April 18, 2019

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on the Final Regulations Under Section 199A

Dear Commissioner Rettig:

Enclosed please find comments with respect to the final regulations under new section 199A of the Internal Revenue Code. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Eric Solomon
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Acting Tax Legislative Counsel, Department of the Treasury
Audrey W. Ellis, Attorney-Advisor, Department of the Treasury
Hon. Michael Desmond, Chief Counsel, Internal Revenue Service
Scott K. Dinwiddie, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Holly Porter, Associate Chief Counsel (Passthroughs & Special Industries), Internal Revenue Service
Wendy L. Kribell, Attorney, Office of Associate Chief Counsel, (Passthroughs & Special Industries), Internal Revenue Service
These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the "Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Bryan Keith, Ryan Tucker, and Beverly Katz. Substantial contributions were made by Thomas Phillips. These comments have been reviewed by Grace Kim, Jennifer Alexander, Gary Huffman of the Committee on Government Submissions, and Eric B. Sloan, Vice Chair for Government Relations for the Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments, or has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: April 18, 2019
EXECUTIVE SUMMARY

Section 199A\(^1\) was added to the Code by An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, commonly referred to as the Tax Cuts and Jobs Act (the “Act”).\(^2\) Final regulations under section 199A were issued on January 18, 2019 (the “Final Regulations”).

We commend the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) for providing expedited guidance under section 199A. We respectfully request that Treasury and the Service consider the following recommendations with respect to the Final Regulations.

I. Recommendations on the Final Regulations – Determination of UBIA of Qualified Property

We recommend amending the Final Regulations to make the following clarifications and corrections:

A. Revise Regulation section 1.199A-2(a)(3)(iv)(B) to clarify that an Excess Section 743(b) Basis Adjustment is limited to zero when the tentative Excess Section 743(b) Basis Adjustment is negative and the actual section 743(b) adjustment is positive (or vice versa).

B. Revise Regulation section 1.199A-2(c)(3)(iv) to clarify the mechanics of determining a transferee’s UBIA when money is transferred in connection with a transaction described in section 168(i)(7)(B).

C. Revise Regulation section 1.199A-2(c)(3)(ii)(B) by adopting the language in the preamble to the Final Regulations defining excess boot to mean “the excess of the amount of money or fair market value of other property received by the taxpayer in the exchange over the amount of appreciation in the relinquished property.”

D. Clarify whether the deemed section 721 contribution resulting from a termination of a partnership under former section 708(b)(1)(B) is considered a “transaction described in section 168(i)(7)(B)” for purposes of applying the special rules provided by Regulation sections 1.199A-2(c)(2)(iv)(A) and (c)(3)(iv).

II. Recommendations on the Final Regulations – Allocation of UBIA

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\(^1\) Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Regulation section” are to the Treasury regulations promulgated under the Code.

A. We recommend amending Regulation section 1.199A-2(a)(3)(ii) to clarify the operation of this rule by providing that a partnership allocates the UBIA to its partners in accordance with how the partners share depreciation for the entire taxable year, disregarding any depreciation allocated to a partner who disposes of its entire interest before the end of the taxable year.
DISCUSSION

I. Comments Regarding the Determination of UBIA of Qualified Property

This section of the Comments addresses the determination of the unadjusted basis immediately after acquisition (“UBIA”) of qualified property (“Qualified Property”) of an individual or relevant passthrough entity (“RPE”).

We made a number of recommendations with respect to the determination of UBIA of Qualified Property in a previous comment letter (“Prior Letter”).3 While we appreciate the consideration that was given in the Final Regulations to many of those recommendations, we recommend amending the Final Regulations to make the following clarifications and corrections.

A. Application of the Absolute Value Language in the Calculation of an Excess Section 743(b) Basis Adjustment

1. Background

The Proposed Regulations did not allow a partnership or its partners to treat a section 743(b) adjustment allocated to Qualified Property as UBIA of Qualified Property.4 The preamble to the Proposed Regulations explained that “[t]reating partnership special basis adjustments as qualified property could result in inappropriate duplication of UBIA of qualified property (if, for example, the fair market value of the property has not increased and its depreciable period has not ended).”5

In response to comments, the Final Regulations under section 199A provide that a specified portion of a section 743(b) adjustment can be treated as Qualified Property (“Excess Section 743(b) Basis Adjustment”).6 Although a draft version of the Final Regulations that was made public on January 18, 2019, contained a definition of Excess Section 743(b) Basis Adjustment, that definition was modified in the version of the Final Regulations that was published in the Federal Register.7 The following shows the

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7 Although the definition of Excess Section 743(b) Basis Adjustment was corrected, the term itself was not modified. Because the calculation no longer contains an “excess of” formula, we recommend that a more descriptive name be used for the portion of a section 743(b) adjustment that can be taken into account in determining the transferee partner’s UBIA, such as “qualified section 743(b) basis adjustment” or “UBIA section 743(b) basis adjustment.”
changes that were made from the initial version to the final version of Regulation section 1.199A-2(a)(3)(iv)(B) –

**Excess section 743(b) basis adjustments.** A partner’s excess section 743(b) basis adjustment is an amount that is determined with respect to each item of qualified property and is equal to an amount that would represent the partner’s section 743(b) basis adjustment with respect to the same item of qualified property, as determined under §1.743-1(b) and §1.755-1, but calculated as if the adjusted basis of all of the partnership’s property was equal to the UBIA of such property. The absolute value of the excess section 743(b) basis adjustment cannot exceed the absolute value of the total section 743(b) basis adjustment with respect to qualified property.

While the deletions were presumably intended to fix a drafting error, the specific purpose of the additional sentence at the end of the paragraph (the “Absolute Value Language”) is unclear. As discussed below, it appears that the Absolute Value Language is, at a minimum, intended to ensure that a negative Excess Section 743(b) Basis Adjustment is not more negative than an actual negative section 743(b) basis adjustment that it relates to. However, it is not clear how the Absolute Value Language should apply to situations in which the tentative Excess Section 743(b) Basis Adjustment is negative and the actual section 743(b) adjustment is positive (or vice versa).

2. **Recommendation**

We recommend that the Final Regulations be amended to provide that an Excess Section 743(b) Basis Adjustment is limited to zero when the tentative Excess Section 743(b) Basis Adjustment is negative and the actual section 743(b) adjustment is positive (or vice versa).

3. **Explanation**

Regulation section 1.199A-2(a)(3)(iv)(D) provides two examples illustrating the computation of Excess Section 743(b) Basis Adjustments. In the first example (Example 1), the transferee’s positive section 743(b) adjustment is equal to the transferee’s Excess Section 743(b) Basis Adjustment, so the Absolute Value Language does not apply. In the second example (Example 2), however, the transferee’s tentative Excess Section 743(b) Basis Adjustment (determined without regard to the Absolute Value Language) is negative $100,000, whereas the transferee’s actual section 743(b) adjustment is negative $50,000. Due to the Absolute Value Language, the example concludes that the Excess

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8 Instead of capturing the portion of the section 743(b) adjustment that reflects the appreciation in the Qualified Property since it was purchased, the initial version of the calculation would have captured the portion of the section 743(b) adjustment that does not reflect appreciation.

9 In mathematics, the absolute value of a real number x is the non-negative value of x without regard to its sign. The absolute value of a number may be thought of as its distance from zero.


10 The transferee purchased a one-third interest in a partnership for $200,000. The partnership only owned Qualified Property that it had purchased for $900,000. The adjusted tax basis of the Qualified Property at
Section 743(b) Basis Adjustment is limited to negative $50,000. This is because the absolute value of the Excess Section 743(b) Basis Adjustment (positive $100,000) exceeds the absolute value of the actual section 743(b) adjustment (positive $50,000). Note that there would have been no limitation had the words “absolute value” not been used, because negative $100,000 does not exceed negative $50,000.

Based on Example 2, it appears that the Absolute Value Language is, at a minimum, intended to ensure that a negative Excess Section 743(b) Basis Adjustment is not more negative than an actual negative section 743(b) basis adjustment that it relates to. This was not an obvious choice for Treasury and the IRS because there are policy reasons that would favor not limiting a negative Excess Section 743(b) Basis Adjustment at all. Specifically, not limiting a negative Excess Section 743(b) Basis Adjustments promotes the greatest amount of parity, from a UBIA of Qualified Property perspective, between the purchase of Qualified Property directly and the purchase of Qualified Property indirectly through a partnership.

Although not illustrated in an example to the Final Regulations, the Absolute Value Language is likely also intended to ensure that a positive Excess Section 743(b) Basis Adjustment is not more positive than an actual positive section 743(b) basis adjustment that it relates to. However, it is unclear how the Absolute Value Language

the time of the transfer was $750,000. Therefore, the transferee’s share of the inside tax basis is $250,000 resulting in a section 743(b) adjustment of negative $50,000 ($200,000 - $250,000). Using UBIA of $900,000 as the adjusted tax basis of the property, the transferee’s share of inside basis would be $300,000, so the tentative Excess Section 743(b) Basis Adjustment is negative $100,000 ($200,000 - $300,000).

Example 2 also appears to confirm that it is mandatory for a transferee partner to take a negative Excess Section 743(b) Basis Adjustment into account (albeit limited to the amount of the negative actual section 743(b) adjustment) when determining its share of the partnership’s UBIA of Qualified Property. While this requirement appears clear based on the language of Regulation section 1.199A-2(a)(3)(iv)(C) (i.e., “that amount will be subtracted from the partner’s UBIA”), the language of Regulation section 1.199A-2(a)(3)(iv)(A) could be read to mean that a partner can choose whether or not to take a negative Excess Section 743(b) Basis Adjustment into account in determining its share of the partnership’s UBIA of Qualified Property (i.e., “a partner will be allowed to take into account …”). Therefore, we recommend that Regulation section 1.199A-2(a)(3)(iv)(A) clearly state that the reduction of a transferee partner’s share of a partnership’s UBIA of Qualified Property for a negative Excess Section 743(b) Basis Adjustment is not optional.

Our prior comments recommended that “all negative section 743(b) adjustments to Qualified Property should reduce the transferee’s share of UBIA of the Qualified Property.” See Prior Letter, at 3.

In Example 2, the UBIA of Qualified Property allocated to the transferee would have been $200,000 ($300,000 share of partnership UBIA, reduced by the $100,000 of negative Excess Section 743(b) Basis Adjustment) before any limitation, which equals the UBIA that the transferee would have had if it had purchased $200,000 of Qualified Property directly. The limitation provided by the Absolute Value Language causes there to be a disparity between the transferee’s share of the Qualified Property’s value at the time of the transfer ($200,000) and the UBIA of Qualified Property allocated the transferee under the Final Regulations ($250,000).

It should be noted that such a situation would be less common because the adjusted tax basis of the Qualified Property would need to exceed the UBIA of the same Qualified Property. The only immediately apparent situation in which that could occur if there is an existing positive section 743(b) adjustment that has increased the adjusted tax basis of the Qualified Property, but not its UBIA.
should apply when the Excess Section 743(b) Basis Adjustment is negative and the actual section 743(b) adjustment is positive (or vice versa).\(^{15}\)

Assume that, in similar facts to Example 2, a transferee’s tentative Excess Section 743(b) Basis Adjustment is negative $100,000, but the actual section 743(b) adjustment is positive $30,000.\(^{16}\) As discussed above, there are policy merits to allowing the entire tentative Excess Section 743(b) Basis Adjustment of negative $100,000 to reduce the transferee’s UBIA of Qualified Property, but the presence of the Absolute Value Language operates to limit the Excess Section 743(b) Adjustment in certain circumstances.

A literal application of the Absolute Value Language would result in an Excess Section 743(b) Basis Adjustment of negative $30,000, because the absolute value of the negative adjustment cannot exceed $30,000 (the absolute value of the actual section 743(b) adjustment). However, the negative $30,000 limitation seems arbitrary, and there does not appear to be a policy reason for such limitation. In addition, this application of the Absolute Value Language results in a negative Excess Section 743(b) Basis Adjustment when there is no actual negative section 743(b) adjustment which it relates.

The preamble to the Final Regulations provides that “[t]he Treasury Department and the IRS agree that section 743(b) basis adjustments should be treated as Qualified Property to [the] extent the section 743(b) basis adjustment reflects an increase in the fair market value of the underlying Qualified Property (emphasis added).\(^{17}\) In other words, the preamble makes clear that a certain portion of an actual section 743(b) basis adjustment itself should be Qualified Property. Under that approach, it does not seem possible for the portion of an actual section 743(b) adjustment that is treated as UBIA of Qualified Property to be negative if the actual section 743(b) adjustment is positive.

When faced with a situation in which the Excess Section 743(b) Basis Adjustment is negative, but the actual section 743(b) adjustment is positive, the most logical interpretation of the Absolute Value Language, based on the explanation in the preamble to the Final Regulations, would be to limit the Excess Section 743(b) Basis Adjustment to zero, due to the fact that no portion of the actual section 743(b) adjustment is negative.\(^{18}\)

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\(^{15}\) For the same reason noted in the previous footnote, a situation in which the Excess Section 743(b) Basis Adjustment is positive and the actual section 743(b) adjustment is negative would not be common.

\(^{16}\) These are the same facts as Example 2, except that the adjusted tax basis of the Qualified Property at the time of the transfer is $510,000, instead of $750,000. The transferee purchased a one-third interest in a partnership for $200,000. The partnership only owned Qualified Property that it had purchased for $900,000. The adjusted tax basis of the Qualified Property at the time of the transfer was $510,000. Therefore, the transferee’s share of the inside tax basis is $170,000 resulting in a positive section 743(b) adjustment of $30,000 ($200,000 - $170,000). Using UBIA of $900,000 as the adjusted tax basis of the property, the transferee’s share of inside basis would be $300,000, so the tentative Excess Section 743(b) Basis Adjustment is negative $100,000 ($200,000 - $300,000).


\(^{18}\) Thus, in the above described example where the transferee’s tentative Excess Section 743(b) Basis Adjustment is negative $100,000 and the actual section 743(b) adjustment is positive $30,000, the transferee’s Excess Section 743(b) Basis Adjustment would be zero and its UBIA would be $300,000.
This interpretation is consistent with the intent of the Absolute Value Language, as illustrated in Example 2, because the Excess Section 743(b) Basis Adjustment would be limited to the amount of the actual section 743(b) adjustment (i.e., the Excess Section 743(b) Basis Adjustment would not be more negative than the actual section 743(b) adjustment). In addition, this interpretation avoids the arbitrary limitation that results from the more literal application of the Absolute Value Language.

On balance, we believe that the Absolute Value Language was intended to limit an Excess Section 743(b) Basis Adjustment to zero when the tentative Excess Section 743(b) Basis Adjustment is negative and the actual section 743(b) adjustment is positive (or vice versa), and that the Final Regulations should be modified to reflect that intent.

B. The Determination of UBIA of Qualified Property Acquired in Transactions Described in Section 168(i)(7)(B)

1. Background

Generally UBIA means the tax basis on the placed in service date of the property as determined under the applicable sections of the Internal Revenue Code.\(^{19}\) The preamble to the Proposed Regulations explains that for purposes of determining the UBIA of any Qualified Property, the relevant placed in service date will be the date the acquired property is placed in service by the taxpayer (for instance, the date a partnership places property received in a section 721 transaction in service).\(^{20}\) However, the Final Regulations contain an exception to the general rule that UBIA is determined based on the date that the taxpayer placed the Qualified Property in service. Specifically, the exception provides that the UBIA of Qualified Property should generally be retained when property is transferred in a transaction described in section 168(i)(7)(B)\(^{21}\).

Qualified property acquired in transactions described in section 168(i)(7)(B).

Solely for purposes of this section, if qualified property is acquired in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the transferee’s UBIA in the qualified property shall be the same as the transferor’s UBIA in the property, decreased by the amount of money received by the transferor in the transaction or increased by the amount of money paid by the transferee to acquire the property in the transaction.\(^{22}\) (Emphasis added.)

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\(^{19}\) Reg. § 1.199A-2(c)(3)(i).


\(^{21}\) Transactions described in section 168(i)(7)(B) include transactions under sections 332 (complete liquidations of subsidiaries), 351 (contributions to controlled corporations for stock), 361 (transfers of property to another corporation in a corporate reorganization), 721 (contributions to partnerships for partnership interests), and 731 (distributions by partnerships to partners).

\(^{22}\) Reg. § 1.199A-2(c)(3)(iv).
Although we support the carryover of UBIA in a nonrecognition transaction, application of the underlined portion of the rule above (the “Adjustment Language”) is unclear in certain circumstances.

2. Recommendation

We recommend that Treasury and the IRS revise Regulation section 1.199A-2(c)(3)(iv) to clarify the mechanics of a transferee’s UBIA determination when money is transferred in connection with a transaction described in section 168(i)(7)(B).

3. Explanation

Although the preamble to the Final Regulations does not address the Adjustment Language in Regulation section 1.199A-2(c)(3)(iv), it appears that it was intended to cover specific situations, such as a taxpayer contributing property to an S corporation and receiving boot as part of the section 351 transaction. In that particular situation, a positive adjustment for the amount of money paid by the S corporation could make sense from a policy perspective because the S corporation is investing more cash into the Qualified Property. However, the actual Adjustment Language does not necessarily support this conclusion, as illustrated by the following example.

Example #1

Shareholder B contributes Qualified Property with UBIA of $150, fair market value of $100, and adjusted tax basis of $80 to an S corporation in exchange for a stock worth $90 and cash of $10 in a transaction qualifying under section 351(a). Under section 351(b), B recognizes $10 as a result of her receipt of the cash. The S corporation’s adjusted tax basis in the Qualified Property under section 362 would be $90 ($80 of carryover basis increased by $10 of gain recognized by B). The Adjustment Language provides that the $150 of carryover UBIA with respect to the Qualified Property is decreased by the $10 of cash received by Shareholder B or increased by the $10 of cash paid by the S corporation. Given the manner in which the Adjustment Language is drafted, it is unclear whether the $150 of carryover UBIA is decreased by the $10 of cash received by B, the transferor, or is increased by the $10 of cash paid by the S corporation, the transferee.

23 Interestingly, there does not appear to be any limitation on the increase to the transferee’s UBIA in the transferred Qualified Property by the Adjustment Language. It is unclear whether rules similar to the rules governing section 743(b) adjustments are needed to prevent the duplication of UBIA.

24 The rationale for providing either an increase or decrease to UBIA for the same amount of transferred cash is not clear.
In addition, it is not clear how much of the money is “paid to acquire the property in the transaction” when more than one asset is contributed in a section 351 transaction.\(^{25}\)

Despite these uncertainties, transferee S corporations may be able to calculate the intended UBI\(A\) amount in a section 351 exchange by increasing the carryover UBI\(A\) by the amount of money paid by the transferee to acquire the property. Nevertheless, the Final Regulations should clarify Regulation section 1.199A-2(c)(3)(iv) to confirm the intended treatment.

It is also unclear how the Adjustment Language is intended to apply to other transactions described in section 168(i)(7)(B). In the context of a partnership contribution, for example, any cash “paid by the transferee [partnership] to acquire the property” would likely result in treating the transfer of the Qualified Property, in whole or in part, as a disguised sale of property under section 707(a)(2)(B). In that case, the portion of the Qualified Property that is deemed to be sold by the transferor partner would have UBI\(A\) equal to its tax basis determined under section 1012, and the portion of the Qualified Property that is deemed contributed would have UBI\(A\) determined by reference to the transferor’s UBI\(A\) in the Qualified Property (i.e., without regard to the Adjustment Language).\(^{26}\) The application of the disguised sale of property rules under section 707(a)(2)(B) and the regulations thereunder construct a taxable purchase and sale and thereby operate to prevent any amount, including reimbursements of preformation expenditures described in Regulation section 1.707-4(d),\(^{27}\) from being treated as “paid to acquire the property” in a section 721 transaction.\(^{28}\) In other words, the only amounts that are treated as “paid to acquire the property” are part of a separate deemed sale transaction, and not part of the section 721 transaction.

In addition, we recommend that deemed contributions and distributions of money under section 752(a) and (b) be ignored for purposes of the transferee partnership’s UBI\(A\) determination,\(^{29}\) except to the extent that such amounts are treated as a part of a disguised sale under section 707(a)(2)(B) and Regulation section 1.707-5.

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\(^{25}\) Presumably general tax principles apply, and section 362 will govern. However, confirmation would be helpful.

\(^{26}\) It is important to note that determining UBI\(A\) using section 1012 for the portion of Qualified Property that is treated as sold under the disguised sale of property rules could result in a decrease in UBI\(A\), even if the transferee partner cannot recognize a loss under section 707(b)(1).

\(^{27}\) It would not be appropriate to increase UBI\(A\) for reimbursements of preformation expenditures because the preformation expenditures would already be reflected in the UBI\(A\) of the transferor.

\(^{28}\) Some advisors have expressed concern about this point, notwithstanding the clarity of the operative rules. For this reason, confirmation would be helpful.

\(^{29}\) It is not clear whether increases or decreases in a partner’s share of liabilities could be considered “money received by the transferor” or “money paid by the transferee” for purposes of Regulation section 1.199A-2(c)(3)(iv). Section 752(a) and (b) provide that any increase or decrease in a partner’s share of partnership liabilities, or the partner’s individual liabilities (by reason of the partner assuming the
Finally, it is not clear why the Adjustment Language is limited to money that is exchanged as part of the transaction. We think it would be appropriate to extend the special rules to noncash consideration.

Given the uncertainties in the application of the Adjustment Language, we recommend that the language be revised to clarify the specific mechanics of a transferee’s UBIA determination when money or other property is transferred in connection with a transaction described in section 168(i)(7)(B). We also recommend that examples be provided to illustrate the intended application of Regulation section 1.199A-2(c)(3)(iv) to specific transactions described in section 168(i)(7)(B).

C. Determination of the Amount of UBIA in a Section 1031 Like-Kind Exchange

1. Background

The Final Regulations provide that the UBIA of qualified replacement property acquired in a section 1031 like-kind exchange is the same as the UBIA of the qualified relinquished property exchanged, decreased by “excess boot” received in such exchange. “Excess boot” is defined as the amount of any money or the fair market value of other property received by the taxpayer in the exchange over the amount of appreciation in the relinquished property.

2. Recommendation

We recommend that the Final Regulations be amended to adopt the language in the preamble to the Final Regulations defining excess boot to mean “the excess of the amount of money or fair market value of other property received by the taxpayer in the exchange over the amount of appreciation in the relinquished property.”

3. Explanation

We believe that the suggested changes are consistent with the intent of the Final Regulations. The preamble provides that the UBIA of replacement property generally is the same as the UBIA of the relinquished property. However, if the taxpayer receives

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30 This explanation addressed specific concerns with respect to some of the transactions described in section 168(i)(7)(B), but the remaining transactions (i.e., transactions under sections 332, 361, and 731) may warrant additional consideration.

31 We note that the same flaw exists in the excess boot definition for involuntary conversions under section 1033. See Reg. § 1.199A-2(c)(3)(iii)(B).


34 Preamble to Section 199A Final Regulations, 84 Fed. Reg. 2952, 2959.
money or non-like-kind property, the replacement property UBIA must be reduced.\textsuperscript{35} The preamble provides that the replacement property UBIA is adjusted downward by "the excess of any money or the FMV of other property received by the taxpayer in the exchange over the taxpayer’s appreciation in the relinquished property (excess boot)."\textsuperscript{36}

**Example #2**

Assume that real property owned by A was originally purchased for $400 (and a remaining useful life of 20 years) and has appreciated in value by $200 to $600. A enters into a like-kind exchange whereby she receives property with a value of $580 and $20 of cash. Under the rule in the preamble, A’s UBIA would not be reduced because there is no excess boot. That is because the amount of boot ($20) is less than the appreciation on the property ($200). Under the Final Regulations, however, excess boot could be read to mean $20 divided by (over) $200 or .1, resulting in a reduction in UBIA of .1.

We recommend that the Final Regulations be clarified to reflect the intended result as described in the language in the preamble.

**D. Impact of Technical Terminations on UBIA of Qualified Property**

1. **Background**

   Under former section 708(b)(1)(B), a partnership was considered terminated if, within a twelve-month period there was a sale or exchange of 50 percent or more of the total interests in partnership capital and profits. These terminations are commonly referred to as “technical terminations.” As part of the Act, however, section 708(b)(1)(B) was repealed for taxable years beginning after December 31, 2017.

   Generally, the transactions that are listed in section 168(i)(7)(B) do not cause depreciation to restart.\textsuperscript{37} Before the Act, technical terminations did cause the recovery period of depreciable property to restart because former section 168(i)(7)(B) contained a special rule that shut off section 168(i)(7)(A) in the case of a technical termination.\textsuperscript{38} This special rule was removed when section 708(b)(1)(B) was repealed.\textsuperscript{39}

\textsuperscript{35} Id.
\textsuperscript{36} Id.
\textsuperscript{37} Section 168(i)(7)(A) provides that “[i]n the case of any property transferred in a transaction described in subparagraph (B), the transferee shall be treated as the transferor for purposes of computing the depreciation deduction determined under this section with respect to so much of the basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor” (emphasis added).
\textsuperscript{38} The flush language of former section 168(i)(7)(B) provided that “[s]ubparagraph (A) shall not apply in the case of a termination of a partnership under section 708(b)(1)(B).”
\textsuperscript{39} Although the amendment to section 708(b)(1)(B) is effective for taxable years beginning after December 31, 2017, it is unclear whether the statutory language at the time of the past transaction or the statutory
As described above, whether a transaction is “described in section 168(i)(7)(B)” is relevant to a transferee taxpayer’s determination of its UBIA of Qualified Property. Because taxpayers, including partnerships that received property in a deemed section 721 transaction as a result of a technical termination, need to examine historical transactions to calculate UBIA of Qualified Property, it is important for Regulation section 1.199A-2(c) to provide guidance with respect to the treatment of technical terminations occurring before 2018 as well as technical terminations that occurred in 2018 for a partnership taxable year that began before January 1, 2018. In other words, transferee partnerships need to be able to determine the depreciable period and UBIA of any Qualified Property transferred in the deemed section 721 transaction under Regulation sections 1.199A-2(c)(2)(iv)(A) and (c)(3)(iv), respectively.

2. **Recommendation**

We recommend that Treasury and the IRS clarify whether the deemed section 721 contribution resulting from a technical termination of a partnership under section 708(b)(1)(B) prior to 2018 is considered a “transaction described in section 168(i)(7)(B)” for purposes of applying the special rules provided by Regulation sections 1.199A-2(c)(2)(iv)(A) and (c)(3)(iv).

3. **Explanation**

There are two main questions when determining whether the deemed section 721 contribution resulting from a termination of a partnership under section 708(b)(1)(B) is considered a “transaction described in section 168(i)(7)(B)” for purposes of applying the special rules provided by Regulation sections 1.199A-2(c)(2)(iv)(A) and (c)(3)(iv).

The first question is whether the references to “transactions described in section 168(i)(7)(B)” in Regulation sections 1.199A-2(c)(2)(iv)(A) and (c)(3)(iv) should be construed to refer to the language in section 168(i)(7)(B) that existed immediately after section 199A was enacted or the language in section 168(i)(7)(B) at the time of the transaction in question. If the former is the proper interpretation, then the special rule that was in former section 168(i)(7)(B) is irrelevant and the section 721 transaction is clearly a “transaction described in section 168(i)(7)(B).” Otherwise, a second question becomes relevant.

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40 Under Regulation section 1.708-1(b)(4), the following was deemed to occur upon a technical termination of a partnership: “The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership.”
The second question is whether the special rule that was in former section 168(i)(7)(B), which turned off section 168(i)(7)(A), caused the deemed section 721 contributions resulting from technical terminations to not be a “transaction described in section 168(i)(7)(B).”

Because the answer to both of these questions is unclear, we recommend that Treasury and the IRS issue guidance to provide more certainty with respect to the UBIA of Qualified Property determinations being made by partnerships that previously received property in a deemed section 721 contribution resulting from the termination of a partnership under section 708(b)(1)(B).

II. Allocation of UBIA

A. The Allocation of UBIA of Qualified Property held by a Partnership

1. Background

In the case of qualified property held by a partnership, the Final Regulations provide that “each partner’s share of the UBIA of qualified property is determined in accordance with how the partnership would allocate depreciation under Regulation section 1.704-1(b)(2)(iv)(g) on the last day of the taxable year.”41

2. Recommendation

We recommend that the Final Regulations be amended to clarify the operation of this rule by providing that a partnership allocates the UBIA to its partners in accordance with how the partners share depreciation for the entire taxable year, disregarding any depreciation allocated to a partner who disposes of its entire interest before the end of the taxable year.

3. Explanation

It appears that the rule in the Final Regulations was intended to address two points. First, it appears that the provision was intended to preclude the allocation of UBIA to a partner who disposed of its entire interest before the end of the taxable year, putting such partner in the same position as that of a partnership that disposes of the underlying Qualified Property during the taxable year. Second, it appears that the provision was intended to require the allocation of UBIA to the remaining partners in proportion to their shares of section 704(b) for the entire taxable year. We think the rule as written precludes the allocation of UBIA to a partner that has disposed of its interest; however, with respect to the remaining partners, it could be interpreted as requiring the

allocation of UBIA in accordance with the way in which the partners share depreciation on the last day of the taxable year, rather than throughout the taxable year.

Example #3

A, B, and C are each equal partners in calendar year partnership X. On November 30, 2019, C’s interest in the partnership is fully redeemed. Since C is not a partner at the end of the taxable year, C is not entitled to an allocation of UBIA from the partnership. As a result, when determining A’s and B’s allocable share of the partnership’s UBIA, C’s share of the partnership’s depreciation should be ignored. Thus, A and B would each be allocated 50% of the partnership’s UBIA.42

Example #4

Assume the facts are the same as in Example #3, above, except that instead of C being redeemed on November 30, 2019, D, a new partner, contributes cash to the partnership on November 30, 2019, in exchange for a 25% interest. As a result, A, B, C and D each share 25% of the partnership’s depreciation on the last day of the taxable year and, under the Final Regulation, might share UBIA equally. We believe that each partner’s share of partnership UBIA should equal the partner’s share of the total depreciation for the taxable year, taking into account all applicable tax rules, including the rules of section 706. Thus, D should not be entitled to 25% of the partnership’s UBIA (his share of depreciation on the last day of the taxable year) but rather D should be allocated approximately 2 percent of the UBIA, an amount equal to D’s share of depreciation for the year (25% of 1/12 of the depreciation for the year).43

We recommend amending Regulation section 1.199A-2(a)(3)(ii) to clarify that only those who are partners on the last day of the taxable year can be allocated UBIA, and that UBIA would be allocated to them in the same ratio that such partners share depreciation for the taxable year.

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42 Our recommendation is that all of the partnership’s UBIA be allocated to those who are partners on the last day of the taxable year (in accordance with their interest throughout the taxable year disregarding the partner that disposed of his interest). We do not think that the portion of UBIA that would have been allocated to the partner that sold his interest (but for the sale) should disappear and no one should benefit from it.

43 Similar to Example #3, all of the partnership’s UBIA has been allocated to those who are partners on the last day of the taxable year.