BRIEF SUMMARY AND ANALYSIS OF PARTNERSHIP ASPECTS OF FINAL FDII REGULATIONS

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**Highlights Summary:**

With respect to partnerships and partners, the inclusion rule refers to distributive shares. The regulatory examples assume validity under section 704. This means that if the principal partners are related, section 704’s SEE test will not police the allocations. Those allocations can easily meet the 704 tests but flunk section 482. This means that the FDII elements should be easily manipulated.

The inclusion rule does not tie into GILTI final rule or the subpart F proposed rule relating to US shareholder-partners of US partnerships. The latter rule looks to proportionate interests in the partnership under section 958(a)(2) and the former rule looks to 704 and the allocations need not be proportionate to partnership capital. Thus, special allocations should work under the FDII rule and deviate from capital percentages but the GILTI and subpart F amounts will work off of economic interests, both capital and income. This can result in the same partner owning differing shares of the partnership for GILTI and subpart F, on the one hand, and FDII on the other hand.

In other words, a less than 10% domestic corporate partner can obtain a FDII deduction but for GILTI the domestic corporate partner must be a US shareholder-partner. There is also no separate treatment of foreign partnerships as compared to domestic partnerships.

Reporting through tiered partnerships to domestic corporate partners is required. The modified affiliated group can include foreign corporations and partnerships controlling foreign corporations.

A partnership is treated as an entity under the related party and income from property and services rules and not as an aggregate under the general property and income inclusion rules. However, the partnership can be treated as an aggregate under one of the FDII regulatory anti-abuse rules. But disregarded entities are treated as aggregates and so there could be a huge difference in treatment between a DRE and a 99-1 partnership.

1. **Proposed 250 regs**

##### Preamble: Treatment of Partnerships

“[Section 250(a)(1)](https://www.taxnotes.com/lr/resolve/cqht#cqht-0000005) allows a deduction to a domestic corporation, but does not provide any rules for domestic corporations that are partners in a partnership. However, the conference report accompanying the Act (“Conference Report”) suggests that Congress intended that a domestic corporate partner of a partnership receive the benefit of a [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction for its FDII and GILTI. See H. Rept. 115-466, at 623, fn. 1517 (2017) (Conf. Rep.) (“The Committee intends that the deduction allowed by new Code [section 250](https://www.taxnotes.com/lr/resolve/cqht) be treated as exempting the deducted income from tax. Thus, for example, the deduction for global intangible low-taxed income could give rise to an increase in a domestic corporate partner's basis in a domestic partnership under [section 705(a)(1)(B)](https://www.taxnotes.com/lr/resolve/cp8v#cp8v-0000005).”).

“The proposed regulations give effect to this legislative intent by adopting an aggregate approach to partnerships for determining a domestic corporate partner's FDII attributable to the income and assets of a partnership. Specifically, the proposed regulations provide that a domestic corporate partner of a partnership takes into account its distributive share of a partnership's gross DEI, gross FDDEI, and deductions in order to calculate the partner's FDII. See proposed §1.250(b)-1(e)(1). In addition, for purposes of determining a domestic corporate partner's DTIR, a domestic corporation's QBAI is increased by its share of the partnership's adjusted basis in partnership specified tangible property. See proposed §1.250(b)-2(g).

“Under the proposed regulations, the [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction is computed and allowed solely at the level of a domestic corporate partner. The Conference Report in footnote 1517 suggests that the [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction could give rise to an increase in a domestic corporate partner's basis in a domestic partnership under [section 705(a)(1)(B)](https://www.taxnotes.com/lr/resolve/cp8v#cp8v-0000005) because some of the partnership's income may be treated as exempt income by reason of [section 250](https://www.taxnotes.com/lr/resolve/cqht). However, regardless of whether the deduction gives rise to exempt income in other contexts, because the [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction is computed and allowed solely at the level of a domestic corporate partner, the [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction does not exempt the deducted income from tax for purposes of applying [section 705(a)(1)(B)](https://www.taxnotes.com/lr/resolve/cp8v#cp8v-0000005). As a result, a basis adjustment to a domestic corporate partner's interest in a domestic partnership is not appropriate to account for a [section 250](https://www.taxnotes.com/lr/resolve/cqht) deduction.”

**Prop. Reg. Text: 1.250(b)-1(e) and 1.250(b)-2(g)**

1. **Reg. 1.250(b)-1(e)** Domestic corporate partners — (1) In general. A domestic corporation's deduction eligible income and foreign-derived deduction eligible income for a taxable year are determined taking into account the corporation's share of gross DEI, gross FDDEI, and deductions of any partnership (whether domestic or foreign) in which the corporation is a direct or indirect partner. For purposes of the preceding sentence, a domestic corporation's share of each such item of a partnership is determined in accordance with the corporation's distributive share of the underlying items of income, gain, deduction, and loss of the partnership that comprise such amounts. See §1.250(b)-2(g) for rules calculating the increase to a domestic corporation's qualified business asset investment by the corporation's share of partnership QBAI.

(2) Reporting requirement for partnership with domestic corporate partners. A partnership that has one or more direct or indirect partners that are domestic corporations and that is required to file a return under [section 6031](https://www.taxnotes.com/lr/resolve/cqh2) must furnish to each such partner on or with such partner's Schedule K-1 (Form 1065 or any successor form) by the due date (including extensions) for furnishing Schedule K-1 the partner's share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI (as determined under §1.250(b)-2(g)) for each taxable year in which the partnership has gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI or gross FDDEI, or partnership specified tangible property (as defined in §1.250(b)-2(g)(2)(iii)).

(3) Examples. The following examples illustrate the application of this paragraph (e).

(i) Presumed facts. The following facts are assumed for purposes of the examples —

(A) DC, a domestic corporation, is a partner in PRS, a partnership.

(B) FP and FP2 are foreign persons.

(C) FC is a foreign corporation.

(D) The allocations under PRS's partnership agreement satisfy the requirements of [section 704](https://www.taxnotes.com/lr/resolve/cpfs).

(E) No partner of PRS is a related party of DC.

(F) DC, PRS, and FC all use the calendar year as their taxable year.

(G) PRS has no items of income, loss, or deduction for its taxable year, except the items of income described.

(ii) Examples.

1. Example 1: Sale by partnership to foreign person — (1) Facts. Under the terms of the partnership agreement, DC is allocated 50% of all income, gain, loss, and deductions of PRS. For the taxable year, PRS recognizes $20x of gross income on the sale of general property (as defined in §1.250(b)-3(b)(3)) to FP, a foreign person (as determined under §1.250(b)-4(c)), for a foreign use (as determined under §1.250(b)-4(d)). The gross income recognized on the sale of property is not described in [section 250(b)(3)(A)(I)](https://www.taxnotes.com/lr/resolve/cqht#cqht-0000031) through (VI) or paragraphs (c)(14)(i) through (vi) of this section.

(2) Analysis. PRS's sale of property to FP is a FDDEI sale as described in §1.250(b)-4(b). Therefore, the gross income derived from the sale ($20x) is included in PRS's gross DEI and gross FDDEI, and DC's share of PRS's gross DEI and gross FDDEI ($10x) is included in DC's gross DEI and gross FDDEI for the taxable year.

(B) Example 2: Sale by partnership to foreign person attributable to foreign branch — (1) Facts. The facts are the same as in paragraph (e)(3)(ii)(A)(1) of this section (the facts in Example 1), except the income from the sale of property to FP is attributable to a foreign branch of PRS.

(2) Analysis. PRS's sale of property to FP is excluded from PRS's gross DEI under section 250(b)(3)(A)(VI) and paragraph (c)(14)(vi) of this section. Accordingly, DC's share of PRS's gross income of $10x from the sale is not included in DC's gross DEI or gross FDDEI for the taxable year.

1. Example 3: Partnership with a loss in gross FDDEI — (1) Facts. The facts are the same as in paragraph (e)(3)(ii)(A)(1) of this section (the facts in Example 1), except that in the same taxable year, PRS also sells property to FP2, a foreign person (as determined under §1.250(b)-4(c)), for a foreign use (as determined under §1.250(b)-4(d)). After taking into account both sales, PRS has a gross loss of $30x.

(2) Analysis. Both the sale of property to FP and the sale of property to FP2 are FDDEI sales because each sale is described in §1.250(b)-4(b). DC's share of PRS's gross loss ($15x) from the sales is included in DC's gross DEI and gross FDDEI.

1. Example 4: Sale by partnership to foreign related party of the partnership — (1) Facts. Under the terms of the partnership agreement, DC has 25% of the capital and profits interest in the partnership and is allocated 25% of all income, gain, loss, and deductions of PRS. PRS owns 100% of the single class of stock of FC. In the taxable year, PRS has $20x of gain on the sale of general property (as defined in §1.250(b)-3(b)(3)) to FC, and FC makes a material physical change to the property within the meaning of §1.250(b)-4(d)(2)(iii) outside the United States before selling the property to customers in the United States. PRS satisfies the documentation requirement of §1.250(b)-4(d)(3) with respect to the sale.

(2) Analysis. The sale of property by PRS to FC is described in §1.250(b)-4(b) without regard to the application of §1.250(b)-6, since the sale is to a foreign person (as determined under §1.250(b)-4(c)) for a foreign use (as determined under §1.250(b)-4(d)). However, FC is a foreign related party of PRS within the meaning of [section 250(b)(5)(D)](https://www.taxnotes.com/lr/resolve/cqht#cqht-0000055) and §1.250(b)-6(b)(1), because FC and PRS are members of a modified affiliated group within the meaning of paragraph (c)(17) of this section. Therefore, the sale by PRS to FC is a related party sale within the meaning of §1.250(b)-6(b)(3). Under [section 250(b)(5)(C)(i)](https://www.taxnotes.com/lr/resolve/cqht#cqht-0000051) and §1.250(b)-6(c), because FC did not sell the property, or use the property in connection with other property sold or the provision of a service, to a foreign unrelated party before the property was subject to a domestic use, the sale by PRS to FC is not a FDDEI sale. See §1.250(b)-6(c)(1). Accordingly, the gain from the sale ($20x) is included in PRS's gross DEI but not its gross FDDEI, and DC's share of PRS's gain ($5x) is included in DC's gross DEI but not gross FDDEI. This is the result notwithstanding that FC is not a related party of DC because FC and DC are not members of a modified affiliated group within the meaning of paragraph (c)(17) of this section.

##### Determination of QBAI

##### PROPOSED REG PREAMBLE

“[Section 250(b)(2)(B)](https://www.taxnotes.com/lr/resolve/cqht#cqht-0000028) provides that QBAI for purposes of [section 250](https://www.taxnotes.com/lr/resolve/cqht) is defined under [section 951A(d)](https://www.taxnotes.com/lr/resolve/1xfwv#1xfwv-0000004), and is determined by substituting “deduction eligible income” for “tested income” and without regard to whether the corporation is a CFC. Accordingly, the determination of QBAI for purposes of FDII is similar to the determination of QBAI for purposes of GILTI. Compare proposed §1.951A-3 with proposed §1.250(b)-2. A domestic corporation's QBAI for FDII is equal to its aggregate average adjusted bases in specified tangible property, which is defined as tangible property used in the production of gross DEI. See proposed §1.250(b)-2(b) and (c). The proposed regulations also provide rules for dual use property, calculating QBAI in a short taxable year, and calculating a domestic corporate partner's share of partnership QBAI. See proposed §1.250(b)-2(d), (f), and (g).”

2. **Prop. 1.250(b)-2(g)** Partnership property — (1) In general. For purposes of paragraph (b) of this section, if a domestic corporation holds an interest in one or more partnerships as of the close of the domestic corporation's taxable year, the qualified business asset investment of the domestic corporation for its taxable year is increased by the sum of the domestic corporation's partnership QBAI with respect to each partnership for the domestic corporation's taxable year.

(2) Definitions related to partnership QBAI — (i) In general. The term partnership QBAI means the sum of the domestic corporation's share of the partnership's adjusted basis in partnership specified tangible property as of the close of a partnership taxable year that ends with or within a domestic corporation's taxable year. A domestic corporation's share of the partnership's adjusted basis in partnership specified tangible property is determined separately with respect to each partnership specified tangible property of the partnership by multiplying the partnership's adjusted basis in the property by the partnership QBAI ratio with respect to the property. If the partnership's taxable year is less than twelve months, the principles of paragraph (f) of this section apply in determining a domestic corporation's partnership QBAI with respect to the partnership.

(ii) Partnership QBAI ratio. The term partnership QBAI ratio means, with respect to partnership specified tangible property —

(A) In the case of partnership specified tangible property that produces directly identifiable income for a partnership taxable year, the ratio of the domestic corporation's distributive share of the gross income produced by the property for the partnership taxable year that is included in the gross DEI of the domestic corporation for its taxable year to the total gross income produced by the property for the partnership taxable year.

(B) In the case of partnership specified tangible property that does not produce directly identifiable income for a partnership taxable year, the ratio of the domestic corporation's distributive share of the gross income of the partnership for the partnership taxable year that is included in the gross DEI of the domestic corporation for its taxable year to the total amount of gross income of the partnership for the partnership taxable year.

(iii) Partnership specified tangible property. The term partnership specified tangible property means tangible property (as defined in paragraph (c)(2) of this section) of a partnership that is —

(A) Used in the trade or business of the partnership;

(B) Of a type with respect to which a deduction is allowable under [section 167](https://www.taxnotes.com/lr/resolve/cpsk); and

(C) Used in the production of gross DEI.

(3) Determination of adjusted basis. For purposes of this paragraph (g), a partnership's adjusted basis in partnership specified tangible property is determined based on the average of the partnership's adjusted basis in the property as of the close of each quarter in the partnership taxable year. The principles of paragraphs (e) and (h) of this section apply for purposes of determining a partnership's adjusted basis in partnership specified tangible property and the portion of such adjusted basis taken into account in determining a domestic corporation's partnership QBAI.

(4) Example. The following example illustrates the rules of this paragraph (g).

(i) Facts. DC, a domestic corporation, is a partner in PRS. Both DC and PRS use the calendar year as their taxable year. PRS owns two assets, Asset A and Asset B, both of which are tangible property used in PRS's trade or business that it depreciates under [section 168](https://www.taxnotes.com/lr/resolve/cp0w). Asset A and Asset B are used solely in the production of gross DEI. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset A is $100x, and the average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset B is $50x. Asset A produces $10x of directly identifiable gross income for the taxable year, and Asset B produces $50x of directly identifiable gross income for the taxable year. DC's distributive share of the gross income from Asset A is $8x and its distributive share of the gross income from Asset B is $10x. DC's entire distributive share of income from Asset A and Asset B is included in DC's gross DEI for the taxable year. See §1.250(b)-1(e)(1). DC's distributive share satisfies the requirements of [section 704(b)](https://www.taxnotes.com/lr/resolve/cpfs#cpfs-0000003).

(ii) Analysis. Each of Asset A and Asset B is partnership specified tangible property because each is tangible property, of a type with respect to which a deduction is allowable under [section 167](https://www.taxnotes.com/lr/resolve/cpsk), used in PRS's trade or business, and used in the production of gross DEI. DC's partnership QBAI ratio for Asset A is 80%, the ratio of DC's distributive share of the gross income from Asset A for the taxable year that is included in DC's gross DEI ($8x) to the total gross income produced by Asset A for the taxable year ($10x). DC's partnership QBAI ratio for Asset B is 20%, the ratio of DC's distributive share of the gross income from Asset B for the taxable year that is included in DC's gross DEI ($10x) to the total gross income produced by Asset B for the taxable year ($50x). DC's share of the average of PRS's adjusted basis of Asset A is $80x, PRS's adjusted basis in Asset A of $100x multiplied by DC's partnership QBAI ratio for Asset A of 80%. DC's share of the average of PRS's adjusted basis of Asset B is $10x, PRS's adjusted basis in Asset B of $50x multiplied by DC's partnership QBAI ratio for Asset B of 20%. Therefore, DC's partnership QBAI with respect to PRS is $90x ($80x + $10x). Accordingly, under paragraph (g)(1) of this section, DC increases its qualified business asset investment for the taxable year by $90x.

**Final regs**

**Preamble:** No discussion at all on inclusion rule

#### **Partnership reporting requirements Preamble**

“The proposed regulations required partnership information reporting in order to administer section 250. See proposed §§1.250(b)-1(e)(2) and 1.6038-3(g)(4). One comment asserted that the partnership information reporting requirements of proposed §1.250(b)-1(e)(2) impose unnecessary administrative burdens on a partnership that reasonably believes it has no (direct or indirect) domestic corporate partners, even after the partnership has performed reasonable due diligence as to the identity of its partners and reasonably relied on information provided by the partners. The comment requested that the Treasury Department and IRS consider some form of relief from this reporting; the comment expressed the view that this limited reporting requirement would not prejudice the government's interest because the use of partnership items can only reduce the partner's tax liability. The comment further requested the addition of a reasonable cause exception (consistent with the penalty defenses available for the Form 8865 penalties).

“The final regulations do not include a more limited reporting requirement because the Treasury Department and IRS are concerned that this might undermine accurate reporting at the partner level. In addition, the Treasury Department and IRS disagree with the comment's observation that reporting by the partnership of items under section 250 could only reduce a partner's tax liability — for example, a domestic corporate partner might reduce its tax liability by failing to include partnership QBAI. As to the comment's request for a reasonable cause exception, generally applicable penalty exceptions already apply to the extent information relevant to FDII is not reported on the applicable form. See section 6698(a) for filing Form 1065, section 6038(c)(4)(B) for filing Form 8865, and section 6724(a) for filing Schedule K-1 (Form 1065). For example, under §301.6724-1(a)(2)(ii) and (c)(6), a partnership may establish reasonable cause because a payee failed to provide information necessary for the partnership to comply (or because of incorrect information provided by the payee or any other person that the partnership relied on in good faith). However, the final regulations clarify the reporting rules for tiered-partnership situations as well as provide guidance on certain computational aspects. See §1.250(b)-1(e)(2). Similar additions are made to the reporting rules with respect to controlled foreign partnerships. See §1.6038-3(g)(3).”

**Final reg 1.250(b)-1(e)**

**1. Final 1.250(b)-1(e)**Domestic corporate partners — (1) In general. A domestic corporation's DEI and FDDEI for a taxable year are determined by taking into account the corporation's share of gross DEI, gross FDDEI, and deductions of any partnership (whether domestic or foreign) in which the corporation is a direct or indirect partner. For purposes of the preceding sentence, a domestic corporation's share of each such item of a partnership is determined in accordance with the corporation's distributive share of the underlying items of income, gain, deduction, and loss of the partnership that comprise such amounts. See §1.250(b)-2(g) for rules on calculating the increase to a domestic corporation's QBAI by the corporation's share of partnership QBAI.

(2) Reporting requirement for partnership with domestic corporate partners. A partnership that has one or more direct partners that are domestic corporations and that is required to file a return under section 6031 must furnish to each such partner on or with such partner's Schedule K-1 (Form 1065 or any successor form) by the due date (including extensions) for furnishing Schedule K-1 the partner's share of the partnership's gross DEI, gross FDDEI, deductions that are properly allocable to the partnership's gross DEI and gross FDDEI, and partnership QBAI (as determined under §1.250(b)-2(g)) for each taxable year in which the partnership has gross DEI, gross FDDEI, deductions that are properly allocable to the partnership's gross DEI or gross FDDEI, or partnership specified tangible property (as defined in §1.250(b)-2(g)(5)). In the case of tiered partnerships where one or more partners of an upper-tier partnership are domestic corporations, a lower-tier partnership must report the amount specified in this paragraph (e)(2) to the upper-tier partnership to allow reporting of such information to any partner that is a domestic corporation. To the extent that a partnership cannot determine the information described in the first sentence of this paragraph (e)(2), the partnership must instead furnish to each partner its share of the partnership's attributes that a partner needs to determine the partner's gross DEI, gross FDDEI, deductions that are properly allocable to the partner's gross DEI and gross FDDEI, and the partner's adjusted bases in partnership specified tangible property.

(3) Examples. The following examples illustrate the application of this paragraph (e).

(i) Assumed facts. The following facts are assumed for purposes of the examples —

(A) DC, a domestic corporation, is a partner in PRS, a partnership.

(B) FP and FP2 are foreign persons.

(C) FC is a foreign corporation.

(D) The allocations under PRS's partnership agreement satisfy the requirements of section 704.

(E) No partner of PRS is a related party of DC.

(F) DC, PRS, and FC all use the calendar year as their taxable year. 177

(G) PRS has no items of income, loss, or deduction for its taxable year, except the items of income described.

(ii) Examples —

(A) Example 1: Sale by partnership to foreign person — (1) Facts. Under the terms of the partnership agreement, DC is allocated 50 percent of all income, gain, loss, and deductions of PRS. For the taxable year, PRS recognizes $20x of gross income on the sale of general property (as defined in §1.250(b)-3(b)(10)) to FP, a foreign person (as determined under §1.250(b)-4(c)), for a foreign use (as determined under §1.250(b)-4(d)). The gross income recognized on the sale of property is not described in section 250(b)(3)(A)(I) through (VI) or paragraphs (c)(15)(i) through (vi) of this section.

(2) Analysis. PRS's sale of property to FP is a FDDEI sale as described in §1.250(b)-4(b). Therefore, the gross income derived from the sale ($20x) is included in PRS's gross DEI and gross FDDEI, and DC's share of PRS's gross DEI and gross FDDEI ($10x) is included in DC's gross DEI and gross FDDEI for the taxable year.

(B) Example 2: Sale by partnership to foreign person attributable to foreign branch — (1) Facts. The facts are the same as in paragraph (e)(3)(ii)(A)(1) of this section (the facts in Example 1), except the income from the sale of property to FP is attributable to a foreign branch of PRS.

(2) Analysis. PRS's sale of property to FP is excluded from PRS's gross DEI under section 250(b)(3)(A)(VI) and paragraph (c)(15)(vi) of this section. Accordingly, DC's share of PRS's gross income of $10x from the sale is not included in DC's gross DEI or gross FDDEI for the taxable year.

(C) Example 3: Partnership with a loss in gross FDDEI — (1) Facts. The facts are the same as in paragraph (e)(3)(ii)(A)(1) of this section (the facts in Example 1), except that in the same taxable year, PRS also sells property to FP2, a foreign person (as determined under §1.250(b)-4(c)), for a foreign use (as determined under §1.250(b)-4(d)). After taking into account both sales, PRS has a gross loss of $30x.

(2) Analysis. Both the sale of property to FP and the sale of property to FP2 are FDDEI sales because each sale is described in §1.250(b)-4(b). DC's share of PRS's gross loss ($15x) from the sales is included in DC's gross DEI and gross FDDEI.

(D) Example 4: Sale by partnership to foreign related party of the partnership — (1) Facts. Under the terms of the partnership agreement, DC has 25 percent of the capital and profits interest in the partnership and is allocated 25 percent of all income, gain, loss, and deductions of PRS. PRS owns 100 percent of the single class of stock of FC. In the taxable year, PRS has $20x of gain on the sale of general property (as defined in §1.250(b)-3(b)(10)) to FC, and FC makes a physical and material change to the property within the meaning of §1.250(b)-4(d)(1)(iii)(B) outside the United States before selling the property to customers in the United States.

(2) Analysis. The sale of property by PRS to FC is described in §1.250(b)-4(b) without regard to the application of §1.250(b)-6, since the sale is to a foreign person (as determined under §1.250(b)-4(c)) for a foreign use (as determined under §1.250(b)-4(d)). However, FC is a foreign related party of PRS within the meaning of section 250(b)(5)(D) and §1.250(b)-3(b)(6), because FC and PRS are members of a modified affiliated group within the meaning of paragraph (c)(17) of this section. Therefore, the sale by PRS to FC is a related party sale within the meaning of §1.250(b)-6(b)(1). Under section 250(b)(5)(C)(i) and §1.250(b)-6(c), because FC did not sell the property, or use the property in connection with other property sold or the provision of a service, to a foreign unrelated party before the property was subject to a domestic use, the sale by PRS to FC is not a FDDEI sale. See §1.250(b)-6(c)(1). Accordingly, the gain from the sale ($20x) is included in PRS's gross DEI but not its gross FDDEI, and DC's share of PRS's gain ($5x) is included in DC's gross DEI but not gross FDDEI. This is the result notwithstanding that FC is not a related party of DC because FC and DC are not members of a modified affiliated group within the meaning of paragraph (c)(17) of this section.

**Final Reg. 1.250-2(g)**

Preamble

“The section 951A final regulations made certain revisions and clarifications to the proposed regulations under that section (“section 951A proposed regulations”). See §1.951A-3. The preamble to the section 951A final regulations noted that, except as indicated with respect to the election to use a depreciation method other than the alternative depreciation system (“ADS”) for determining the adjusted basis in specified tangible property for assets placed in service before the enactment of section 951A (see part V.B of this Summary of Comments and Explanation of Revisions section), modifications similar to the revisions to proposed §1.951A-3 will be made to proposed §1.250(b)-2. These modifications generally clarify the QBAI computation with respect to dual-use property (§1.250(b)-2(d)) and partnerships (§1.250(b)-2(g)). Accordingly, the final regulations make conforming changes to QBAI for purposes of FDII similar to the changes made to proposed §1.951A-3 in the section 951A final regulations. See §1.250(b)-(2).”

**Final Reg text 1.250(b)-2(g)**

Reg.1.250-2(g) Partnership property — (1) In general. If a domestic corporation holds an interest in one or more partnerships during a taxable year (including indirectly through one or more partnerships that are partners in a lower-tier partnership), the QBAI of the domestic corporation for the taxable year (determined without regard to this paragraph (g)(1)) is increased by the sum of the domestic corporation's partnership QBAI with respect to each partnership for the taxable year.

(2) Determination of partnership QBAI. For purposes of paragraph (g)(1) of this section, the term partnership QBAI means, with respect to a partnership, a domestic corporation, and a taxable year, the sum of the domestic corporation's partner adjusted basis in each partnership specified tangible property of the partnership for each partnership taxable year that ends with or within the taxable year. If a partnership taxable year is less than twelve months, the principles of paragraph (f) of this section apply in determining a domestic corporation's partnership QBAI with respect to the partnership.

(3) Determination of partner adjusted basis — (i) In general. For purposes of paragraph (g)(2) of this section, the term partner adjusted basis means the amount described in paragraph (g)(3)(ii) of this section with respect to sole use partnership property or paragraph (g)(3)(iii) of this section with respect to dual use partnership property. The principles of section 706(d) apply to this determination.

(ii) Sole use partnership property — (A) In general. The amount described in this paragraph (g)(3)(ii), with respect to sole use partnership property, a partnership taxable year, and a domestic corporation, is the sum of the domestic corporation's proportionate share of the partnership adjusted basis in the sole use partnership property for the partnership taxable year and the domestic corporation's partner-specific QBAI basis in the sole use partnership property for the partnership taxable year.

(B) Definition of sole use partnership property. The term sole use partnership property means, with respect to a partnership, a partnership taxable year, and a domestic corporation, partnership specified tangible property of the partnership that is used in the production of only gross DEI of the domestic corporation for the taxable year in which or with which the partnership taxable year ends. For purposes of the preceding sentence, partnership specified tangible property of a partnership is used in the production of only gross DEI for a taxable year if all the domestic corporation's distributive share of the partnership's depreciation deduction or cost recovery allowance with respect to the property (if any) for the partnership taxable year that ends with or within the taxable year is allocated and apportioned to the domestic corporation's gross DEI for the taxable year under §1.250(b)-1(d)(2) and, if any of the partnership's depreciation or cost recovery allowance with respect to the property is capitalized to inventory or other property held for sale, all the domestic corporation's distributive share of the partnership's gross income or loss from the sale of such inventory or other property for the partnership taxable year that ends with or within the taxable year is taken into account in determining the DEI of the domestic corporation for the taxable year.

(iii) Dual use partnership property — (A) In general. The amount described in this paragraph (g)(3)(iii), with respect to dual use partnership property, a partnership taxable year, and a domestic corporation, is the sum of the domestic corporation's proportionate share of the partnership adjusted basis in the property for the partnership taxable year and the domestic corporation's partner-specific QBAI basis in the property for the partnership taxable year, multiplied by the domestic corporation's dual use ratio with respect to the property for the partnership taxable year determined under the principles of paragraph (d)(3) of this section, except that the ratio described in paragraph (d)(3) of this section is determined by reference to the domestic corporation's distributive share of the amounts described in paragraph (d)(3) of this section.

(B) Definition of dual use partnership property. The term dual use partnership property means partnership specified tangible property other than sole use partnership property.

(4) Determination of proportionate share of the partnership's adjusted basis in partnership specified tangible property — (i) In general. For purposes of paragraph (g)(3) of this section, the domestic corporation's proportionate share of the partnership adjusted basis in partnership specified tangible property for a partnership taxable year is the partnership adjusted basis in the property multiplied by the domestic corporation's proportionate share ratio with respect to the property for the partnership taxable year. Solely for purposes of determining the proportionate share ratio under paragraph (g)(4)(ii) of this section, the partnership's calculation of, and a partner's distributive share of, any income, loss, depreciation, or cost recovery allowance is determined under section 704(b).

(ii) Proportionate share ratio. The term proportionate share ratio means, with respect to a partnership, a partnership taxable year, and a domestic corporation, the ratio (expressed as a percentage) calculated as —

(A) The sum of —

(1) The domestic corporation's distributive share of the partnership's depreciation deduction or cost recovery allowance with respect to the property for the partnership taxable year; and

(2) The amount of the partnership's depreciation or cost recovery allowance with respect to the property that is capitalized to inventory or other property held for sale, the gross income or loss from the sale of which is taken into account in determining the domestic corporation's distributive share of the partnership's income or loss for the partnership taxable year; divided by

(B) The sum of —

(1) The total amount of the partnership's depreciation deduction or cost recovery allowance with respect to the property for the partnership taxable year; and

(2) The total amount of the partnership's depreciation or cost recovery allowance with respect to the property capitalized to inventory or other property held for sale, the gross income or loss from the sale of which is taken into account in determining the partnership's income or loss for the partnership taxable year.

(5) Definition of partnership specified tangible property. The term partnership specified tangible property means, with respect to a domestic corporation, tangible property (as defined in paragraph (c)(2) of this section) of a partnership that is —

(i) Used in the trade or business of the partnership;

(ii) Of a type with respect to which a deduction is allowable under section 167; and

(iii) Used in the production of gross income included in the domestic corporation's gross DEI.

(6) Determination of partnership adjusted basis. For purposes of this paragraph (g), the term partnership adjusted basis means, with respect to a partnership, partnership specified tangible property, and a partnership taxable year, the amount equal to the average of the partnership's adjusted basis in the partnership specified tangible property as of the close of each quarter in the partnership taxable year determined without regard to any adjustments under section 734(b) except for adjustments under section 734(b)(1)(B) or section 734(b)(2)(B) that are attributable to distributions of tangible property (as defined in paragraph (c)(2) of this section) and for adjustments under section 734(b)(1)(A) or 734(b)(2)(A). The principles of paragraphs (e) and (h) of this section apply for purposes of determining a partnership's adjusted basis in partnership specified tangible property and the proportionate share of the partnership's adjusted basis in partnership specified tangible property.

(7) Determination of partner-specific QBAI basis. For purposes of this paragraph (g), the term partner-specific QBAI basis means, with respect to a domestic corporation, a partnership, and partnership specified tangible property, the amount that is equal to the average of the basis adjustment under section 743(b) that is allocated to the partnership specified tangible property of the partnership with respect to the domestic corporation as of the close of each quarter in the partnership taxable year. For this purpose, a negative basis adjustment under section 743(b) is expressed as a negative 191 number. The principles of paragraphs (e) and (h) of this section apply for purposes of determining the partner-specific QBAI basis with respect to partnership specified tangible property.

(8) Examples. The following examples illustrate the rules of this paragraph (g).

(i) Assumed facts. Except as otherwise stated, the following facts are assumed for purposes of the examples:

(A) DC, DC1, DC2, and DC3 are domestic corporations.

(B) PRS is a partnership and its allocations satisfy the requirements of section 704.

(C) All properties are partnership specified tangible property.

(D) All persons use the calendar year as their taxable year.

(E) There is no partner-specific QBAI basis with respect to any property.

(ii) Example 1: Sole use partnership property — (A) Facts. DC is a partner in PRS. PRS owns two properties, Asset A and Asset B. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset A is $100x and in Asset B is $500x. In Year 1, PRS's section 704(b) depreciation deduction is $10x with respect to Asset A and $5x with respect to Asset B, and DC's section 704(b) distributive share of the depreciation deduction is $8x with respect to Asset A and $1x with respect to Asset B. None of the depreciation with respect to Asset A or Asset B is capitalized to inventory or other property held for sale. DC's entire distributive share of the depreciation deduction with respect to Asset A and Asset B is allocated and apportioned to DC's gross DEI for Year 1 under §1.250(b)-1(d)(2).

(B) Analysis — (1) Sole use partnership property. Because all of DC's distributive share of the depreciation deduction with respect to Asset A and B is allocated and apportioned to gross DEI for Year 1, Asset A and Asset B are sole use partnership property within the meaning of paragraph (g)(3)(ii)(B) of this section. Therefore, under paragraph (g)(3)(ii)(A) of this section, DC's partner adjusted basis in Asset A and Asset B is equal to the sum of DC's proportionate share of PRS's partnership adjusted basis in Asset A and Asset B for Year 1 and DC's partner-specific QBAI basis in Asset A and Asset B for Year 1, respectively.

(2) Proportionate share. Under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset A and Asset B is PRS's partnership adjusted basis in Asset A and Asset B for Year 1, multiplied by DC's proportionate share ratio with respect to Asset A and Asset B for Year 1, respectively. Because none of the depreciation with respect to Asset A or Asset B is capitalized to inventory or other property held for sale, DC's proportionate share ratio with respect to Asset A and Asset B is determined entirely by reference to the depreciation deduction with respect to Asset A and Asset B. Therefore, DC's proportionate share ratio with respect to Asset A for Year 1 is 80 percent, which is the ratio of DC's section 704(b) distributive share of PRS's section 704(b) depreciation deduction with respect to Asset A for Year 1 ($8x), divided by the total amount of PRS's section 704(b) depreciation deduction with respect to Asset A for Year 1 ($10x). DC's proportionate share ratio with respect to Asset B for Year 1 is 20 percent, which is the ratio of DC's section 704(b) distributive share of PRS's section 704(b) depreciation deduction with respect to Asset B for Year 1 ($1x), divided by the total amount of PRS's section 704(b) depreciation deduction with respect to Asset B for Year 1 ($5x). Accordingly, under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset A is $80x ($100x x 0.8), and DC's proportionate share of PRS's partnership adjusted basis in Asset B is $100x ($500x x 0.2).

(3) Partner adjusted basis. Because DC has no partner-specific QBAI basis with respect to Asset A and Asset B, DC's partner adjusted basis in Asset A and Asset B is determined entirely by reference to its proportionate share of PRS's partnership adjusted basis in Asset A and Asset B. Therefore, under paragraph (g)(3)(ii)(A) of this section, DC's partner adjusted basis in Asset A is $80x, DC's proportionate share of PRS's partnership adjusted basis in Asset A, and DC's partner adjusted basis in Asset B is $100x, DC's proportionate share of PRS's partnership adjusted basis in Asset B.

(4) Partnership QBAI. Under paragraph (g)(2) of this section, DC's partnership QBAI with respect to PRS is $180x, the sum of DC's partner adjusted basis in Asset A ($80x) and DC's partner adjusted basis in Asset B ($100x). Accordingly, under paragraph (g)(1) of this section, DC increases its QBAI for Year 1 by $180x.

(iii) Example 2: Dual use partnership property — (A) Facts. DC owns a 50 percent interest in PRS. All section 704(b) and tax items are identical and are allocated equally between DC and its other partner. PRS owns three properties, Asset C, Asset D, and Asset E. PRS sells two products, Product A and Product B. All of DC's distributive share of the gross income or loss from the sale of Product A is taken into account in determining DC's DEI, and none of DC's distributive share of the gross income or loss from the sale of Product B is taken into account in determining DC's DEI.

(1) Asset C. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset C is $100x. In Year 1, PRS's depreciation is $10x with respect to Asset C, none of which is capitalized to inventory or other property held for sale. DC's distributive share of the depreciation deduction with respect to Asset C is $5x ($10x x 0.5), $3x of which is allocated and apportioned to DC's gross DEI under §1.250(b)-1(d)(2).

(2) Asset D. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset D is $500x. In Year 1, PRS's depreciation is $50x with respect to Asset D, $10x of which is capitalized to inventory of Product A and $40x is capitalized to inventory of Product B. None of the $10x depreciation with respect to Asset D capitalized to inventory of Product A is capitalized to ending inventory. However, of the $40x capitalized to inventory of Product B, $10x is capitalized to ending inventory. Therefore, the amount of depreciation with respect to Asset D capitalized to inventory of Product A that is taken into account in determining DC's distributive share of the income or loss of PRS for Year 1 is $5x ($10x x 0.5), and the amount of depreciation with respect to Asset D capitalized to inventory of Product B that is taken into account in determining DC's distributive share of the income or loss of PRS for Year 1 is $15x ($30x x 0.5).

(3) Asset E. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset E is $600x. In Year 1, PRS's depreciation is $60x with respect to Asset E. Of the $60x depreciation with respect to Asset E, $20x is allowed as a deduction, $24x is capitalized to inventory of Product A, and $16x is capitalized to inventory of Product B. DC's distributive share of the depreciation deduction with respect to Asset E is $10x ($20x x 0.5), $8x of which is allocated and apportioned to DC's gross DEI under §1.250(b)-1(d)(2). None of the $24x depreciation with respect to Asset E capitalized to inventory of Product A is capitalized to ending inventory. However, of the $16x depreciation with respect to Asset E capitalized to inventory of Product B, $10x is capitalized to ending inventory. Therefore, the amount of depreciation with respect to Asset E capitalized to inventory of Product A that is taken into account in determining DC's distributive share of the income or loss of PRS for Year 1 is $12x ($24x x 0.5), and the amount of depreciation with respect to Asset E capitalized to inventory of Product B that is taken into account in determining DC's distributive share of the income or loss of PRS for Year 1 is $3x ($6x x 0.5).

(B) Analysis. Because Asset C, Asset D, and Asset E are not used in the production of only gross DEI in Year 1 within the meaning of paragraph (g)(3)(ii)(B) of this section, Asset C, Asset D, and Asset E are dual use partnership property within the meaning of paragraph (g)(3)(iii)(B) of this section. Therefore, under paragraph (g)(3)(iii)(A) of this section, DC's partner adjusted basis in Asset C, Asset D, and Asset E is the sum of DC's proportionate share of PRS's partnership adjusted basis in Asset C, Asset D, and Asset E, respectively, for Year 1, and DC's partner-specific QBAI basis in Asset C, Asset D, and Asset E, respectively, for Year 1, multiplied by DC's dual use ratio with respect to Asset C, Asset D, and Asset E, respectively, for Year 1, determined under the principles of paragraph (d)(3) of this section, except that the ratio described in paragraph (d)(3) of this section is determined by reference to DC's distributive share of the amounts described in paragraph (d)(3) of this section.

(1) Asset C — (i) Proportionate share. Under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset C is PRS's partnership adjusted basis in Asset C for Year 1, multiplied by DC's proportionate share ratio with respect to Asset C for Year 1. Because none of the depreciation with respect to Asset C is capitalized to inventory or other property held for sale, DC's proportionate share ratio with respect to Asset C is determined entirely by reference to the depreciation deduction with respect to Asset C. Therefore, DC's proportionate share ratio with respect to Asset C is 50 percent, which is the ratio calculated as the amount of DC's section 704(b) distributive share of PRS's section 704(b) depreciation deduction with respect to Asset C for Year 1 ($5x), divided by the total amount of PRS's section 704(b) depreciation deduction with respect to Asset C for Year 1 ($10x). Accordingly, under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset C is $50x ($100x x 0.5).

(ii) Dual use ratio. Because none of the depreciation with respect to Asset C is capitalized to inventory or other property held for sale, DC's dual use ratio with respect to Asset C is determined entirely by reference to the depreciation deduction with respect to Asset C. Therefore, DC's dual use ratio with respect to Asset C is 60 percent, which is the ratio calculated as the amount of DC's distributive share of PRS's depreciation deduction with respect to Asset C that is allocated and apportioned to DC's gross DEI under §1.250(b)-1(d)(2) for Year 1 ($3x), divided by the total amount of DC's distributive share of PRS's depreciation deduction with respect to Asset C for Year 1 ($5x).

(iii) Partner adjusted basis. Because DC has no partner-specific QBAI basis with respect to Asset C, DC's partner adjusted basis in Asset C is determined entirely by reference to DC's proportionate share of PRS's partnership adjusted basis in Asset C, multiplied by DC's dual use ratio with respect to Asset C. Under paragraph (g)(3)(iii)(A) of this section, DC's partner adjusted basis in Asset C is $30x, DC's proportionate share of PRS's partnership adjusted basis in Asset C for Year 1 ($50x), multiplied by DC's dual use ratio with respect to Asset C for Year 1 (60 percent).

(2) Asset D — (i) Proportionate share. Under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset D is PRS's partnership adjusted basis in Asset D for Year 1, multiplied by DC's proportionate share ratio with respect to Asset D for Year 1. Because all of the depreciation with respect to Asset D is capitalized to inventory, DC's proportionate share ratio with respect to Asset D is determined entirely by reference to the depreciation with respect to Asset D that is capitalized to inventory and included in cost of goods sold. Therefore, DC's proportionate share ratio with respect to Asset D is 50 percent, which is the ratio calculated as the amount of PRS's section 704(b) depreciation with respect to Asset D capitalized to Product A and Product B that is taken into account in determining DC's section 704(b) distributive share of PRS's income or loss for Year 1 ($20x), divided by the total amount of PRS's section 704(b) depreciation with respect to Asset D capitalized to Product A and Product B that is taken into account in determining PRS's section 704(b) income or loss for Year 1 ($40x). Accordingly, under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset D is $250x ($500x x 0.5).

(ii) Dual use ratio. Because all of the depreciation with respect to Asset D is capitalized to inventory, DC's dual use ratio with respect to Asset D is determined entirely by reference to the depreciation with respect to Asset D that is capitalized to inventory and included in cost of goods sold. Therefore, DC's dual use ratio with respect to Asset D is 25 percent, which is the ratio calculated as the amount of depreciation with respect to Asset D capitalized to inventory of Product A and Product B that is taken into account in determining DC's DEI for Year 1 ($5x), divided by the total amount of depreciation with respect to Asset D capitalized to inventory of Product A and Product B that is taken into account in determining DC's income or loss for Year 1 ($20x).

(iii) Partner adjusted basis. Because DC has no partner-specific QBAI basis with respect to Asset D, DC's partner adjusted basis in Asset D is determined entirely by reference to DC's proportionate share of PRS's partnership adjusted basis in Asset D, multiplied by DC's dual use ratio with respect to Asset D. Under paragraph (g)(3)(iii)(A) of this section, DC's partner adjusted basis in Asset D is $62.50x, DC's proportionate share of PRS's partnership adjusted basis in Asset D for Year 1 ($250x), multiplied by DC's dual use ratio with respect to Asset D for Year 1 (25 percent).

(3) Asset E — (i) Proportionate share. Under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset E is PRS's partnership adjusted basis in Asset E for Year 1, multiplied by DC's proportionate share ratio with respect to Asset E for Year 1. Because the depreciation with respect to Asset E is partly deducted and partly capitalized to inventory, DC's proportionate share ratio with respect to Asset E is determined by reference to both the depreciation that is deducted and the depreciation that is capitalized to inventory and included in cost of goods sold. Therefore, DC's proportionate share ratio with respect to Asset E is 50 percent, which is the ratio calculated as the sum ($25x) of the amount of DC's section 704(b) distributive share of PRS's section 704(b) depreciation deduction with respect to Asset E for Year 1 ($10x) and the amount of PRS's section 704(b) depreciation with respect to Asset E capitalized to inventory of Product A and Product B that is taken into account in determining DC's section 704(b) distributive share of PRS's income or loss for Year 1 ($15x), divided by the sum ($50x) of the total amount of PRS's section 704(b) depreciation deduction with respect to Asset E for Year 1 ($20x) and the total amount of PRS's section 704(b) depreciation with respect to Asset E capitalized to inventory of Product A and Product B that is taken into account in determining PRS's section 704(b) income or loss for Year 1 ($30x). Accordingly, under paragraph (g)(4)(i) of this section, DC's proportionate share of PRS's partnership adjusted basis in Asset E is $300x ($600x x 0.5).

(ii) Dual use ratio. Because the depreciation with respect to Asset E is partly deducted and partly capitalized to inventory, DC's dual use ratio with respect to Asset E is determined by reference to the depreciation that is deducted and the depreciation that is capitalized to inventory and included in cost of goods sold. Therefore, DC's dual use ratio with respect to Asset E is 80 percent, which is the ratio calculated as the sum ($20x) of the amount of DC's distributive share of PRS's depreciation deduction with respect to Asset E that is allocated and apportioned to DC's gross DEI under §1.250(b)-1(d)(2) for Year 1 ($8x) and the amount of depreciation with respect to Asset E capitalized to inventory of Product A and Product B that is taken into account in determining DC's DEI for Year 1 ($12x), divided by the sum ($25x) of the total amount of DC's distributive share of PRS's depreciation deduction with respect to Asset E for Year 1 ($10x) and the total amount of depreciation with respect to Asset E capitalized to inventory of Product A and Product B that is taken into account in determining DC's income or loss for Year 1 ($15x).

(iii) Partner adjusted basis. Because DC has no partner-specific QBAI basis with respect to Asset E, DC's partner adjusted basis in Asset E is determined entirely by reference to DC's proportionate share of PRS's partnership adjusted basis in Asset E, multiplied by DC's dual use ratio with respect to Asset E. Under paragraph (g)(3)(iii)(A) of this section, DC's partner adjusted basis in Asset E is $240x, DC's proportionate share of PRS's partnership adjusted basis in Asset E for Year 1 ($300x), multiplied by DC's dual use ratio with respect to Asset E for Year 1 (80 percent).

(4) Partnership QBAI. Under paragraph (g)(2) of this section, DC's partnership QBAI with respect to PRS is $332.50x, the sum of DC's partner adjusted basis in Asset C ($30x), DC's partner adjusted basis in Asset D ($62.50x), and DC's partner adjusted basis in Asset E ($240x). Accordingly, under paragraph (g)(1) of this section, DC increases its QBAI for Year 1 by $332.50x.

(iv) Example 3: Sole use partnership specified tangible property; section 743(b) adjustments — (A) Facts. The facts are the same as in paragraph (g)(8)(ii)(A) of this section (the facts in Example 1), except that there is an average of $40x positive adjustment to the adjusted basis in Asset A as of the close of each quarter of PRS's taxable year with respect to DC under section 743(b) and an average of $20x negative adjustment to the adjusted basis in Asset B as of the close of each quarter of PRS's taxable year with respect to DC under section 743(b).

(B) Analysis. Under paragraph (g)(3)(ii)(A) of this section, DC's partner adjusted basis in Asset A is $120x, which is the sum of $80x (DC's proportionate share of PRS's partnership adjusted basis in Asset A as illustrated in paragraph (g)(8)(ii)(B)(2) of this section (the analysis in Example 1)) and $40x (DC's partner-specific QBAI basis in Asset A). Under paragraph (g)(3)(ii)(A) of this section, DC's partner adjusted basis in Asset B is $80x, the sum of $100x (DC's proportionate share of the partnership adjusted basis in the property as illustrated in paragraph (g)(8)(ii)(B)(2) of this section (the analysis in Example 1)) and (-$20x) (DC's partner-specific QBAI basis in Asset B). Therefore, under paragraph (g)(2) of this section, DC's partnership QBAI with respect to PRS is $200x ($120x + $80x). Accordingly, under paragraph (g)(1) of this section, DC increases its QBAI for Year 1 by $200x.

(v) Example 4: Sale of partnership interest before close of taxable year — (A) Facts. DC1 owns a 50 percent interest in PRS on January 1 of Year 1. PRS does not have an election under section 754 in effect. On July 1 of Year 1, DC1 sells its entire interest in PRS to DC2. PRS owns Asset G. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset G is $100x. DC1's section 704(b) distributive share of the depreciation deduction with respect to Asset G is 25 percent with respect to PRS's entire year. DC2's section 704(b) distributive share of the depreciation deduction with respect to Asset G is also 25 percent with respect to PRS's entire year. Both DC1's and DC2's entire distributive shares of the depreciation deduction with respect to Asset G are allocated and apportioned under §1.250(b)-1(d)(2) to DC1's and DC2's gross DEI, respectively, for Year 1. PRS's allocations satisfy section 706(d).

(B) Analysis — (1) DC1. Because DC1 owns an interest in PRS during DC1's taxable year and receives a distributive share of partnership items of the partnership under section 706(d), DC1 has partnership QBAI with respect to PRS in the amount determined under paragraph (g)(2) of this section. Under paragraph (g)(3)(i) of this section, DC1's partner adjusted basis in Asset G is $25x, the product of $100x (the partnership's adjusted basis in the property) and 25 percent (DC1's section 704(b) distributive share of depreciation deduction with respect to Asset G). Therefore, DC1's partnership QBAI with respect to PRS is $25x. Accordingly, under paragraph (g)(1) of this section, DC1 increases its QBAI by $25x for Year 1.

(2) DC2. DC2's partner adjusted basis in Asset G is also $25x, the product of $100x (the partnership's adjusted basis in the property) and 25 percent (DC2's section 704(b) distributive share of depreciation deduction with respect to Asset G). Therefore, DC2's partnership QBAI with respect to PRS is $25x. Accordingly, under paragraph (g)(1) of this section, DC2 increases its QBAI by $25x for Year 1.

(vi) Example 5: Partnership adjusted basis; distribution of property in liquidation of partnership interest — (A) Facts. DC1, DC2, and DC3 are equal partners in PRS, a partnership. DC1 and DC2 each has an adjusted basis of $100x in its partnership interest. DC3 has an adjusted basis of $50x in its partnership interest. PRS has a section 754 election in effect. PRS owns Asset H with a fair market value of $50x and an adjusted basis of $0, Asset I with a fair market value of $100x and an adjusted basis of $100x, and Asset J with a fair market value of $150x and an adjusted basis of $150x. Asset H and Asset J are tangible property, but Asset I is not tangible property. PRS distributes Asset I to DC3 in liquidation of DC3's interest in PRS. None of DC1, DC2, DC3, or PRS recognizes gain on the distribution. Under section 732(b), DC3's adjusted basis in Asset I is $50x. PRS's adjusted basis in Asset H is increased by $50x to $50x under section 734(b)(1)(B), which is the amount by which PRS's adjusted basis in Asset I immediately before the distribution exceeds DC3's adjusted basis in Asset I.

(B) Analysis. Under paragraph (g)(6) of this section, PRS's adjusted basis in Asset H is determined without regard to any adjustments under section 734(b) except for adjustments under section 734(b)(1)(B) or section 734(b)(2)(B) that are attributable to distributions of tangible property and for adjustments under section 734(b)(1)(A) or 734(b)(2)(A). The adjustment to the adjusted basis in Asset H is under section 734(b)(1)(B) and is attributable to the distribution of Asset I, which is not tangible property. Accordingly, for purposes of applying paragraph (g)(1) of this section, PRS's adjusted basis in Asset H is $0.

##### D. Treatment of Interests in Partnerships: 1.250(b)-3(b)(10)

1. Preamble

“The proposed regulations did not address the conditions under which the sale of a partnership interest that is not described in section 475(c)(2) will satisfy the foreign use requirement. One comment suggested that when a taxpayer sells a partnership interest, a look-through approach should apply such that the sale of a partnership interest would be considered a sale of the partner's proportionate share in the partnership's assets. As such, the sale of the partnership interest could be considered a sale of general property and would qualify as a FDDEI sale so long as the other relevant requirements of the regulations were met. The same comment noted an alternative approach that would preclude looking through to the underlying assets and instead would require the foreign purchaser to determine if the acquisition of the partnership interest is for a foreign use.

“The Treasury Department and the IRS have determined that, like an interest in a corporation (which is a security under section 475(c)(2)(A) and therefore not general property under §1.250(b)-3(b)(10)), interests in a partnership are not the type of property that can be subject to “any use, consumption, or disposition” outside the United States. Furthermore, a look-through approach would be inconsistent with the fact that title to the partnership's property does not change upon the sale of an interest in a partnership and also would be difficult to administer given that the underlying property that would be tested for foreign use is not actually being transferred. Accordingly, the final regulations provide that an interest in a partnership, as well as an interest in a trust or estate, is not general property. See §1.250(b)-3(b)(10).”

1. **Final reg 1.250-3(b)(10)** General property. The term general property means any property other than: intangible property (as defined in paragraph (b)(11) of this section); a security (as defined in section 475(c)(2)); an interest in a partnership, trust, or estate; a commodity described in section 475(e)(2)(A) that is not a physical commodity; or a commodity described in section 475(e)(2)(B) through (D). A physical commodity described in section 475(e)(2)(A) is treated as general property, including if it is sold pursuant to a forward or option contract (including a contract described in section 475(e)(2)(C), but not a section 1256 contract as defined in section 1256(b) or other similar contract that is traded on a U.S. or non-U.S. regulated exchange and cleared by a central clearing organization in a manner similar to a section 1256 contract) that is physically settled by delivery of the commodity (provided that the taxpayer physically settled the contract pursuant to a consistent practice adopted for business purposes of determining whether to cash or physically settle such contracts under similar circumstances).

**Final reg. 1.250(b)-3(e)**

(e) Treatment of partnerships — (1) In general. For purposes of determining whether a sale of property to or by a partnership or a provision of a service to or by a partnership is a FDDEI transaction, a partnership is treated as a person. Accordingly, for example, a partnership may be a seller, renderer, recipient, or related party, including a foreign related party (as defined in paragraph (b)(6) of this section).

(2) Examples. The following examples illustrate the application of this paragraph (e).

(i) Example 1: Domestic partner sale to foreign partnership with a foreign branch — (A) Facts. DC, a domestic corporation, is a partner in PRS, a foreign partnership. DC and PRS are not related parties. PRS has a foreign branch within the meaning of §1.904-4(f)(3)(iii). DC and PRS both use the calendar year as their taxable year. For the taxable year, DC recognizes $20x of gain on the sale of general property to PRS for a foreign use (as determined under §1.250(b)-4(d)). During the same taxable year, PRS recognizes $20x of gain on the sale of other general property to a foreign person for a foreign use (as determined under §1.250(b)-4(d)). PRS's income on the sale of the property is attributable to its foreign branch.

(B) Analysis. DC's sale of property to PRS, a foreign partnership, is a FDDEI sale because it is a sale to a foreign person for a foreign use. Therefore, DC's gain of $20x on the sale to PRS is included in DC's gross DEI and gross FDDEI. However, PRS's gain of $20x is not included in the gross DEI or gross FDDEI of PRS because the gain is foreign branch income within the meaning of §1.250(b)-1(c)(11). Accordingly, none of PRS's gain on the sale of property is included in DC's gross DEI or gross FDDEI under §1.250(b)-1(e)(1).

(ii) Example 2: Domestic partner sale to domestic partnership without a foreign branch — (A) Facts. The facts are the same as in paragraph (e)(2)(i)(A) of this section (the facts in Example 1), except PRS is a domestic partnership that does not have a foreign branch within the meaning of §1.904-4(f)(3)(iii).

(B) Analysis. DC's sale of property to PRS, a domestic partnership, is not a FDDEI sale because the sale is to a United States person. Therefore, the gross income from DC's sale to PRS is included in DC's gross DEI but is not included in its gross FDDEI. However, PRS's sale of other general property is a FDDEI sale, and therefore the gain of $20x is included in the gross DEI and gross FDDEI of PRS. Accordingly, DC includes its distributive share of PRS's gain from the sale in determining DC's gross DEI and gross FDDEI for the taxable year under §1.250(b)-1(e)(1).