

IRS Issues Section 50(d) Guidance

August 1, 2016

On July 22, 2016, the United States Department of Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued temporary Treasury Regulations (Temporary Regulations) related to the income inclusion rules under Section 50(d)(5) of the Internal Revenue Code of 1986, as amended (Code), in a pass-through tax credit investment structure, on which Temporary Regulations are applicable to property placed in service on or after September 19, 2016 (effective date). A summary of the Temporary Regulations was also published in the *Federal Register*, where the Treasury Department and IRS provided comments respecting the intent of the Temporary Regulations.

The Temporary Regulations address the tax structure, under former Code Section 48(d), in which a lessor of certain tax credit investment property could elect to treat the lessee of such property as having acquired such property, for purposes of claiming applicable investment credits (as defined below), in which case, pursuant to former Code Section 48(d)(5)(B), the lessee would ratably recognize income equal to 100 percent or 50 percent, as applicable, of the allowable investment credit over the shortest recovery period for such property. Prior to the issuance of the Temporary Regulations, there was no clear guidance on how a lessee partnership or S corporation should treat such income. The Temporary Regulations clarify that, in the context of such a pass-through election, each partner or S corporation shareholder who is an ultimate credit claimant (as defined below), as opposed to the pass-through entity in which it is a partner/shareholder, should be treated as the lessee.^[1] Under such Regulation, each ultimate credit claimant must include in its gross income, ratably over the shortest applicable recovery period under Code Section 168 with respect to the property (generally, 39 years for commercial property, 27.5 years for residential property, 15 years for qualified leasehold improvement property and five years for energy property) income equal to 100 percent or 50 percent, depending on the investment credit involved, of the investment credit amount allowed to such partner or S corporation shareholder.

The Temporary Regulations also provide that there is no basis increase in a partnership interest or in an S corporation shareholder's stock basis for Code Section 50(d)(5) income upon such income recognition.

If there is a recapture of an Investment Credit (such as a lease termination or a disposition of a partnership interest or of S corporation stock) during the compliance period for an investment credit (recapture event), the Temporary Regulations provide that the remaining gross income attributable to the unrecaptured portion



of the investment credit is accelerated to the taxable year of such recapture and provide rules to calculate the correct income inclusion, based on the amount of the unrecaptured investment credit at the time of such recapture event, as compared to the amount of Code Section 50(d)(5) income previously included in gross income by the ultimate credit claimant.

Lastly, the Temporary Regulations provide that, if there is a disposition of a partnership interest or of S corporation stock or a lease termination that occurs after the end of the compliance period of the applicable investment credit, the ultimate credit claimant may continue to claim Code Section 50(d)(5) income ratably over the remainder of the applicable recovery period. Alternatively, the ultimate credit claimant may make a one-time irrevocable election under the Temporary Regulations to accelerate the remaining Code Section 50(d)(5) income into the taxable year in which the lease terminates or in which the ultimate credit claimant disposes of its entire interest in a lessee partnership or of all of its stock in a lessee S corporation, whichever occurs first (acceleration event). Ultimate credit claimants should analyze this provision, based on their investment goals, respecting whether to defer income and continue to recognize such Code Section 50(d)(5) income ratably over the remainder of the applicable recovery period, or to make the election to accelerate the Code Section 50(d)(5) income into the taxable year of the first acceleration event to occur.

For questions regarding Temporary Regulations and the impact on your development, please contact your Lathrop Gage attorney or the attorneys listed above.

[1] *Treasury Regulations Section 1.50-1T(b)(3)(ii) provides that the “ultimate credit claimant” (ultimate credit claimant) is any partner or S corporation shareholder that files (or would file) IRS Form 3468 “Investment Credit” (or its successor form), with such partner’s or shareholder’s income tax return to claim the investment credit determined under Code Section 46 (each an investment credit) that results in the corresponding income inclusion under Temporary Regulation Section 1.50-1T(b)(2).*