Bloomberg BNA Daily Tax Report®

No. 166

Wednesday, August 27, 2014

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ISSN 1947-3923

Federal Tax & Accounting

Tax Administration

New IRS Priority Guidance Plan May Signal Clearer Guidance for PTPs, Penalty Relief

BNA Snapshot

IRS 2014-2015 Priority Guidance Plan

Key Issue: Latest guidance plan emphasizes key projects in partnership taxation.

Key Takeaway: Guidance projects could suggest clearer rules for publicly traded partnership, noncompensatory partnership options and penalty relief for late filings of short year returns following a partnership's technical termination.

By ***Lydia Beyoud***

The 2014-2015 IRS Priority Guidance Plan puts a strong focus on partnership issues for the coming year, and suggests that the agency will issue rules to help thaw an ongoing private letter ruling "freeze" for publicly traded partnerships.

In the new plan, issued Aug. 26, the Internal Revenue Service indicated it intends to issue guidance in the next 12 months on the definition of qualifying income for PTPs under tax code Section 7704(d)(1)(E).

IRS officials have previously indicated that they were progressing in creating a "workable standard" for granting or denying a large number of private letter ruling requests by PTPs, which are found primarily in the oil and gas exploration industries (99 DTR G-9, 5/22/14).

Practitioners told Bloomberg BNA Aug. 26 that private industry has been pushing an expanded definition of "qualifying income" in recent years through PLR requests. That trend has mirrored a push to expand the definition of qualifying real property for real estate investment trust (REIT) purposes.

Within the government, "there's a growing concern that the private sector is kind of pushing the envelope on expanding the definition of qualifying income," said Michael Grace, counsel with Whiteford Taylor Preston LLP in Washington.

To address this, the administration appears to be taking the view that some kind of uniform guidance ought to be issued for PTPs to address the issue, he said.

After such guidance is issued-in whatever form it takes-the IRS may decide to resume private letter rulings with the understanding that many of those currently in the queue may be withdrawn.

Technical Termination Relief

The new plan also indicates that some sort of relief may be offered to partnerships who file a late return for a short tax year following a technical termination under Section 708.

Guidance on this issue will hopefully provide some sort of relief from late filing penalties, said Steven Schneider, a partner at Goulston & Storrs PC in Washington.

"That's very good news" as penalties for late filing have increased significantly in recent years, Schneider said.

Both practitioners said it is quite common for partnerships to forget to file a return for a short tax year after undergoing a technical termination, in which 50 percent or more of a partnership interest is transferred within a 12-month period.

"In the real world, people overlook technical terminations all the time," Grace said.

The nature of the guidance referred to in the plan could provide a relief mechanism whereby partnerships are assured that filing a late short tax year return doesn't result in a "cataclysmic event," such as disregarding the technical termination or treating the successor partnership as not existing, said Grace.

Schneider said the guidance could provide a "reasonable cause" period for lateness, similar to procedures for a late tax election.

Noncompensatory Options

Another new item on the 2014-2015 plan is final regulations under Section 761 and 1234 on the tax treatment of noncompensatory partnership options.

The IRS proposed regulations (REG-106918-08) on the issue in February 2013 (24 DTR G-3, 2/5/13).

The regulations address the tax treatment of a partnership granting an option to acquire a partnership interest in the future for capital contributions rather than for providing services.

The proposed rules were very comprehensive but also complex, Grace said. Listing the final rules as a priority project could indicate that the IRS may try to simplify them somewhat, he said.

Carried Interest

However, the plan doesn't reference any projects on the tax treatment of compensatory partnership options, an issue that is likely of greater concern to taxpayers because of its implications for the taxability of carried interest, Grace said.

The issue may be absent from the plan because of an unwillingness on the part of the IRS and the Treasury Department to work on the issue until Congress issues any legislation addressing carried interest, he said.

Currently, carried interest is taxed at a more favorable rate than ordinary income. Proposed rules (REG-105346-03) were issued in 2005 to treat carried interest as ordinary income, but they were roundly shot down by stakeholders (98 DTR G-7, 5/23/05).

Clifford M. Warren, special counsel to the IRS associate chief counsel (passthroughs and special industries), said May 20 that "no one is eager to revisit" the proposed rules, though the Obama administration did include such a provision in its fiscal year 2015 budget request.

Material Participation of Trusts

The PGP also highlighted a guidance project on material participation by trusts and estates under Section 469.

The issue gained importance upon finalization of the net investment income (NII) tax rules under Section 1411, which levies a 2.3 percent surtax on certain individuals, estates and trusts.

The IRS encouraged comments on material participation for trusts and estates when it finalized the Section 1411 rules in December 2013.

Grace said it was "encouraging" to see the issue formalized as a project. "Their having added the project to the new plan doesn't magically mean the regulations are going to come out anytime soon, but at least it signals the view within government that this issue is viewed as a priority."

In total, the plan contains 317 priority projects for the agency over the next 12 months. Some projects from the 2013-2014 PGP weren't carried over in the latest plan due to resource issues, the IRS said.

The IRS also issued its fourth-quarter update to the 2013-2014 PGP along with the new plan.

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Texts of the 2014-2015 Priority Guidance Plan and the fourth-quarter update to the 2013-2014 Priority Guidance Plan are in TaxCore.