

## Basis Limit in Passthrough Law Shouldn't Hinder Like-Kind Exchanges

by Eric Yauch

Regulators shouldn't interpret a passthrough deduction provision to create a double burden on taxpayers that engage in like-kind exchanges, such as real estate professionals.

The 20 percent passthrough deduction in section 199A was intended to give passthrough entities tax parity with corporations, so that passthrough partners don't face up to 37 percent in individual income taxes, according to Suzanne Baker of Investment Property Exchange Services. And one way to ensure that parity is for the IRS and Treasury to interpret the unadjusted basis limitation in section 199A to use the cost basis of replacement property received in like-kind exchanges, she told Tax Analysts on July 11.

One issue with the Tax Cuts and Jobs Act (P.L. 115-97), which limits the passthrough deduction by wages paid to employees and 2.5 percent of the unadjusted basis in property immediately after acquisition, is the uncertainty about the "unadjusted basis" language, Baker said. She noted that it's unclear how the IRS will determine which amount in a like-kind transaction will be taken into consideration in applying the limitation.

For example, a taxpayer could purchase real estate and depreciate it over time, and instead of later selling it, that taxpayer could exchange the property and defer capital gain. If the taxpayer exchanged the property for replacement property, it would take a carryover basis in the new property to avoid doubling up on depreciation deductions.

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Baker said that's been the rule for years and isn't controversial, but that if the IRS also used the carryover basis in the replacement property in applying the section 199A unadjusted basis limitation, it would doubly burden taxpayers.

In June, 14 real estate industry groups argued in a letter to Treasury that the regs should use the

cost basis of replacement property to determine the unadjusted basis limitation. The groups argued that the cost of acquisition approach, which relies on the fair market value of the replacement property, is the only proper and administrable way to measure substantial investment.

The issue was also raised in a meeting with Treasury officials in mid-June. David E. Franasiak of Williams & Jensen told Tax Analysts that he and others, including Baker, made recommendations to Treasury officials, and that while the officials didn't commit to those recommendations, they also didn't seem surprised or offended by them.

Franasiak said it's important to keep in mind Congress's intent in enacting the passthrough deduction when thinking about the like-kind exchange issue. He said corporations now have the lower 21 percent rate and can take full advantage of like-kind exchanges, but that if the IRS and Treasury apply a carryover basis in the 199A basis limitation, passthroughs won't get the full benefit of the deduction.

The IRS has said its main focus this summer is releasing guidance on the most important aspects of tax reform, which includes proposed regulations on section 199A. Franasiak said he expects that the first guidance documents will focus on how to apply the deduction broadly, and that more complicated issues, like those concerning like-kind exchanges, may be addressed later. ■