ADISA™
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September 28, 2018

VIA www.regulations.gov IRS and REG-107892-18

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William M. Paul
Principal Deputy Chief Counsel and
Deputy Chief Counsel (Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Unadjusted Basis Immediately After Acquisition of Qualified Property Acquired In Like-Kind Exchanges (LKE) For Section 199A Purposes: IRS and REG-107892-18

Dear Mr. Kautter and Mr. Paul:

ADISA (the Alternative & Direct Investment Securities Association), the nation's largest trade association for investment professionals involved in the non-traded alternative investment space, wishes to comment on the proposed regulations concerning the deduction for qualified business income under IRC ("Code") Section 199A. We commend the Administration for its efforts in reforming tax regulations regarding the pass-through deductions, which we believe will spur investment in real estate and the economy at large. We also appreciate this opportunity to provide our thoughts on the proposed regulations and stand ready to provide any additional information to you that we can on this issue.

Background

ADISA's membership includes over 4,000 professionals (sponsors, broker-dealers, registered investment advisors, attorneys, accountants and third party due diligence firms), who reach more than one million investors nationwide. Since 2014, ADISA has been involved in research into, and communication about, LKEs at the national level. Our role as an association of investment professionals gives us a unique perspective on LKEs and in particular, how potential/proposed changes in the Section 1031 tax treatment could affect investors.

Cautions and Concerns on the Cost Basis Definition

In order to preserve the significant economic benefits and to limit any damage to LKEs, ADISA urges caution when drafting rules which may affect LKEs, especially with respect to Code Section 199A. The calculation of Unadjusted Basis Immediately After Acquisition (UBIA) following a LKE is an area in which implementing Code Section 199A may be affected. ADISA believes that the guiding principles of calculating UBIA after an LKE should consist of the following:

(1) the treatment of UBIA should be consistent with the treatment already provided by Congress for the underlying transaction; and

(2) the calculation of UBIA should be neutral to the taxpayer as a result of having engaged in an alternative transaction such as an LKE.

While Code Section 199A(h)(2) gives Treasury authority to determine the UBIA of property acquired in an LKE, Treasury property regulation (Treas.prop.reg.) Section 1.199A-2(c)(3) provides that UBIA is the basis on the date the property is placed in service under Code Section 1012. However, it is unclear how this rule applies to the calculation of UBIA for the replacement property following an LKE. Example 2 of Treas.prop.reg.sec.1.199A-2(c)(4) states that the UBIA of the replacement property acquired in an LKE will be the adjusted basis of the relinquished property. However, the depreciable period begins –for Section 199A purposes— when the relinquished property was placed in service. This means that the general rule could provide the taxpayer with the worst of both worlds: the taxpayer takes a reduced basis in the replacement property and also has the shorter depreciable period attributable to the relinquished property.

ADISA does not believe that Congress intended this treatment, but it is possible to interpret the proposed regulation in such a detrimental way. ADISA believes that if Congress had indeed intended to create such a bifurcated approach, it would have provided it in the legislation. Our view is that Congress intended the UBIA rule to be consistent with the current treatment of LKEs. We join with the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) in their assessment[1] that Congress provided nonrecognition treatment for LKE transactions. The theory relies on the fact that the taxpayer's economic position has not changed as a result of the transaction, and Congress required a substituted or carryover exchanged basis with respect to property—the replacement property should "step in the shoes" of the relinquished property. This result is only achieved when the UBIA of the replacement property is calculated as the UBIA of the relinquished property, not on an adjusted basis for the relinquished property.

Potential effects

[1] Letter of NMHC and NAA to the IRS (REG-107892-18) sent September 4, 2018.

If the result of the proposed rule is to determine UBIA on an adjusted basis, it would increase the administrative burden on the taxpayer since just using the purchase price of the relinquished property is already known. Otherwise, calculating the adjusted basis would require various approaches to the tracking of the basis of the properties and could lead to confusion and potentially discourage the use of LKEs for some taxpayers who would otherwise benefit from their use because a taxpayer will have a greater amount of UBIA by retaining the property which otherwise would have been relinquished. The proposed UBIA rules would deter exchange of property because taxpayers will always have a lower UBIA for replacement property under the proposed regulation than they otherwise had in the replacement property. However, it is currently unknown what the true micro-economic effects of a rule that would discourage LKEs and would require extensive additional study to fully appreciate the magnitude of the problem.

Though current studies of these effects show how sensitive a given local economy can be to even a small reduction in the volume of LKEs – which would likely result if the current cost basis definition is considered—we simply do not know the unintended consequences of changing the cost basis definition. Further examination of the extent to which investment and the velocity of real estate investment suffer and the administrative burden on the IRS in shifting the original cost basis language away from its current meaning is worthwhile. There is little doubt that conserving the cost basis rule as the standard would ease the tax administration of the proposed regulations.

From ADISA's perspective, we know and understand the more macro national effects of tinkering with Code Section 1031, but to what effect this seemingly minor change may have on real estate owners, renters, and investors deserves investigation. ADISA would certainly be willing to assist in any research effort.

We assume some effort to understand the consequences of this proposed regulation language is already underway, and we hope we can provide contacts, ideas, and advice on the best course for both investors and the Administration. We stand ready to help and appreciate your consideration of our voice of concern and caution.

Sincerely,

Keith Lampi
President

cc: *Drafting Committee*
Catherine Bowman, ADISA Legislative & Regulatory Committee Chair
Larry Sullivan, ADISA Legislative & Regulatory Committee Vice-chair
Deborah S. Froling, ADISA Legislative & Regulatory Committee
John H. Grady, ADISA Legislative & Regulatory Committee