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## Federal Tax & Accounting

### Passthrough Entities

#### IRS Very Close to Reproposing Rules On Noncompensatory Partnership Options

The Internal Revenue Service is on the verge of reproposing rules on noncompensatory partnership options, dealing with nonrecognition of gain to both the partnership and the option holder at exercise, IRS Associate Chief Counsel Curtis Wilson said June 29.

The 2003 proposed rules (REG-103580-02) accomplished this through adjustments to capital accounts (14 DTR G-4, 1/22/03 ), Wilson told a D.C. Bar Association Taxation Section Passthroughs and Real Estate Committee meeting.

The original proposed rules met with considerable opposition and were issued so long ago that the final rules would have to be significantly different when they came out, leading IRS to conclude that new proposed rules should be issued, attorneys familiar with the rules told BNA.

In essence there were issues about how the 2003 rules would apply, they said, with questions about how individuals who exercised an option would get the right amount of capital to reflect their interest in the deal.

#### Section 108(e)(8)

Another project almost out of the gate is on final rules on Section 108(e)(8). The rules address what happens when a creditor exchanges debt for a partnership interest. Proposed rules were issued on this in

2008, allowing no gain or loss to the creditor. As a consequence the creditor does not get a bad debt deduction, Wilson said.

“We got a lot of comments on this but we were not entirely convinced that a [tax code] Section 721 approach is the wrong one,” he said.

In response to a question, Wilson said the final rules will not address the issue of self-help, where a creditor bifurcates the debt instrument in connection with an exchange transaction, in order to facilitate a write-off of the portion of the debt that exceeds the value of the equity to be received in the exchange.

“Self-help is likely to be a very facts-and-circumstances situation, so it would be difficult to draw bright lines unless we just did it arbitrarily,” he said.

## **Five-Month Extension**

IRS's recently released final rules allowing an automatic five-month extension for the filing of partnership returns also was discussed.

“Tax preparers complained because they were doing returns for the partners of the partnerships, but they were not getting K-1s from those partnerships until the day the partners' returns were due,” said Steven Schneider, a partner with Goulston & Storrs in Washington, D.C., who was on the panel. “That was not a very happy day for them because they were just late,” he said.

Robert Honigman, a partner with Arent Fox in Washington, D.C., noted that comments IRS received on the extension indicated “a big split between the big accounts and the small accounts, where the small accounts representing a lot of individuals were very happy, and the big accounts representing partnerships in tiers have the same issue, just a month earlier.”

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