Current Federal Tax Developments

Week of July 15, 2019

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ACCOUNTING
CONTINUING EDUCATION

KAPLAN

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JULY 15, 2019
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Current Federal Tax Developments

Kaplan Financial Education

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SECTION: SECURITY
SECURITY SUMMIT ANNOUNCES TAX PREPARER SECURITY CHECKLIST

Citation: "Tax Security 2.0 – A "Taxes. Security. Together" Checklist," IRS Website, 7/9/19

As part of the continuing campaign to remind tax professionals of data protection and data security issues, the members of the Security Summit have announced a "Taxes-Together-Security Checklist" for tax professionals.[1]

The actual checklist[2] contains the following items:

- Deploy the "Security Six" measures
  - Activate anti-virus software
  - Use a firewall
  - Opt for two-factor authentication when it's offered
  - Use backup software/services
  - Use drive encryption
  - Create and secure Virtual Private Networks
- Create a data security plan
  - Federal law requires all "professional tax preparers" to create and maintain an information security plan for client data
  - The requirement is flexible enough to fit any size of tax preparation, from small to large

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[1] "Tax Security 2.0 – A 'Taxes. Security. Together' Checklist," IRS Website, July 9, 2019, https://www.irs.gov/newsroom/tax-security-2-point-0-a-taxes-security-together-checklist, retrieved July 11, 2019

[2] "Tax Security 2.0 The Taxes-Security-Together Checklist," IRS Website, June 12, 2019

   - Tax preparers are asked to focus on key areas such as employee management and training; information systems; and detecting and managing system failures.

- Educate yourself on phishing scams
   - Learn about spear phishing emails
   - Beware of ransomware
- Recognize the signs of client data theft
   - Clients receive IRS letters about suspicious tax returns in their name
   - More returns filed with your Electronic Filing Identification Number than you submitted
   - Clients receive tax transcripts they did not request
- Create a data theft recovery plan
   - Contact local IRS stakeholder liaison immediately
   - Assist IRS in protecting clients
   - Contract with cybersecurity expert to stop thefts

SECTION: 408 BOOKKEEPING ERROR BY FINANCIAL INSTITUTION MEANT THAT TAXPAYER'S IRA ROLLOVER QUALIFIED FOR LATE ROLLOVER RELIEF

Citation: Burack v. Commissioner, TC Memo 2019-83, 7/8/19

The taxpayer in the case of *Burack v. Commissioner,* TC Memo 2019-83[3], had withdrawn over $500,000 from her IRA. She used the funds to pay for her new home in Philadelphia as she was awaiting the funds from the sale of her former residence. She

[3] https://ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11996, retrieved July 9, 2019

planned to return the funds to an IRA with 60 days of the original receipt, completing a tax free rollover.[4]

The provision Nancy Burack wished to take advantage of is found at IRC §408(d)(3)(A) which provides:

> (A) In general
>
> Paragraph (1)[5] does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if—
>
> > (i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution;

On June 25, 2014 the taxpayer withdrew $524,981.99 from her IRA she held with Capital Guardian LLC/Pershing LLC. On Thursday, August 21 the sale of her former home closed and she received a cashier's check made out to "Pershing FBO Nancy J. Burack."[6] August 21 was 57 days after the original distribution—so Nancy had time to complete the rollover, but the clock was running.

Nancy now looked to place the check back in her IRA. The Tax Court describes what happened next:

> Petitioner's financial adviser initially advised her that she could deposit the check into the Pershing account at Bank of New York on Wall Street. But petitioner credibly testified that Capital Guardian later assured her that she could redeposit the distribution into her IRA by overnighting the check to Capital Guardian in North Carolina. On Thursday, August 21, 2014, petitioner overnighted the check to Capital Guardian. The check arrived at Capital Guardian on Friday, August 22, which was 58 days after petitioner received the IRA distribution.

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[4] *Ibid,* pp. 2-3

[5] The inclusion of the IRS in the taxpayer's gross income under IRC §408(d)(1)

[6] https://ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11996, retrieved July 9, 2019, p. 2-3

> On August 26, 2014, 62 days after petitioner received the IRA distribution, the check was deposited at Pershing into petitioner's IRA account ending in 0946. Both the deposit and the receipt of funds are reflected on the August 2014 Capital Guardian IRA statement.[7]

This created a problem in the view of the IRS—the funds were not reflected in Nancy's IRA account until 62 days after the distribution. To the IRS this meant she had not timely rolled the funds back into the IRA, and thus the original distribution was fully taxable to Nancy.

The taxpayer argued that her rollover should be treated as timely for two separate reasons:

- The rollover is not shown as timely due to a bookkeeping error by Capital Guardian that is similar to that faced by the taxpayer in *Wood v. Commissioner*, 93 TC 122 (1989) and

- The taxpayer should be entitled to a hardship waiver under IRC §408(d)(3)(I) as she met the requirements of Rev. Proc. 2003-16 for an automatic waiver.

The Tax Court first looked the bookkeeping error argument. That argument looks to the Tax Court's decision in *Wood*, where the Court for the first time allowed for a late rollover where the funds did not actually make it into another IRA within 60 days due to an error by the custodian.

The Court summarizes the facts and holdings in *Wood* as follows:

> In *Wood v. Commissioner*, 93 T.C. 114 (1989), a taxpayer transferred stock to Merrill Lynch before the expiration of the 60-day rollover period with the instruction that the shares be deposited into his IRA account. But Merrill Lynch's records showed that the shares were deposited into a nonqualified account and rolled over into the IRA after the expiration of the 60-day rollover period. *Id*. at 117.
>
> In deciding whether the transaction qualified for rollover treatment, we looked at the substance of the transaction and the relationship between the taxpayer and Merrill Lynch. *Id*. at 120-121. We explained that where book entries conflict with the facts, the facts control. *Id*. at 121. We found that the transaction was entitled to rollover treatment because Merrill Lynch "had accepted petitioner's Sears stock for deposit to the IRA rollover account and held the stock subject to the

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[7] *Ibid*, pp. 3-4

> IRA trust instrument." *Id*. We found that Merrill Lynch's failure to record the transfer within 60 days was a bookkeeping error.[8]

The Tax Court found that this case, while not identical, was similar enough that the taxpayer qualified for relief due to a similar bookkeeping error. The IRS argued that in this case it was different—Pershing was the custodian, not Capital Guardian, and that the failure to present the check to Pershing is a key difference.[9]

The Tax Court disagreed that not going directly to Pershing was a key difference in this case:

> …[P]etitioner's IRA was held with both Capital Guardian and Pershing in a single account bearing the same account number. Petitioner's IRA statement, which was generated by Capital Guardian, listed both Capital Guardian and Pershing. The relationship between Capital Guardian and Pershing is not entirely clear. All of the documentation in the record appears to have been generated by Capital Guardian. The substance of the relationship between petitioner and Capital Guardian shows that Capital Guardian was an appropriate institution for petitioner to send the check to. Petitioner had no communication with Pershing. None of the IRA account statements in the record were from Pershing; they were all generated by Capital Guardian. All discussions about the rollover contribution were held with Capital Guardian. The June 25, 2014, distribution was received by petitioner from a Capital Guardian IRA as shown by the Capital Guardian account statement. There is no documentation generated by Pershing in the record. The rollover payment was received by Capital Guardian 58 days later. Because the check was received by Capital Guardian during the rollover period but not book-entered by Capital Guardian until after, we find that the late recording is due to a bookkeeping error.[10]

The Tax Court found that even if *Wood* had not been applicable, the taxpayer qualified for hardship relief under IRC §408(d)(3)(I).

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[8] *Ibid*, p. 6

[9] *Ibid*, p. 7

[10] *Ibid*, pp. 7-8

Revenue Procedure 2003-16, issued by the IRS to provide guidance on when a hardship waiver under IRC §408(d)(3)(I) is available, provides two conditions for an automatic hardship waiver due to a financial institution error:

- The funds are deposited into an eligible retirement plan within 1 year from the beginning of the 60-day rollover period; and
- If the financial institution had deposited the funds as instructed, it would have been a valid rollover.

Again, the IRS's main argument against the transaction qualifying for this relief was that Pershing was the custodian, not Capital Guardian. So the wrong party given the check. As the Court had already concluded that Capital Guardian was an appropriate party to give the check to, not surprisingly the Tax Court concluded that Nancy also qualified for relief under this provision.

SECTION: 448

31 YEARS LATER, TREASURY NOTICES TYPO FIX DID NOT MAKE IT INTO CODE OF FEDERAL REGULATIONS

Citation: TD 8179, 7/11/19

Although it took 30 years, the IRS has issued a correction to a regulation dealing with attribution rules for purposes of determining a "brother-sister group" under IRC §52. In TD 8179 the IRS changes a reference from "Reg. §1.414(c)-4(b)(1)" to "Reg. §1.414-4." And it's the sort of quirky flaw that only tax geeks can love—and potentially exploit for the (temporary) benefit of eligible clients.

Since IRC §52 is titled "Special rules" and is found the IRC provisions dealing with the Work Opportunity Credit you may figure this issue has limited impact. But that's actually not the case—the attribution rules for IRC §52 are cross-referenced in other provisions, most importantly in IRC §448(c) that provide the $25 million test that, after the TCJA, allows businesses with gross receipts below that level to:

- Elect to use the overall cash basis of accounting;
- Escape the requirement to apply the uniform capitalization rules of IRC §263A;
- Elect out of following the inventory provisions of §471 and either treat items held for sale as nonincidental supplies or use inventory methods other than those allowed under §471;
- Apply the small contractor rules when dealing with long-term contracts (no requirement to use the percentage of completion method); and
- Not have to apply the limitations on the deduction of business interest under §163(j).

The cross reference is used to determine which businesses must be aggregated in order to determine if gross receipts exceed $25 million. That is, if businesses are related via defined types of common control, the receipts of those businesses are combined to calculate the $25 million limit. If that combined total ends up with average revenue of over $25 million, all businesses in the group are ineligible for any of the benefits.

Reg. §1.414(c)-4 contains "Rules for determining common ownership" and, as the use of the plural in "rules" would suggest, the regulation defines multiple cases where such ownership must be combined. Conversely Reg. §1.414(c)-4(b)(1) only relates to one specific situation where the entities would be considered related.

So all that trivia is wonderful, but what real impact does this have? It turns out quite a bit. The problem was noted in a March 8, 2019 article posted on *Forbes* website by Tony Nitti, CPA.[11] Tony noted a discrepancy between a 2012 printed copy of Reg. §1.52-1(c) he initially consulted and the version found in the online service from the same publisher (Wolters Kluwer/CCH in this case). The issue is found in the area dealing with brother-sister groups under common control found at Reg. §1.52-1(d)(1)(i).

The online version of the regulation (and the one shown on the Cornell University Legal Information Institute at the time this was written) showed the following:

> (d)Brother-sister group under common control -
>
> (1) In general. The term "brother-sister group under common control" means two or more organizations conducting trades or businesses if -
>
> (i) The same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of *§ 1.414(c)-4(b)(1) (emphasis added)*), a controlling interest of each organization;[12]

However, the printed 2012 copy of the regulation that Mr. Nitti consulted has the cross-referenced provision as "Reg. §1.414(c)-4," no longer restricting it to just (b)(1).

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[11] Tony Nitti, "Is There A Mistake In The Tax Law That Changes The Way We Apply The New Interest Limitation Rules?" *Forbes* website, March 8, 2019, https://www.forbes.com/sites/anthonynitti/2019/03/08/is-there-a-mistake-in-the-tax-law-that-changes-the-way-we-apply-the-new-interest-limitation-rules/#34eefb4b7ca8, retrieved July 11, 2019

[12] https://www.law.cornell.edu/cfr/text/26/1.52-1, retrieved July 11, 2019 (note that this site should be eventually updated to remove the specific reference discussed here)

Tony's article describes his attempts to resolve this issue, eventually leading to contacting Mark Friedlich at Wolters Kluwer/CCH who uncovered a portion of the issue. CCH originally had the reference to Reg. §1.414(c)-4 but changed it to §1.414(c)-4(b)(1) when a customer pointed out that the federal government's online Code of Federal Regulations had the longer reference.

But that begged the question—how did that different reference get into the CFR? And was it correct?

The IRS, in issuing the new "correction" tells us exactly what transpired. TD 8179 notes:

> The final regulations (TD 8179) that are the subject of this correction are under section 52 of the Internal Revenue Code. Treasury Decision 8179 was corrected at 53 FR 16408, May 9, 1988; however, the Office of the Federal Register did not properly incorporate the correction into the Code of Federal Regulations at that time.[13]

Basically—there was a typo in the version of the regulations originally issued in March of 1988, so a correction to the regulations was published on May 9, 1988. However, that correction never did make its way into the Code of Federal Regulations, so the IRS has essentially "republished" the typo correction 31 years later.

So which set of rules apply before this typo correction (hopefully) gets incorporated into the Code of Federal Regulations on (again, hopefully) July 11, 2019? Treasury decided to not force the issue on that question. Continuing on in the preamble, Treasury provides the following titled "Applicability of Correction:"

> Generally, the amendments to the regulations under section 52 of the Code (relating to tax credits for employees) apply to taxable years beginning after December 31, 1976. However, because the May 9, 1988 correction was not properly incorporated into the Code of Federal Regulations at the time of publication, with respect to taxable years that began prior to the Effective date, the Internal Revenue Service will not challenge the application of either published version of the regulation.[14]

The effective date of this correction is July 11, 2019.[15]

So what does any of this really impact?

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[13] *Federal Register*, Vol. 84, No. 133, July 11, 2019, 33002

[14] *Ibid*

[15] *Ibid*

Tony Nitti provides an example in his article that illustrates, step-by-step, what the impact is. We'll condense that down a bit here to show you a situation where, under the regulations we've had in the *Federal Register* for 31 years (without the correction), where two entities would not be related and this could avoid the §163(j) rules, as well as have access to the special accounting rules.

EXAMPLE

No Aggregation for $25 Million Test With the Typo Left in Reg. §1.52-1 – (Based on Example in Tony Nitti's Article)[16]

Castle, Inc. is a corporation with $18 million of revenue each of the last 3 years. It is owned 50% by Albert and 50% by Greg.

Phoenix Real Estate, LLC operates as a partnership for tax purposes, with revenues of $10 million in each of the prior three years. It is owned 10% by Albert, 60% by Greg and 30% by Mary, Albert's wife.

Under the aggregation rules of §52(b), a pair of organizations have to meet two tests to be considered brother-sister organizations subject to aggregation. First, five or fewer owners have to own at least 80% of each business (only counting owners that hold an interest in each business. Second, taking into account the lowest ownership percentage of each owner in each business, they own more than 50% of the businesses.

Under the regulation with the typo intact, we can ignore the ownership held by Mary in Phoenix Real Estate, LLC, even though Mary is Albert's wife. While Reg. §1.414(c)-4(b)(5) would attribute ownership between spouses, the typo limited the types attribution found in Reg. §1.414(c)-4 to only those with an option to acquire an interest in an entity found at Reg. §1.414(c)-4(b)(1).

While Albert and Greg own 100% of Castle, Inc., they only own 70% of Phoenix Real Estate, LLC. Since Mary has no ownership interest in Castle, Inc., we ignore her ownership interest in Phoenix Real Estate, LLC.

Thus, no aggregation is necessary and both entities have average revenue of less than $25 million in the prior years. Thus, neither is subject to the limitation on business interest found at IRC §163(j).

However, when we change the reference back to Reg. §1.414(c)-4 instead of Reg. §1.414(c)-4(b)(1), the attribution of stock owned by a spouse now comes into play—and now the entities must combine their revenues for this test.

EXAMPLE

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[16] Tony Nitti, "Is There A Mistake In The Tax Law That Changes The Way We Apply The New Interest Limitation Rules?" *Forbes* website, March 8, 2019, https://www.forbes.com/sites/anthonynitti/2019/03/08/is-there-a-mistake-in-the-tax-law-that-changes-the-way-we-apply-the-new-interest-limitation-rules/#34eefb4b7ca8, retrieved July 11, 2019

Aggregation for $25 Million Test With the Typo Corrected in Reg. §1.52-1 – (Based on Example in Tony Nitti's Article)[17]

Under Reg. §1.52-1(d), which now references Reg. §1.414(c)-4 in total, stock owned by Mary is considered owned by her spouse, Albert. With that change, Albert and Greg own 100% of each enterprise, meeting the first test.

Albert owns 50% of Castle, Inc. and 40% of Phoenix Real Estate, LLC. For the second test we use the lower percentage (40%) for Albert's interest. Greg owns 50% of Castle, Inc. and 60% of Phoenix Real Estate, Inc. Like Albert, we will only consider the lower of the two interests (50%) for Greg for the second test. Adding those two percentages together (40% + 50%) we get 90% for common ownership—more than the 50% minimum required.

Since Castle, Inc. and Phoenix Real Estate, Inc. meet both tests, they are considered brother-sister organizations and their revenues are combined ($18 million + $10 million). As the total ($28 million) exceeds $25 million, both organizations must limit business interest deductions to no more than is allowed under IRC §163(j)

What is interesting about this issue is that it took over 30 years before anyone appears to have noticed that the correction of the typographical error had never been moved into the Code of Federal Regulations. This sort of correction for typographical errors in recently published regulations is a regular occurrence—in fact, it's rare for there not to be such a correction published for regulations of any significant length.

As well, we all tend to assume that our research service's documents we read or bring up on our screen are ones that can be relied upon. In this case, though, it wasn't clear which version of the regulation was correct (in fact, Treasury doesn't address this issue, effectively allowing either treatment for years beginning before the July 11, 2019 correction date)—but at least one publisher did quietly change the version in their materials and database.

But for now there is one key takeaway—certain related organizations will be able to escape the application of IRC §163(j) for two years. In theory they could also make the small business accounting method changes, but they would face a need to change back in 2020—so that relief would be fleeting.

Note, as well, that if all entities involved are corporations this issue doesn't impact them—they are governed by the controlled group of corporations test at IRC §52(a), and that section isn't affected by this issue.

[17] *Ibid*

SECTION: 704
IRS RELEASES FAQ DEALING WITH TCJA LIMITATIONS IMPOSED ON TAX BENEFITS FROM CHARITABLE CONTRIBUTIONS AND FOREIGN TAXES FOR A PARTNER WITH INSUFFICIENT BASIS

Citation: "Frequently Asked Questions – Tax Cuts and Jobs Act (TCJA) changes to Charitable Contributions and Foreign Taxes Taken into Account in Determining Limitations on Allowance of Partner's Share of Loss," IRS Website, 7/9/19

The IRS has issued a frequently asked questions document related to changes made by the Tax Cuts and Jobs Act of 2017 (TCJA) in the computation of a partner's outside basis limitations due to the payment of foreign taxes and certain charitable contributions.[18]

The IRS outlines the changes in a set of three examples discussing how a partner computes his/her limitations on claiming a tax benefit from charitable contributions and payment of foreign taxes dependent on basis in the partnership under IRC §704(d).

The IRS first outlines the law as it generally applies with regard to §704(d) and the limitations on claiming tax benefits due to basis limitations:

> Section 704(d) of the Code provides, in general, that a partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis of such partner's interest in the partnership (outside basis) at the end of the partnership year in which such loss occurred. If, in a given taxable year, a partner's share of partnership losses exceeds its outside basis, then the losses are allowed to the extent of basis and any excess amount is carried over for use in the next taxable year in which the partner has outside basis available. Except for deductions relating to charitable contributions and foreign taxes, current law and prior law are the same.

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[18] "Frequently Asked Questions – Tax Cuts and Jobs Act (TCJA) changes to Charitable Contributions and Foreign Taxes Taken into Account in Determining Limitations on Allowance of Partner's Share of Loss," Internal Revenue Service, July 9, 2019, https://www.irs.gov/newsroom/frequently-asked-questions-tax-cuts-and-jobs-act-tcja-changes-to-charitable-contributions-and-foreign-taxes-taken-into-account-in-determining-limitations-on-allowance-of-partners-share-of-loss, retrieved July 10, 2019

The FAQ notes that prior to the Tax Cuts and Jobs Act, §704(d) did not apply in the same manner to charitable contributions of appreciated property and payments of foreign taxes:

> …[U]nder prior law a partner's share of a partnership's charitable contributions and foreign tax payments were not subject to the § 704(d) basis limitation. This meant that partners could take into account their entire distributive shares of charitable contributions or foreign tax payments even if they were in excess of outside basis. Although a portion of certain charitable contributions and the entire amount attributable to foreign tax payments were (and still are) subject to basis reduction under § 705(a)(2), prior law did not limit a partner's deductions for payments in excess of basis.

The IRS gives first a general example of the application of §704(b) and the basis limitation rules when neither partner has a basis issue.

EXAMPLE

Application of §704(b) When Partners Have No Basis Problems (Example 1)

Facts

Jen and Dave are equal partners in JD Partnership. At the end of the partnership taxable year, but prior to taking into account the partnership's income and loss items, Jen and Dave each have a $50 basis in the JD partnership. For the taxable year the JD partnership has $20 of non-separately stated taxable income and a $150 long-term capital loss.

Analysis

To determine each partner's basis limitation under §704(d), Jen and Dave increase their outside bases from $50 to $60 under § 705(a)(1) for their $10 distributive shares of the partnership's non-separately stated income. Their $75 shares of long-term capital loss are limited by §704(d) and, as a result, Jen and Dave can each take $60 of the loss into account in the current taxable year. The remaining $15 of long-term capital loss is carried forward. This result is the same under current and prior law.

The IRS then gives an example of the application of the law prior to TCJA:

EXAMPLE

Law Prior to TCJA – Charitable Contributions and §704(d) (FAQ Example 2)

Facts

Assume the same facts as in Example 1, except that, at the end of the partnership taxable year (and before partnership allocations), Jen's outside basis is $50 and Dave's is $30. For the taxable year, the partnership makes a contribution to a § 501(c)(3) charity of property that has a fair market value of $300 and a basis of $100, but has no other items of income, gain, loss, or deduction.

Analysis

Under prior law, Jen and Dave each would have been able to take into account (on their personal returns) their $150 shares of the charitable contribution. Jen would have been required to decrease her outside basis by $50 (her share of the partnership's basis in the property) to zero ($50-$50=0). However, because Dave only has $30 of outside basis, any basis reduction would have been limited to $30 because outside basis cannot be decreased below zero. Therefore, under prior law, Jen would have had to decrease her outside basis by $50 to receive the benefit the entire $150 contribution deduction whereas Dave only would have had to decrease his outside basis by $30 to receive the same $150 benefit.

The IRS goes on to describe the limitation imposed on charitable contributions of appreciated property under the new provision:

> The TCJA adds new § 704(d)(3)(A). That section provides that charitable contributions and foreign taxes are taken into account under the basis limitation rules, thereby putting those items on par with other losses and, as a result, limiting the benefit of such items by a partner's outside basis. However, new § 704(d)(3)(B) provides that, in the case of a charitable contribution of built-in gain property (i.e., property whose fair market value exceeds its adjusted basis), the excess amount is not limited by outside basis. These changes apply to partnership taxable years beginning after December 31, 2017. This new rule means that, for charitable contributions of appreciated property, the amount allocable to the partners will effectively be split into two parts, one equaling the property's built-in-gain amount, the other the property's basis. The deduction for the built-in gain portion neither reduces the partner's bases nor is subject to limitation under section 704(d) (as under prior law). However, the part reflecting the property's basis is limited by section 704(d).

The FAQ concludes with a third example applying this new limitation—and note that the partner without basis loses a pro rata portion of the *entire* deduction, not the just portion of the basis of the donated property in excess of basis in the partner's interest.

EXAMPLE

Applying New §704(b) Limitation to Donation of Appreciated Property (FAQ Example 3)

Facts

Assume the same facts as in Example 2, except that the partnership makes the contribution of appreciated property to charity in a taxable year of the partnership beginning after December 31, 2017.

Analysis

Under the new law, the portion of the contribution that is equal to the property's basis ($100) both reduces the partner's outside bases and is subject to section 704(d). The excess portion neither reduces outside basis nor is subject to section 704(d). Jen, whose outside basis is $50, would reduce her outside basis by $50 (her share of the basis of the contributed property) and receive a charitable contribution allocation of $150. For Dave, whose outside basis is $30, the basis reduction and charitable contribution with respect to the basis portion of the contribution would be limited to $30. The $20 excess would carry over to the following year. Dave's total charitable contribution would be $130.

In an article describing the new FAQ that appeared in *Tax Notes Today Federal*, Glenn Dance of Holthouse Carlin & Van Trigt LLP is quoted as pointing out that if the property had been distributed to the partners and then a contribution made of the proprety, the result would be very different.[19]

In that situation the partners would have taken a basis in the property equal to the lesser of their basis in their interest prior to the distribution or their share of the partnership's basis in the property, very likely (but not necessarily) with no gain or loss recognized at the partner partnership level.[20] Assuming the asset would be a capital asset eligible to long-term capital gain treatment of gain on sale in the hands of the partners, a contribution of that property would nevertheless be eligible for a deduction based on the partners' portion of the fair market value of the property.[21] This treatment is effectively what the prior law provided to the partners when the partnership made the contribution.

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[19] Eric Yauch, "FAQ Highlights Partner Basis Limitation Changes," *Tax Notes Today Federal*, July 10, 2019, 2019 TNTF 132-1, https://www.taxnotes.com/tax-notes-today-federal/basis/faq-highlights-partner-basis-limitation-changes/2019/07/10/29q5w (subscription required)

[20] IRC §§721, 731

[21] IRC §170(e)

But before you advise a client to "drop and contribute" the interests in the property a couple of cautions should be observed:

- The distribution may be taxable due to various provisions found in the law for special cases (remember that it's only very likely there's no taxable gain on the distribution). Mr. Dance in the article cited above noted the potential issue with a distribution of marketable securities,[22] which is only possible way that the distribution could trigger a tax event.

- A drop of undivided interests to the partners followed shortly thereafter by a contribution to a charity is likely to be attacked by the IRS as a purely tax motivated transaction subject to recharacterization under the substance over form doctrine—and the IRS would have a good chance of prevailing with that argument.

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[22] Eric Yauch, "FAQ Highlights Partner Basis Limitation Changes," *Tax Notes Today Federal*, July 10, 2019, 2019 TNTF 132-1, https://www.taxnotes.com/tax-notes-today-federal/basis/faq-highlights-partner-basis-limitation-changes/2019/07/10/29q5w (subscription required)