



November 2, 2020

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-107911-18)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Limitation on Deduction for Business Interest Expense

Dear Ladies and Gentlemen:

The LIHTC Working Group was established by Novogradac & Company LLP to provide low-income housing tax credit (LIHTC) industry participants a platform to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we would like to provide the following comments concerning the proposed regulations (Proposed Regulations) under Internal Revenue Code (IRC) Section 163(j), "Limitation on Business Interest."

Proposed Regulations Section 1.163(j)-6(h)(5)

Proposed Regulations Section 1.163(j)-6(h)(5) addresses partnership basis adjustments upon partner dispositions. If a partner disposes of its partnership interest, then the partnership shall increase the adjusted basis of partnership property by an amount equal to the partner's remaining excess business interest expense (1.163(j)-6(h)(5) basis adjustment). This basis adjustment shall be allocated among capital gain property of the partnership in the same manner as a positive Section 734(b) adjustment. The positive adjustment to partnership assets is a favorable outcome, as it resolves the potential disparity between the partnership's adjusted basis in its assets and the remaining partners' outside basis, thus preventing the shifting of built-in gain to the remaining partners.

Proposed Regulations Section 1.163(j)-6(h)(5) also specifies that the 1.163(j)-6(h)(5) basis adjustment is not depreciable or amortizable. This is a noticeable departure from the treatment of Section 734(b) basis adjustments, which are typically depreciable or amortizable to the extent that they are allocable to depreciable or amortizable property. The Proposed Regulations express concern that treating the 1.163(j)-6(h)(5) basis adjustment as potentially depreciable or amortizable is inconsistent with Section 163(j)(4)(B)(iii)(II), which specifies that no deduction shall be allowed to the transferor or transferee for any excess business interest expense (EBIE) resulting in a basis increase to the partner of a disposed interest.

The Proposed Regulations present this concern in the context of a partnership redeeming a partner's interest, reasoning that the partnership can arguably be viewed as the transferee in such a

transaction. In LIHTC partnerships, it is common for the investor limited partner to sell its partnership interest after the completion of the 15-year tax credit compliance period. Sometimes the general partner will purchase the investor limited partner's interest directly, which results in the termination of the partnership. It is not readily determinable from the Proposed Regulations what would occur with the 1.163(j)-6(h)(5) basis adjustment in this scenario. Would the 1.163(j)-6(h)(5) basis adjustment survive and be retained by the general partner? Therefore, we request clarity on the treatment of 1.163(j)-6(h)(5) basis adjustments in the context of transfers or redemptions that result in the termination of a partnership.

The Proposed Regulations make reference Example 31 in Section 1.163(j)-6(o). In this example, the partnership has a Section 754 election in effect. Proposed Regulations Section 1.163(j)-6(h)(5) does not directly address any interplay between the Section 754 election and the 1.163(j)-6(h)(5) basis adjustment. Therefore, we request confirmation that a partnership does not need a Section 754 election in effect to record the 1.163(j)-6(h)(5) basis adjustment.

Proposed Regulations Section 1.163(j)-6(j)

Proposed Regulations Section 1.163(j)-6(j) addresses the treatment of EBIE in the context of tiered partnerships. The Proposed Regulations adopt an entity approach wherein Section 163(j) is applied independently to each partnership. We believe that this approach strongly aligns with the entity treatment of partnerships for purposes of Section 163(j). This also places the onus of tax compliance on the partnership rather than its partners, which on balance decreases the burden of compliance and also makes IRS review easier to administer. However, reporting and tracking Section 704(b) capital account reductions prescribed by Proposed Regulations Section 1.163(j)-6(j)(2), UTP EBIE prescribed by Proposed Regulations Section 1.163(j)-6(j)(4), and Section 743(b) adjustments to UTP EBIE prescribed by Proposed Regulations Section 1.163(j)-6(j)(8) would add significant complexity and difficulty to tax compliance for ownership structures involving several tiers of partnerships.

The Proposed Regulations do not provide a transition rule related to the treatment of excess business interest expense allocated prior to the finalization of these rules, which may raise additional complexity to the extent that UTP EBIE has not been tracked in accordance with these Proposed Regulations. Therefore, we request that a transition rule be added.

Proposed Regulations Section 1.163(j)(10)(A)(ii)(II)

Proposed Regulations Section 1.163(j)(10)(A)(ii)(II) provides that for taxable years beginning in 2019, 50 percent of any excess business interest expense of a partnership that is allocated to a partner, unless the partner elects out, in 2020 is treated as excess business interest expense that is not subject to the Section 163(j) limitation.

Example 36 in the Proposed Regulations states that if there was a sale of an interest in a partnership in 2019 that 50 percent of any excess business expense allocated to the partner selling the interest

would be treated as paid or accrued in 2020. However, since the sale of the partnership occurred in 2019 and a gain/loss event was recognized during the 2019 taxable year there would be no basis in the partnership for the partnership to deduct 50 percent of the 2019 excess business interest expense. We request confirmation that in this case the partner would not deduct 50 percent of the excess business interest expense.

Tiered Partnership Real Property Trade or Business Election

Neither the Final nor Proposed Regulations address whether a limited partner of a partnership, which is also organized as a partnership, is eligible to be an electing real property trade or business per IRC Section 163(j)(7)(B). There does not appear to be any statutory language that prohibits this, however, we request that partnerships in a tiered partnership structure can in fact make the real property trade or business election if the underlying business is a real property trade or business.

Furthermore, an UTP that is a partner in LTP that is an electing real property trade or business may have a principal business activity that does not involve real property trade or business per IRC Section 163(j)(7)(B). However, Final Regulations Section 1.163(j)-9(c)(d) states that “a taxpayer may make elections for multiple trades or businesses on a single election statement.” Therefore, we request that an UTP which is a partner of a LTP that is an electing real property trade or business be allowed to make the same election pursuant to IRC Section 163(j)(7)(B), even if the UTP’s principal business activity is not the same as the electing LTP.

Additionally, IRC Section 163(j) is not clear as to whether a LTP must make the real property trade or business election in order to allow partnerships in upper-tiers to also make the election. We request that a mechanism be provided by which upper-tier partnerships in a tiered partnership structure make the real property trade or business election if it is necessary for the LTP to first make the election.

Excepted trade or businesses

The Final Regulations state that if a partner is allocated excess business interest expense from a partnership and, in a succeeding taxable year, such partnership engages in excepted trade or businesses then a partner shall not treat any of its excess business interest expense that was previously allocated from such partnership as business interest expense paid or accrued by the partner in such succeeding taxable year by reason of the partnership engaging in excepted trades or business.

This treatment would mean that in a future year if a LTP would make an election per IRC Section 163(j)(7)(B) as an electing real property trade or business, and had previously allocated excess business interest expense to an UTP, the UTP would have excess business interest expense that it could not treat as paid or accrued in a future year. The UTP will never be allocated excess taxable income or excess business interest income from that LTP allowing it to be treated as paid or accrued. The excess business interest expense would essentially be held until the LTP was disposed

of, at which point the excess business interest expense would be added to the UTP's basis in the LTP upon disposition.

We would suggest that in a situation in which a LTP makes an election per IRC Section 163(j)(7)(B) as an electing real property trade or business in a future year, that any excess business interest expense that had been previously allocated to an UTP would be treated as paid or accrued in the year the LTP makes the election.

Cancellation of Indebtedness Income

Neither the Final nor Proposed Regulations address the interaction of Section 108 discharge of indebtedness income with Section 163(j) business interest expense limitations. We request that guidance be provided. We would like to confirm that debt cancellation income should be included in the calculation of a partnership's adjusted taxable income. Furthermore, we would like to determine whether debt cancellation income reported by a lower tier partnership would have any impact on UTP EBIE allocated in prior years. If the debt cancellation income were attributable to a material modification or bona fide retirement of a debt instrument, to what extent would UTP EBIE become deductible?

We appreciate the opportunity to comment on the Proposed Regulations under IRC Section 163(j). Additional guidance on this matter will help the LIHTC program better provide affordable housing in our communities by providing clarification and lessening the risks in LIHTC program compliance. Thank you in advance for your time and careful consideration of these issues. Please do not hesitate to contact us at Dirk.Wallace@novoco.com or (330) 365-5400, if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,
NOVOGRADAC & COMPANY LLP

by 
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