of determining the amount of qualified business income, A has an applicable percentage of 40 percent (1 – (($375,000 – $315,000) / $100,000)) resulting in QBI of $12,000 ($30,000 * 40 percent). 20 percent of the QBI for Activity 3 is $2,400 ($12,000 * 20 percent), representing the maximum deduction for this activity. The allowable deduction is the lesser of this amount or the greater of the amounts described in section 199A(b)(2)(B). The 50 percent wage limitation is $2,000 (($10,000 * 50 percent) * 40 percent) and the 25 percent wages plus capital limitation is $2,000 ((($10,000 * 25 percent) + ($100,000 x 2.5 percent)) * 40 percent). The taxpayer is subject to application of the wage limit due to their taxable income being in excess of the threshold amount but below the maximum phase-in amount of $415,000. As a result, the $2,400 preliminary amount must be reduced by 60 percent of the difference between $2,400 and the wage limitation of $2,000, or $240 (($2,400 – $2,000) * 60 percent). The resulting deductible amount for QBI with respect to activity 3 is $2,160 ($2,400 – $240).

Qualified Trade or Business Amount – Carryover Loss Amount

A also has a carryover qualified business loss of $100,000 that must be taken into account when calculating the current year Section 199A deduction. Accordingly, 20 percent is applied to the carryover qualified business loss which leads to a decrease in the current year eligible deduction by $20,000.

Observation: Taxpayers eligible to claim the full 20 percent deduction on QBI will incur a maximum effective rate of 29.6 percent on the QBI. While this rate reduction is beneficial, it is important to consider the decrease in corporate tax rates from 35 percent to 21 percent. This rate differential is likely to cause taxpayers to reevaluate their choice of entity decisions. There are a number of factors that need to be considered but, from a simple after-tax cash flow perspective, a key determinative factor is the likelihood of the entity distributing vs. retaining operating earnings.

Observation: While a common thought is to consider possibly incorporating an existing partnership in order to benefit from the 21 percent corporate tax rate, a corporate-to-partnership conversion should not be dismissed. When corporate tax rates were 35 percent, the tax liability imposed on gain recognized under Section 311(b) was typically prohibitive in a conversion transaction. However, with corporate rates dropping to 21 percent, consideration should now be given to the possible liquidation of a corporation and re-formation as a partnership, especially in situations where the corporation has net operating loss carryovers that could shelter the recognized Section 311(b) gain.

Observation: The determination of the combined QBI amount is dependent upon the QBI generated from each qualified trade or business activity. Further, the wages and capital-based limitations are determined with reference to wages and qualified property that is allocable to a particular qualified trade or business activity. It is not clear from the statute whether and the extent grouping rules under sections 469 may be applicable.

Observation: Properly tracking partner income and loss allocations will take on greater importance in order to accurately determine a partner's annual net business income allocations and carryover loss amounts. This importance will be further magnified as a result of the potential imputed underpayment obligations that could arise under the new partnership audit rules that went into effect for tax years beginning after December 31, 2017.

Observation: Complexities are likely to arise in situations where a partnership operates multiple activities. Maintaining adequate information and documentation will be necessary to support application of the lower rates. Consequently, partners and partnerships will need to consider the extent to which additional information will be maintained, how it will be communicated to partners, and whether any incremental administrative costs should be borne by the benefiting partners.

RECHARACTERIZATION OF CERTAIN LONG-TERM CAPITAL GAINS (SECTIONS 1061 & 83)

Under general rules, gain recognized by a partnership upon disposition of a capital asset held for at least one year was characterized as long-term capital gain. Further, the sale of a partnership interest held for at least one year generated long-term capital gain except to the extent section 751(a) applies. Under the new tax law, long-term capital gain will only be available with respect to "applicable partnership interests" to the extent the capital asset giving rise to the gain has been held for at least three years.

An applicable partnership interest is any partnership interest transferred, directly or indirectly, to a partner in connection with the performance of services by the partner, provided that the partnership is engaged in an "applicable trade or business." An applicable trade or business means any activity that is conducted on a regular, continuous, and substantial basis consisting of raising or returning capital and either (1) investing in, or disposing of, specified assets (or identifying specified assets for such investing or disposition) or (2) developing such specified assets. For purposes of this provision, specified assets include securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing.

Consistent with the intent to limit applicability of these rules, the law provides that applicable partnership interests do not include (A) a partnership interest held directly or indirectly by a corporation or (B) a capital interest in a partnership commensurate with the partner's capital contributions or the value of the interest subject to tax under Section 83 upon receipt or vesting. However, the fact that an individual may have recognized taxable income upon acquisition of an applicable partnership interest or made a Section 83(b) election with respect to such applicable partnership interest does not change the three-year holding period requirement.

The provision is applicable to taxable years beginning after December 31, 2017.

Observation: Based on the definitions of applicable partnership interests, applicable trades or businesses, and specified assets, it appears that this rule is primarily targeted at hedge funds and real estate funds with relatively short-term holding periods, i.e., more than one year but less than three years. Private equity and venture capital funds generally have a longer holding period and are unlikely to be affected to the same degree. However, care will need to be taken to ensure the holding period requirements are satisfied in all cases. Further, determination of a partner's share of capital gains "commensurate with the amount of capital contributed" will likely require detailed record-keeping and tracking of partner Section 704(b) and tax basis capital accounts. This provision is estimated to increase revenues by $1.1 billion over the 10-year period following enactment.

TAXATION OF GAIN ON THE SALE OF PARTNERSHIP INTEREST BY A FOREIGN PERSON (SECTIONS 864(C) AND 1446)

Revenue Ruling 91-32 generally provides that a foreign partner will recognize effectively connected income (ECI) on a sale of a partnership interest to the extent a sale of underlying partnership assets would give rise to an allocation of ECI to the transferor partner. The revenue ruling effectively adopts an aggregate approach to determining ECI notwithstanding the entity approach mandated by Section 741. In the recently decided case of ***Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Commissioner***, the Tax Court ruled that the taxpayer's gain on sale of its partnership interest was not ECI despite the fact that a sale of the partnership's assets would have generated ECI allocable to the partner, effectively rejecting Rev. Rul. 91-32. The Tax Court's decision applied the entity theory to the sale of a partnership interest and found the IRS' position in the revenue ruling lacked the "power to persuade".

The new tax law effectively codifies the holding in Rev. Rul. 91-32 and overturns the Tax Court's decision in *Grecian Magnesite*. In particular, the law treats the gain recognized on the sale or exchange of a partnership interest as ECI to the extent the transferor would be allocated ECI upon a sale of assets by the partnership. This provision effectively recharacterizes otherwise non-ECI capital gain from the sale of partnership interest into ECI. Additionally, the law provides that the Treasury shall issue regulations as appropriate for application of the rule in exchanges described in sections 332, 351, 354, 355, 356, or 361 and may issue regulations permitting a broker, as agent for the transferee, to deduct and withhold the tax equal to 10 percent of the amount realized on the disposition. The provision treating gain or loss on the sale of a partnership interest as ECI is effective for transactions on or after November 27, 2017, while the provision related to withholding is effective for sales or exchanges after December 31, 2017.

Observation: This proposal effectively codifies the holding Revenue Ruling 91-32 and reverse the Tax Court's decision in Grecian Magnesite. As a result of the coordination of allocable gain on a hypothetical sale of partnership assets with total ECI, accurate tracking of Section 704(c) built-in gain and losses will become significantly more important. This provision is estimated to increase revenues by $3.8 billion over the 10-year period following enactment.

REPEAL OF TECHNICAL TERMINATION RULES UNDER SECTION 708(B)(1)(B)

Under the new tax law, the technical termination rules under Section 708(b)(1)(B) is repealed for tax years beginning after 2017. No changes are made to the actual termination rules under Section 708(b)(1)(A).

Observation: Repeal of the technical termination rule is generally a favorable development since it will eliminate the need to restart depreciation upon the sale or exchange of more than 50 percent capital and profits interest in a partnership. Additionally, the law alleviates the common occurrence of failing to properly identify transactions giving rise to technical terminations which leads to late filing of required tax returns, failure to make appropriate elections, and imposition of penalties. However, technical terminations are sometimes used to eliminate unfavorable elections, and the creation of a "new" partnership entity is oftentimes required in connection with international investments in U.S. joint ventures. While it may be possible to continue structuring transactions to achieve these objectives, the simplicity of triggering a technical termination has been eliminated. This provision is estimated to increase revenues by $1.6 billion over the 10-year period following enactment.

MODIFICATION OF THE DEFINITION OF SUBSTANTIAL BUILT-IN LOSS IN THE CASE OF A TRANSFER OF A PARTNERSHIP INTEREST (SECTION 743(D))

Section 743(b) provides for an adjustment to the basis of partnership property upon the sale or exchange of a partnership interest providing the partnership has a Section 754 election in effect or where the partnership has a substantial built-in loss. Section 743(d) currently provides that a partnership has a substantial built-in loss with respect to a transfer of an interest in a partnership if the partnership's adjusted basis in all of its property exceeds the fair market value of such property by more than $250,000. Under this existing rule, it's possible that a transferee partner could acquire a partnership interest with respect to which there is a built-in loss of more than $250,000 without there being a mandatory basis adjustment because the partnership does not have an overall built-in loss meeting the threshold.

The new tax law modifies the definition of a substantial built-in loss for purposes of section 743(d). Under the law, a substantial built-in loss also exists if the transferee partner is allocated a loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest. This provision applies to transfers of partnership interests occurring after December 31, 2017.

Observation: It is not clear whether a relatively high number of partnership interest transfers will be captured under this rule. However, given the negative consequences of a potential downward basis adjustment it will become even more critical that partnerships properly track each partner's Section 704(b) and tax basis capital accounts. Failure to accurately track capital accounts could lead to incorrect downward adjustments resulting in increased exposure to both the transferring and non-transferring partners. This provision is estimated to increase revenues by $500 million over the 10-year period following enactment.

CHARITABLE CONTRIBUTIONS AND FOREIGN TAXES TAKEN INTO ACCOUNT IN DETERMINING BASIS LIMITATION (SECTION 704(D))

Under the general rules of Section 704(d), a partner's ability to deduct its distributive share of partnership losses is limited to the extent of the partner's outside tax basis in the partnership interest. However, this limitation does not apply to a partner's allocable share of charitable contributions or foreign tax expenditures. As a result, a partner may be able to deduct its share of a partnership's charitable contributions and foreign tax expenditures even to the extent they exceed the partner's basis in its partnership interest.

The new tax law modifies the section 704(d) loss limitation rule to take into account charitable contributions and foreign taxes. However, in the case of a charitable contribution of property where the fair market value exceeds the adjusted tax basis the Section 704(d) basis limitation does not apply to the extent of the partner's allocable share of this excess. This provision applies to taxable years beginning after December 31, 2017.

Observation: This rule change will increase the importance of ensuring accurate calculation of a partner's tax basis. Although partners are generally required to determine their own tax basis, it's not uncommon for partners to look to the partnership to provide relevant data including tax basis capital and liability allocations. The increased importance of outside tax basis calculations will place more pressure on partnerships to accurately track partner capital as well as determining proper liability allocations under Section 752. This provision is estimated to increase revenues by $1.2 billion over the 10-year period following enactment.

LIKE-KIND EXCHANGES OF REAL PROPERTY (SECTION 1031)

Application of Section 1031 is limited to transactions involving the exchange of real property that is not held primarily for sale. Section 1031 no longer applies to any other property including personal property that is associated with real property. This provision is effective for exchanges completed after December 31, 2017. However, if the taxpayer has started a forward or reverse deferred exchange prior to December 31, 2017, Section 1031 may still be applied to the transaction even though completed after December 31, 2017.

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