

Tax

IRS Issues Guidance on Section 50(d) Income Inclusion Rules

Action Item: The recently issued temporary Treasury Regulation § 1.150-1T contains guidance that is significant to businesses and individuals alike. Transactions involving master lease pass-throughs may require special attention for application of new rules. Recently closed transactions may also require reconsideration or renegotiation.

Overview

On July 21, 2016, the IRS issued temporary and proposed Treasury Regulation § 1.150-1T (the “Regulation”) regarding the income inclusion rules of Section 50(d)(5) of the Internal Revenue Code (the “Code”). This new guidance applies to master lease pass-through transactions where the owner, or lessor, of investment credit property (“Property”) monetizes an investment credit. In such a transaction, the owner (master landlord) of the Property elects to forego claiming an investment credit, such as rehabilitation credit or an energy credit, and passes the credit through to the master tenant or lessee.

Former guidance provided that if a lessor of Property makes an election such that the lessee is entitled to claim an investment credit with respect to the leased Property, the lessee is also required to include “50(d) income” (generally, the proportional amount of the credit received) into gross income. Previously, partners commonly included 50(d) income in the basis of their partnership interests, which increased the basis and resulted in a recognition of loss upon sale of the interest.¹ However, the Regulation requires that the entity or individual claiming the credit, e.g., the person or entity filing Form 3468, bear the burden of income. The 50(d) income is therefore a partner item rather than a partnership item and does not increase the partner’s basis in its partnership interest.

The Regulation provides that if a partnership interest is disposed of, or a lease is terminated before the end of the five year recapture period, there will be a recapture of “unvested” credits, which has the effect of accelerating any unreported 50(d) income. However, if the partnership interest is disposed of after the end of the recapture period, the Regulation requires the investor to report the 50(d) income ratably over the remaining life of the Property, unless the investor elects to report the remaining 50(d) income in the taxable year it disposes of its partnership interest.

The Regulation is applicable to Property placed in service on or after September 19, 2016. Accordingly, some recently closed transactions will now be subject to the Regulation. The Treasury Department has not yet provided guidance regarding Property placed in service before September 19, 2016.

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1. These apply equally to S Corporations and their shareholders as well as limited liability companies that choose to be taxed as partnerships.