Partnership & LLC
Hot Topics

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Agenda

1. Section 199A
2. Section 163(j)
3. Section 1061
4. Section 1446 – New proposed regs.
5. Business Plan Items
Section 199A
Section 199A and UBIA

• The availability of the 20% deduction with respect to Qualified Business Income (QBI) from a trade or business is dependent upon the amount of W-2 Wages and the Unadjusted Basis of Qualified Property Immediately after Acquisition (UBIA)

• Qualified Property – with respect to any trade or business for a taxable year, is tangible depreciable property -
  • *held by, and available for use in, the trade or business at the end of the tax year,*
  • used at any point during the taxable year in the trade or business’s production of QBI, and
  • the depreciable period for which has not ended before the close of the taxable year.
Section 199A and UBIA

• What is a partner’s share of the partnership’s UBIA?
  • Proposed regulations based upon share of tax depreciation
  • Final regulations provide that each partner’s share of the UBIA of qualified property is determined in accordance with how depreciation would be allocated for section 704(b) book purposes under §1.704-1(b)(2)(iv)(g) on the last day of the taxable year.”
    • Assume the sharing ratios change during the year because a partner is admitted.
    • Is the share determined based upon how the book depreciation would be allocated based upon solely the percentages on the last day of the taxable year or to only those partners that are partners on the last day of the taxable year based on their effective percentage of the overall book depreciation for the tax year (excluding the amount allocated to any partner that is no longer a partner on the last day of the taxable year)?
Section 199A and UBIA

• What if a partner withdraws from or transfers his/her interest in the partnership during the taxable year?
  • Preamble to the final regulations provides that a taxpayer who transfers an interest in an RPE prior to the close of the RPE’s taxable year is **not entitled to a share** of UBIA from the RPE.
  • If the partnership shares the UBIA based upon each partner’s overall share of section 704(b) depreciation for the year, what happens to the share that would have been allocated to the partner who transferred his interest?
    • Is it lost?
    • Does it go to the buyer (in the case of a transfer)?
    • Does it get reallocated among all end of year partners (proportionately)?
Section 199A and UBIA

• What is the buyer’s share of the UBIA of the Qualified Property as a result of a purchase of a partnership interest if the partnership has/makes a section 754 election?

  • Proposed regulations
    • Section 734 and section 743 adjustments not treated as Qualified Property for purposes of section 199A

  • Final regulations
    • Section 734 adjustments are not treated as qualified property.
      • Preamble indicates that the Treasury Department and the IRS do not believe that a section 734(b) adjustment is an acquisition of qualified property for purposes of determining UBIA.
Section 199A and UBIA

• Final regulations
  • Section 743 adjustments create additional UBIA to the extent allocated to qualified property to the extent of the “excess section 743(b) basis adjustment.”
  • 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).
  • ABA suggests that a 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.
Section 199A and UBIA

- For each item of qualified property:
  - Calculate partnership UBIA
  - Calculate partner’s share of partnership UBIA
  - Calculate excess section 743(b) basis adjustment
    - Amount equals the partner’s 743(b) basis adjustment calculated as if the basis of partnership property was equal to its UBIA
  - Final version of the final regulations added: the absolute value of the excess section 743(b) adjustment cannot exceed the absolute value of the total section 743(b) adjustment wrt qualified property.
Qualified Property

FMV: 1,050
AB: 750
UBIA: 900

Regular section 743(b) adjustment
- Amount Paid: 350
- Inside AB: (250)
- Section 743(b) Adj: 100

“Excess section 743(b) adjustment”
- Amount Paid: $350
- Inside UBIA AB: (300)
- UBIA 743(b) Adj: 50

Absolute value of “excess section 743(b) adjustment” [50] cannot exceed the absolute value of regular section 743(b) adjustment [100].
- The excess section 743(b) adjustment is 50, not 100.
**Section 199A - UBIA Section 743(b) Adjustment Ex. 2**

- **Qualified Property**
  - FMV: 600
  - AB: 750
  - UBIA: 900

- **Regular section 743(b) adjustment**
  - Amount Paid: 200
  - Inside AB: (250)
  - Section 743(b) Adj: (50)

- **“Excess section 743(b) adjustment”**
  - Amount Paid: 200
  - Inside UBIA AB: (300)
  - UBAI 743(b) Adj: (100)

- The absolute value of “excess section 743(b) adjustment” [100] cannot exceed the absolute value of regular section 743(b) adjustment [50].
  - The excess section 743(b) adjustment amount is negative 50, not negative 100.
Section 199A - UBIA Section 743(b) Adjustment
Ex. 3

Qualified Property
FMV: 600
AB: 450
UBIA: 900

- Regular section 743(b) adjustment
  - Amount Paid: 200
  - Inside AB: (150)
  - Section 743(b) Adj: 50

- “Excess section 743(b) adjustment”
  - Amount Paid: 200
  - Inside UBIA AB: (300)
  - UBAI 743(b) Adj: (100)

- The absolute value of “excess section 743(b) adjustment” [100] cannot exceed the absolute value of regular section 743(b) adjustment [50].
  - The excess section 743(b) adjustment amount is 50, (50), or zero?
Section 199A and UBIA

• What is the buyer’s share of the UBIA of the Qualified Property as a result of a transfer of the property in a nonrecognition transaction?
  • Proposed regulations
    • Based upon the adjusted tax basis of the partnership. No carryover of UBIA of the partner.
  • Final regulations
    • UBIA of Qualified Property generally carries over.
    • However, the regulations provide that the transferee’s UBIA in the Qualified Property is
      • decreased by the amount of money received by the transferee in the transaction or
      • increased by the amount of money paid by the transferee to acquire the property in the transaction.
    • What is this computation getting at?
Section 199A Other Questions

• Final regulations left some uncertainty regarding what is a specified service trade or business (SSTB) and what is a separate trade or business.

  • A taxpayer must determine
    • If there is one or more trades or businesses and if any trade or business an SSTB
    • If any qualified trade or business has common ownership which may result in recharacterized as an SSTB
    • The final regulations refer solely to sections 707(b) and 267(b) but there have been public statements that it may be the position of the IRS that the scope would include section 267(c). Can you discuss?
  • Not aggregate any SSTBs
    • Is there any thought to provide additional guidance to allow for the aggregation of SSTBs to simplify reporting?
  • Separately report each SSTB
Section 163(j)
Section 163(j)

• Proposed Regulations issued November 26, 2018
• Can you give any update on the timeframe for any anticipated final regulations or new proposed regulations?
• Scope -
  • What is current thinking about whether it is appropriate to treat guaranteed payments under section 707(c) as interest.
  • Is the government considering any additional guidance or relief for self-charged items? For instance – partner loans. How would guaranteed payments be handled if treated as interest?
Section 163(j)

• **Aggregate vs. Entity**

  • There are a number of instances in the proposed regulations where the entity approach of section 163(j) is at odds with an aggregate view of partnerships.

  • With respect to a corporate partner, the proposed regulations made an initial determination of section 163(d) or section 163(j) at the partnership level but then recharacterized as 163(j) at the corporate partner level – only one bite at the apple.

  • With respect to trader partnerships, the preamble suggests that the interests if first tested under section 163(j) at the partnership level and then tested again at the partner level potentially under section 163(d) – two bites of the apple.

  • Do you expect to provide guidance on the treatment of debt financed distributions? Any initial thoughts on the treatment? (i.e. whether the interest expense of the partnership should be characterized at the partnership level, the partner level or potentially both).
Section 163(j)

• **Exceptions vs. Elections**
  • There is an exception for small businesses – generally with average gross receipts for three years preceding the taxpayer year of less than $25 million.
  • Will additional guidance be provided with respect to how this exception applies for first year taxpayers? Also, where taxpayers may be considered a continuation or successor to a prior taxpayer?
  • Are you reconsidering whether a small business can make a real property trade or business election?
  • What happens if a taxpayer who made a valid RPTOB elections becomes a small business? Is election still valid?
Section 163(j)

- Tiered Partnerships
  - Does the government anticipate guidance with respect to the application of section 163(j) in tiered partnerships?
  - The push out of the disallowed interest expense causes issues.
    - A partner’s basis in its partnership interest is:
      - Reduced by its allocable share of deductible BIE
      - Reduced by its allocable share of nondeductible EBIE
      - Increased for any EBIE that has not been treated as paid or accrued by the partner when they partner disposes of its partnership interest

- Specifically, how do the section 743 basis adjustments work in this context?
Section 163(j) Impact on Basis in PRS Interest

Example: Tiered Partnership

Year 2: MTP is allocated $10 of EBIE from LTP

1. How does the EBIE impact MTP and UTP’s basis?
2. What if MTP or UTP sell’s their partnership interest?
   --How is EBIE added back?
   --What kind of information sharing would be needed?
Section 1061

- Who is the “taxpayer” for purposes of section 1061 – the partner or the partnership?
- Where does the recharacterization occur?
  - Given that the exceptions may be available at the ultimate partner level it seems that recharacterization should not occur at the partnership level.
- Does recharacterization occur with respect to each item of gain with respect to an API or should there be aggregation of all gains and losses with respect to an API with only a net gain subject to recharacterization?
- Does the government anticipate guidance as to how to apply section 1061 in a tiered structure?
Section 1061

• How does the commensurate with capital exception apply in the context of partners that hold interest that represent interests that were received for services, received for capital, and may include previously undistributed earnings?
  • Will taxpayers be able to bifurcate such interests?
  • Will an approach similar to the release of the recent proposed Qualified Opportunity Zone regulations be available?
  • Has the government considered the need for additional guidance with respect to bifurcated holding periods and basis in the context of interests received for services?
Section 1446
May 7, 2019 Proposed Regulations
Transfers of Foreign Partner’s Interests

Section 864(c)(8) provides that gain from the sale or exchange of a partnership interest is characterized as ECI to the extent that a foreign corporation or foreign individual would be allocated ECI if the partnership sold all of its assets for fair market value on the date of the sale or exchange.

—Sale or exchange means sale, exchange, or other disposition
—Effective for sales and exchanges occurring after November 27, 2017.

Section 1446(f) imposes a withholding obligation on transferees, and secondary withholding obligation on the partnership.
IRS Guidance

IRS has issued two Notices:

— Issued Notice 2018-08 on December 29, 2018 (PTP)
— Issued Notice 2018-29 on March 2, 2018 (non-PTP)

- Can be relied upon for transfers that occur before the finalization date of final section 1446(f) regulations.
- IRS intends to obsolete both notices 60 days following finalization of the section 1446(f) Proposed Regulations.

IRS has issued two sets of Proposed Regulations:

— Proposed regulations under section 864(c)(8) issued December 26, 2018
— Proposed regulations primarily under section 1446(f) issued May 7, 2019

- Effective generally for transfers that occur on or after the date that is 60 days after the finalization date of final regulations.
- Certain sections of the regulations can be relied upon for periods before the finalization date provided they are applied in entirety to all transfers
  — Treas. Reg. 1.1446(f)-1: General rules
  — Treas. Reg. 1.1446(f)-2: Transferee withholding on non-PTP interests
  — Treas. Reg. 1.1446(f)-5: Liability for failure to withhold
Primary Withholding Provision

**General rule of section 1446(f):**

— If any portion of the gain on the disposition of a partnership interest would be treated as ECI under section 864(c)(8), the **transferee** is required to deduct and withhold 10% of the **amount realized by the transferor** on the disposition.

— The **amount realized** will include relief of partner’s share of partnership liabilities.

— **Proposed regulations provide amount realized includes**
  
  — Cash paid or to be paid
  
  — FMV of property transferred (or to be transferred);
  
  — Amount of liabilities assumed by transferee or to which the partnership interest is subject, and
  
  — The reduction of the transferor’s share of partnership liabilities.
Exceptions from Withholding

Proposed regulations added one additional exception to withholding (#6):

1. U.S. Person certification – Transferor certification
2. Minimal ECI Prior Years - Transferor certification
3. Minimal ECI Current Year – Partnership Certification
4. No realized gain – Transferor certification
5. Exception for certain nonrecognition transactions – Transferor certification
6. Excepted by Treaty – Transferor certification (only available by relying on -2 of the Proposed Regulations)
Partnership “Secondary” Withholding

Section 1446(f) imposes a withholding requirement on the partnership if transferee fails to withhold.

— If the transferee fails to withhold the correct amount as required, Section 1446(f)(4) imposes an obligation on the partnership to deduct and withhold from distributions to the transferee partner a tax equal to the amount the transferee failed to withhold, plus interest.
  - Tax equal to 10% of the amount realized

Proposed regulations 1.1446(f)-3 provide rules for partnership withholding.

— Partnership-level withholding is suspended until the regulations are finalized.

— Proposed regulations do not require partnership to withhold on distributions made wrt transfers of PTP interests (but would apply to transfers on nonpublicly traded interests (such as GP))
Partnership Secondary Withholding (cont’d)
(Non-PTPs)

Proposed regulations allow a partnership to rely on the transferee’s certification (that transferee withheld the correct amount) unless it knows or has reason to know the certification is incorrect or unreliable.

—Proposed regulations allow reliance on the certification only if such certification has been provided to the partnership within 10 days following the transfer. Prop. Reg. section 1.1446(f)-3(b)(1).

—However, if certification is provided late but certifies an exception to withholding (not a reduction), then Partnership can stop withholding. Prop. Reg. section 1.1446(f)-3(c)(B).

—What does “reason to know” mean? Preamble indicates that partnership must review the certification, and “because the partnership may have information that may not be available to the transferee (for example, information in its books and records), a partnership may know or have reason to know, that an underlying certification is incorrect or unreliable.”

- Thus, partnership must audit the certifications. If unreliable, partnership is required to withhold on distributions made to the transferee.

A partnership that is required to withhold must withhold on all distributions made to the transferee beginning 30 days after the transfer date, or 15 days after the date the partnership acquires actual knowledge of the transfer.
Publicly Traded Partnerships

Proposed regulations provide rules for withholding on transfers of interests that are publicly traded on an established securities market or is readily tradeable on a secondary market or substantial equivalent (“PTP interests”).

—Finalization of proposed regulations ends the suspension on withholding provided in Notice 2018-08 with regard to the disposition of PTP interests.
  - No withholding until regulations are finalized.

—Proposed regulations do not apply secondary withholding obligations on the PTP with respect to the transferred PTP interest unless its qualified notice is inaccurate.
  - PTP has obligation to withhold with respect to its distributions.

Proposed regulations require Brokers to withhold

—Transferees are not required to withhold with respect to transfers in PTPs effected by a “broker.”

—Brokers, in the ordinary course of their trade or business, effect sales made by others, and that receive all or a portion of the amount realized on behalf of a transferor.

—May include clearing organizations.

—Ordering rules provided in the case of multiple brokers.
PTP Withholding – General Rules

Proposed regulations

Distributions by PTPs

— Proposed regulations contain changes to existing qualified notice rules to add certain detailed information necessary to determine the amount required to be withheld

- Notice must be posted in a readily accessible format in an area of the primary public website of the PTP

- Default rule subjects gross distributions to the higher withholding rate required under sections 1441, 1442, or section 1446(b)(2), unless sufficient information is provided to the nominee

— Definition of nominee for withholding is expanded to include a qualified intermediary or a U.S. branch treated as a U.S. person.

— Changes to the qualified notice rules under section 1445 to conform to proposed section 1.1446-4(b)(4).
Proposed Regulations - Initial Observations

1. The partnership secondary withholding obligation is not in effect until 60 days after regulations are finalized.

2. The PTP transferee withholding obligations (on the publicly traded interests) is not in effect until 60 days after regulations are finalized.

3. There are timing rules for submitting paperwork that should not be missed or transferees can find themselves being withheld on by the partnership:
   
a. 10 days to provide certification of withholding to partnership.

b. 20 days to report and pay withholding to IRS.

c. Partnership has to withhold on any distributions made (30 days or later from transfer date) until it receives that certification

d. A late provided certification to the partnership will stop partnership withholding if there’s an *exception*, but if there’s a *modification*, the partnership cannot take that into account. The Liability certifications are modifications.

e. If the transferee gets withheld upon by the partnership, and there’s over withholding in the system, only the partnership can apply to IRS for a refund on behalf of the transferee partner.

f. A transferor can’t credit this partnership-secondary withholding on its tax returns (but it doesn’t have to pay twice – not sure how this isn’t effectively “crediting”).
Initial Observations (continued)

4. The partnership can’t blindly accept a transferor certification, but has to audit it. If partnership has information that would indicate the certification is invalid or incorrect, the secondary withholding obligation will kick in. Preamble makes a point that it might behoove the transferee (who relied on the certification) to get sign off from the partnership.

5. IRS makes clear that exception for no gain realized, is after application of section 751(a). So even with a transaction the partner thinks is an overall loss, there could still be a section 751(a) gain and if so, this certification does not hold.

6. The exception for nonrecognition transfers requires a statement of the applicable law that governs and the facts to support it. This has to be done practically by the time of the transfer, due to the 10-day partnership notice requirement (which requires all underlying documentation).

7. For PTP Interests, withholding is done on gross proceeds paid for the interest (not including debt changes), and typically done by the broker unless the partnership itself is the transferee due to a distribution. But the non-publicly traded GP interests are not “PTP Interests” as so defined, so regular withholding rules seem to apply to those.

8. Note that withholding is done generally on all items comprising amount realized, including “amounts to be paid”. Installment sales where cash is backloaded may therefore result in the transferee having to front the withholding tax payment.

9. Three sections of the regulations can be relied upon currently, but only if all provisions therein are followed – note the last one (general rules, transferee withholding on non-PTP interests, liability for failure to withhold).
Business Plan
Business Plan Items

• Final regulations under §§704 and 752 concerning partnership recourse liabilities, including bottom dollar payment obligations.
  • Temporary and proposed regulations were published on October 5, 2016.
  • Timing?
• Final regulations under §752 regarding related person rules.
  • Proposed regulations were published on December 16, 2013.
  • Timing?
• Fee waiver regulations were removed from business plan.
  • What is the significance of the removal?
• Guidance under section 707 on disguised sale, including disguised sale of partnership interest.
  • What issues will be addressed?
  • Timing?
Thank you