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

November 28, 2018
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).
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)).
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.
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.
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.
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).
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.
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
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.
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.
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

Basis after all distributions and before deductions: $20

<table>
<thead>
<tr>
<th>Category</th>
<th>Total</th>
<th>PR share (50%)</th>
<th>% of total loss</th>
<th>Reduction to Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary business loss</td>
<td>(60)</td>
<td>(30)</td>
<td>29%</td>
<td>(6)</td>
</tr>
<tr>
<td>Charitable contributions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AB Property Subtotal</td>
<td>(150)</td>
<td>(75)</td>
<td>71%</td>
<td>(14)</td>
</tr>
<tr>
<td>Partner basis</td>
<td>(210)</td>
<td>(105)</td>
<td>100%</td>
<td>(20)</td>
</tr>
</tbody>
</table>

Total Reduction to Basis: 0

15
The taxpayer may deduct the following for charitable contributions:

<table>
<thead>
<tr>
<th>Excess of FMV over Adjusted Basis</th>
<th>FMV</th>
<th>AB</th>
<th>Excess</th>
<th>Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowable adjusted basis from above</td>
<td></td>
<td></td>
<td></td>
<td>14</td>
</tr>
<tr>
<td>Deduction subject to 170 limitations</td>
<td></td>
<td></td>
<td></td>
<td>89</td>
</tr>
</tbody>
</table>
C. Compute charitable contribution carryover

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributive share of basis</td>
<td>75</td>
</tr>
<tr>
<td>Less: Deduction allowed against basis</td>
<td>14</td>
</tr>
<tr>
<td>Charitable contribution carryover</td>
<td></td>
</tr>
</tbody>
</table>
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
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

<table>
<thead>
<tr>
<th>Outside Basis</th>
<th>50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less allocable share of:</td>
<td></td>
</tr>
<tr>
<td>Loss</td>
<td>(30)</td>
</tr>
<tr>
<td>Adjusted basis of charitable contribution</td>
<td>(20)</td>
</tr>
<tr>
<td>Ending Outside Basis</td>
<td>0</td>
</tr>
</tbody>
</table>
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.
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.