STRADLEY RONON

# Tax Insights

A Publication of the Stradley Ronon
Tax Practice Group

WWW.STRADLEY.COM

JANUARY 25, 2017

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

www.meritas.org

*Our firm is a member of Meritas – a worldwide business alliance of more than 175 law offices in 80 countries, offering high-quality legal services through a closely integrated group of independent, full-service law firms.*

Information contained in this publication should not be construed as legal advice or opinion or as a substitute for the advice of counsel. The enclosed materials may have been abridged from other sources. They are provided for educational and informational purposes for the use of clients and others who may be interested in the subject matter.

Copyright © 2017
Stradley Ronon Stevens & Young, LLP
All rights reserved.

## IRS Issues Proposed Regulations on New Partnership Uniform Audit Rules

The IRS has issued proposed regulations (REG-136118-15 at http://www.stradley.com/~/media/Files/Publications/2017/01/Audit%20regs-TaxInsights-Jan252017.pdf) on the new partnership audit regime that was enacted as part of the Bipartisan Budget Act of 2015 (the BBA) (see our prior coverage at http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-november-4-2015). The proposed regulations span 277 pages and provide rules for partnerships subject to the new regime, including procedures for electing out of the centralized partnership audit regime, filing administrative adjustment requests and determining amounts owed by the partnership or its partners attributable to adjustments that arise out of an examination of a partnership. The proposed regulations also address the scope of the centralized partnership audit regime and provide definitions and special rules that govern its application, including the designation of a partnership representative.

> **Note:** The future of the partnership audit regulations is uncertain because of a Jan. 20 White House memorandum ordering a freeze of all regulations. However, as announced by a member of senior counsel of the Treasury Office of Tax Legislative Counsel, the proposed regulations reflect the IRS's thinking on how to implement the partnership audit rules, which were created by statute and will be effective in less than one year absent further action by Congress and the President.

**Background on TEFRA**

The unified partnership audit and litigation rules currently in effect were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and are commonly referred to as the TEFRA partnership procedures. Under these rules, the IRS generally is unable to adjust partnership items on a partner's tax return except by a unified entity-level proceeding, which is binding on all partners and allows IRS to make the necessary corresponding adjustments on the partners' individual returns. Generally effective for tax years beginning after Dec. 31, 2017, the BBA repeals the TEFRA partnership procedures, replacing them with new rules described in the BBA and the proposed regulations. However, partnerships are allowed to elect to have most of the new partnership audit regime apply to returns of the partnership filed for partnership tax years beginning after Nov. 2, 2015 (i.e., the BBA's enactment date), and before Jan. 1, 2018.

**Overview of BBA Code Provisions**

Under Section 6221 (section references are to the Internal Revenue Code of 1986, as amended (the Code), in general, any adjustment to items of income, gain, loss, deduction or credit of a partnership for a partnership tax year (and any partner's distributive share thereof) will be determined, and any tax attributable thereto will be assessed and collected, at the partnership level. The applicability of any penalty, addition to tax or additional amount that relates to an adjustment to any such item or share will also be determined at the partnership level.

Section 6221(b) allows partnerships that are required to furnish 100 or fewer Schedules K-1 (Partner's Share of Income, Deductions, Credits, etc.) to elect out of the new

regime. Generally, a partnership will be able to elect out only if each of its partners is an individual, corporation (including certain types of foreign entities) or estate. Special rules will apply for purposes of determining the number of partners in the case of a partner that is an S corporation. Section 6221(b)(2)(C) provides that the IRS, by regulation or other guidance, may prescribe rules for purposes of the 100-or-fewer-Schedule-K-1 requirement similar to the rules for S corporations with respect to any partner that is not an individual, corporation or estate.

Section 6225 provides rules for how partnership adjustments will be made by the IRS, including how an imputed underpayment will be determined and that the amount of any imputed underpayment resulting from an adjustment will have to be paid by the partnership (subject to an exception described below). A special rule, in Section 6225(c), addresses certain passive losses of publicly traded partnerships. Section 6223 provides the rules for how interest and penalties will be computed on an imputed underpayment.

Section 6227 enables a partnership to request an administrative adjustment, which will be taken into account in the year the administrative adjustment request (AAR) is made. The partnership generally will have three years from the date of filing the return to make an AAR for that year, but it will not be able to make an AAR for a partnership tax year after the IRS has mailed the partnership a notice of an administrative proceeding with respect to the tax year.

Section 6231 describes notices of proceedings and adjustments, including applicable time frames for mailing the notices and the authority to rescind any notice of adjustment with the partnership's consent.

**Summary of the Proposed Regulations**

The proposed regulations would affect partnerships for tax years beginning after Dec. 31, 2017, and any partnerships that elect application of the centralized partnership audit regime pursuant to Temporary Regulation Section 301.9100-22T for tax years beginning after Nov. 2, 2015, and before Jan. 1, 2018. The regulations also withdraw previously issued proposed regulations on the conversion of partnership items related to listed transactions.

The proposed regulations take an expansive view of the scope of the centralized partnership audit regime to cover all items and information related to or derived from the partnership. Under Proposed Regulation Section 301.6221(a)-1, all items required to be shown or reflected on the partnership's return and information in the partnership's books and records related to a determination of such items, as well as factors that affect the determination of items of income, gain, loss, deduction or credit, would be subject to determination and adjustment at the partnership level under the centralized partnership audit regime. Further, the proposed regulations would provide that any "Chapter 1 tax" (referring to Chapter 1 of the Code) resulting from an adjustment to items under the centralized partnership audit regime is assessed and collected at the partnership level. Under the proposed regulations, the applicability of any penalty, addition to tax or additional amount that relates to an adjustment to any such item or share would also be determined at the partnership level.

**Christopher C. Scarpa**

**Kristin M. McKenna**

*For more information, contact Christopher C. Scarpa at 215.564.8106 or cscarpa@stradley.com or Kristin M. McKenna at 215.564.8145 or kmckenna@stradley.com.*

Proposed Regulation Section 301.6221(b)-1(b) provides that only an "eligible partnership" can elect out of the centralized partnership audit regime. Under that section, a partnership is an eligible partnership if it has 100 or fewer partners during the year and all partners are eligible partners, as defined in Proposed Regulation Section 301.6221(b)-1(b)(3), at all times during the tax year. Proposed Regulation Section 301.6221(b)-1(c) provides the time, form and manner for the partnership to make an election out of the centralized partnership audit regime, and unless all these requirements were satisfied, an election would not be valid.

Proposed Regulation Section 301.6222-1(a)(1) states that a partner's treatment of each item of income, gain, loss, deduction or credit attributable to a partnership would have to be consistent with the treatment of those items on the partnership return, including treatment with respect to the amount, timing and characterization of those items. Additionally, Proposed Regulation Section 301.6222-1(a)(1) clarifies that the determination of whether a partner treats an item consistently with the partnership return is determined with reference to the treatment of that item on the partnership return filed with the IRS and not with reference to any schedule or other information provided or furnished by the partnership to the partner – for example, a Schedule K-1 furnished to the partner by the partnership (unless the election under Proposed Regulation Section 301.6222-1(d), regarding incorrect statements or information, applies).



© 2017 Stradley Ronon Stevens & Young, LLP

Proposed Regulation Section 301.6223-1 supplies rules (i) requiring a partnership to designate a partnership representative, (ii) describing the eligibility requirements for a partnership representative, (iii) describing designation of the partnership representative and (iv) describing the termination of a designation of a partnership representative.

Proposed Regulation Section 301.6225-1(a) states the general rule that if a partnership adjustment results in an imputed underpayment, the partnership must pay the imputed underpayment in the adjustment year. As described in Proposed Regulation Section 301.6225-1(a)(3), the partnership adjustments and any imputed underpayment resulting from such adjustments are set out in a notice of proposed partnership adjustment (NOPPA) mailed to the partnership and the partnership representative. The partnership may request modification with respect to an imputed underpayment set forth in the NOPPA under the procedures described in Proposed Regulation Section 301.6225-2.

Proposed Regulation Section 301.6226-1(a) states that a partnership may elect under Section 6226 to "push out" adjustments to its reviewed-year partners rather than paying the imputed underpayment determined under Section 6225. If a partnership makes a valid election in accordance with Proposed Regulation Section 301.6226-1, the partnership is no longer liable for the imputed underpayment. A partnership may make an election under this section with respect to one or more imputed underpayments identified in a final partnership adjustment (FPA). For example, when the FPA includes a general imputed underpayment and one or more specific imputed underpayments, the partnership may make an election under this section with respect to any or all of the imputed underpayments.

Proposed Regulation Section 301.6227-1(a) describes the general rules for filing an administrative adjustment request (AAR). In accordance with Section 6227(a), Proposed Regulation Section 301.6227-1(a) provides that a partnership may file an AAR with respect to one or more items of income, gain, loss, deduction or credit of the partnership and any partner's distributive share thereof for any partnership tax year as determined under Section 6221 and the regulations thereunder.

## IRS Issues Final and Temporary Dividend Equivalent Regulations

The Treasury Department and the IRS issued final and temporary dividend equivalent regulations (TD 9815 at https://www.federalregister.gov/documents/2017/01/24/2017-01163/dividend-equivalents-from-sources-within-the-united-states) providing guidance to nonresident alien individuals and foreign corporations that hold certain financial products providing for payments that are contingent upon or determined by reference to U.S. source dividend payments and to withholding agents that are responsible for withholding U.S. tax with respect to a dividend equivalent, as well as certain other parties to Section 871(m) transactions and their agents. The final regulations generally adopt the proposed regulations issued on Sept. 18, 2015 (see our prior coverage at http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-september-23-2015), with certain changes. They also include several technical amendments to the final regulations, also issued in September 2015, in response to comments on those regulations. Finally, Treasury and the IRS also issued new temporary regulations based on comments received with respect to the 2015 proposed regulations.

In response to comments regarding the inclusion of regulated investment companies as brokers, Treasury and the IRS have revised the definition of the term "broker" in the temporary regulations so that it will not apply to a corporation that would be treated as a broker pursuant to Section 6045(c) solely because it regularly redeems its own shares. Comments noted that regulated investment companies may enter into transactions as a short party with a foreign financial institution that is the long party. In these transactions, the comments asserted, the foreign financial institution (not the regulated investment company) is more capable of determining delta and making other calculations. Treasury and the IRS agreed that the financial institution is in the better position to determine delta and make other determinations required by Section 871(m) in this type of transaction.

Treasury Regulation Section 1.871-15(c) provides that subject to certain exceptions, a dividend equivalent includes any payment that references the payment of a dividend from an underlying security pursuant to a securities lending or sale-repurchase transaction, specified notional principal contract, or specified equity-linked instrument. Treasury and the IRS received comments suggesting that the regulations clarify how this rule applies when a derivative references an underlying security that has a Section 305(c) dividend. Another comment noted that Treasury Regulation Section 1.871-15(c)(2)(ii) reduces the dividend equivalent amount by Section 305(c) dividends, and that this reduction arguably applies both to the person who holds the underlying security giving rise to the Section 305(c) dividend and to a holder of a Section 871(m) transaction that references the underlying security that gives rise to the Section 305(c) dividend. Accordingly, the final regulations revise the definition of dividend to explicitly provide that it applies without regard to whether there is an actual distribution of cash or property. A conforming change is also made to Treasury Regulation Section 1.871-15(c)(2)(ii), which is revised to clarify that only a long party that is treated as receiving a Section 305(c) dividend is


© 2017 Stradley Ronon Stevens & Young, LLP

entitled to reduce its dividend equivalent amount and that a Section 305(c) dividend gives rise to a dividend equivalent.

Numerous comments were submitted suggesting a change in the time for calculating delta for simple contracts, the method used for determining the delta for listed options and a change in the time for conducting the substantial equivalence test for complex contracts. Treasury and the IRS generally agreed with the comments that the date for determining delta and for performing the substantial equivalence test should be revised to be more administrable and to reflect more accurately the economics of the transactions. Accordingly, the regulations provide that the delta of a simple contract is determined on the earlier of the date that the potential Section 871(m) transaction is priced and the date when the potential Section 871(m) transaction is issued; however, the issue date must be used to determine the delta if the potential Section 871(m) transaction is priced more than 14 calendar days before it is issued. A similar rule also applies to the substantial equivalence test. In addition, the regulations provide a new rule for determining the delta of an option listed on a "regulated exchange." For these options, the delta is determined based on the delta of the option at the close of business on the business day before the date of issuance.

Treasury and the IRS requested comments regarding the substantial equivalence test. The comments submitted generally did not recommend material changes to the test. As a result, the final regulations adopt the substantial equivalence test as proposed in the 2015 proposed regulations, with a few minor changes.

With respect to the amount and timing of a taxpayer's liability, the final regulations include several new provisions. First, Treasury Regulation Section 1.871-15(j)(4) is added to provide that a long party generally is liable for tax on a dividend equivalent in the year the dividend equivalent payment is subject to withholding pursuant to Treasury Regulation Section 1.1441-2(e)(7) or, in the case of a qualified derivatives dealer, when the payment of the applicable dividend on the underlying security is subject to withholding. Second, the regulations are amended to clarify that the amount of a dividend equivalent subject to tax will not change because the tax is withheld at a later date. For example, changes in facts (such as the tax rate or whether the recipient is a qualified resident of a country with which the United States has an income tax treaty) between the time that the amount of a dividend equivalent is determined and the time that withholding occurs do not affect tax liability. Finally, Treasury Regulation Section 1.871-15(j)(1) expressly provides that the long party is liable for tax only on dividend equivalents that arise while the long party is a party to the transaction.

The qualified indices rules were also modified. The final regulations are revised to clarify that in order to meet the 10 percent safe harbor described in Treasury Regulation Section 1.871-15(l)(4), an index must be widely traded and must not be formed or availed of with a principal purpose of tax avoidance. The final regulations also add a rule to provide that, for the first year, an index is tested on the first business day it is listed and the dividend yield calculation is determined using the dividend yield that the index would have had in the immediately preceding year if it had the same components throughout that year that it has on the day it is created.

Treasury and the IRS received numerous comments regarding the combination rules but did not revise the final regulations in response to any of these comments. Specifically, the final regulations were not amended to provide clarity and resolve ambiguities because, according to Treasury and the IRS, the final regulations are intended to provide a general framework for determining when two or more transactions should be combined, but Treasury and the IRS have not ruled out publishing subsequent guidance on these issues.

Under the 2015 final regulations, multiple parties could be responsible for determining whether a transaction is a Section 871(m) transaction under the definition of a "party to the


## Stradley Ronon's Tax  Practice Group

Todd C. Vanett, Chair ........ 215.564.8070 ........ tvanett@stradley.com
Zachary P. Alexander ........ 215.564.8043 ........ zalexander@stradley.com
Jacquelyn Gordon ........ 215.564.8176 ........ jgordon@stradley.com
Kristin M. McKenna ........ 215.564.8145 ........ kmckenna@stradley.com
William S. Pilling III ........ 215.564.8079 ........ wpilling@stradley.com
William R. Sasso ........ 215.564.8045 ........ wsasso@stradley.com
Christopher C. Scarpa ........ 215.564.8106 ........ cscarpa@stradley.com
Roger Wise ........ 202.419.8436 ........ rwise@stradley.com



© 2017 Stradley Ronon Stevens & Young, LLP

transaction." Treasury and the IRS agree, and new temporary regulations resolve this duplication of responsible parties under Treasury Regulation Section 1.871-15(p)(1) in the following circumstances: (1) both the short party and an agent or intermediary of the short party are brokers or dealers; (2) the short party is not a broker or dealer, and more than one of the agents or intermediaries of the short party are brokers or dealers; (3) the short party and its agents or intermediaries are not brokers or dealers, and more than one agent or intermediary acting on behalf of the long party are brokers or dealers; and (4) potential Section 871(m) transactions are traded on an exchange and cleared by a clearing organization. Additionally, temporary regulations provide that the issuer of a potential Section 871(m) transaction will be the responsible party for certain equity-linked instruments. Specifically, the issuer is the responsible party for structured notes (including contingent payment debt instruments), warrants, convertible stocks and convertible debt instruments.

The final regulations include changes to the qualified derivatives dealer rules. For example, the definition of an eligible entity is defined to include any other person acceptable to the IRS, which is similar to the allowance provided to the IRS in defining persons eligible to enter into a "QI agreement" as provided in Treasury Regulation Section 1.1441-1(e)(5)(ii)(D). Additionally, the final regulations further explain how a qualified derivatives dealer's Section 871(m) amount is computed, and they revise the calculation of a qualified derivatives dealer's tax liability on the Section 871(m) amount in order to correspond with this change. Treasury and the IRS did not change the timing of withholding, and a qualified derivatives dealer should continue to be required to withhold on the dividend payment date as determined in Treasury Regulation Section 1.1441-2(e)(4), because the time that a qualified derivatives dealer withholds on customer transactions should match the time period for which it determines its own tax liability with respect to the Section 871(m) amount. Treasury and the IRS confirmed that the credit-forward regime announced in Notice 2010-46 created administrative problems for the IRS, and that Notice 2010-46 will be obsolete as of Jan. 1, 2018.

Finally, the final regulations include new rules for withholding dividend equivalents. Treasury Regulation Section 1.1441-2(e)(7) is revised to provide that a payment of a dividend equivalent occurs when a Section 871(m) transaction is transferred to an account not maintained by the withholding agent or upon a termination of the account relationship. The final regulations also now allow withholding agents the flexibility to withhold either based on the "later of" rule, as determined under Treasury Regulation Section 1.1441-2(e)(7), or on the dividend payment date for the underlying security, which will allow withholding agents that prefer to withhold on the dividend payment date to do so, without eliminating the later-of rule in Treasury Regulation Section 1.1441-2(e)(7) that generally ties withholding to a cash payment.

The final regulations postpone the implementation of the Section 871(m) regulations with respect to non-delta-one transactions only until Jan. 1, 2018. The 2015 regulations continue to apply to all other Section 871(m) transactions issued after Dec. 31, 2016. The final regulations provide that a qualified derivatives dealer will not be subject to withholding on actual or deemed dividends in 2017 (which is also consistent with the 2017 QI agreement, discussed at http://www.stradley.com/insights/publications/2017/01/tax-insights-january-11-2017). Finally, the 2017 QI agreement and the final regulations do not impose tax on a qualified derivative dealer's Section 871(m) amount for tax years beginning before Jan. 1, 2018.

### IRS Issues Final Regulations Describing Recognition Period for RIC/REIT Conversion Transactions

The IRS has issued final regulations (TD 9810 at https://www.federalregister.gov/documents/2017/01/18/2017-00479/certain-transfers-of-property-to-regulated-investment-companies-rics-and-real-estate-investment) to provide that the term "recognition period" means recognition period described in Section 1374(d)(7) (five years as opposed to 10 years), beginning, in the case of a conversion transaction that is a qualification of a C corporation as a RIC or a REIT, on the first day of the RIC's or the REIT's first taxable year and, in case of other conversion transactions, on the day a RIC or a REIT acquires property. Temporary regulations issued in TD 9770 (June 18, 2016) were removed in part.

The final regulations shorten the recognition period provided in the prior temporary regulations from 10 years to five years to reflect the amendment of Section 1374(d)(7) by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), which changed the length of the recognition period from 10 years to five years with respect to C corporations that elect to be, or transfer property to, S corporations. The change means that RICs, REITs and S corporations are all subject to the same five-year built-in gain recognition period.

### IRS Issues Final Regulations on PTP Qualifying Income

The IRS issued final regulations (TD 9817 at https://s3.amazonaws.com/public-inspection.federalregister.gov/2017-01208.pdf) under Section 7704(d)(1)(E) relating to the qualifying income exception for publicly traded partnerships (PTPs) to not be treated as corporations for federal income tax purposes. Specifically, the regulations define the activities that generate qualifying income from exploration, development, mining or production, processing, refining, transportation and marketing of minerals or natural resources. Effective Jan. 19,


© 2017 Stradley Ronon Stevens & Young, LLP

the final regulations adopt, with some modifications, proposed regulations issued in May 2015 (see prior coverage at http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-may-13-2015).

The final regulations are divided into seven parts. The first part establishes the basic rule that qualifying income includes income and gains from qualifying activities regarding minerals or natural resources. Qualifying activities are either Section 7704(d)(1)(E) activities or intrinsic activities. The second part defines mineral or natural resource consistent with the definition in Section 7704(d)(1).

The third part defines and identifies the specific component activities that are included in each of the Section 7704(d)(1)(E) activities. Where necessary, component activities are listed by type of mineral or natural resource. The fourth part provides rules for determining whether activities that are not Section 7704(d)(1)(E) activities are nonetheless intrinsic activities, which are those that are specialized, essential and require significant services by the PTP in connection with a Section 7704(d)(1)(E) activity.

The fifth and sixth parts provide, respectively, a rule regarding interpretations of Sections 611 and 613 (dealing with depletion of minerals and natural resources) in relation to Treasury Regulation Section 1.7704-4 and examples illustrating the provisions in that regulation. The last part sets forth the effective date, as described above, but also contains a 10-year transition period for specified PTPs.

### Temporary and Proposed Regulations Address Gain Recognition for Transfers to Partnerships With Related Foreign Partners

The IRS has issued temporary regulations (TD 9814 at https://s3.amazonaws.com/public-inspection.federalregister.gov/2017-01049.pdf) that address transfers of appreciated property by U.S. persons to partnerships with foreign partners related to the transferor. The regulations reflect rules previously described in Notice 2015-54 (see our prior coverage at http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-august-12-2015) and were issued pursuant to the IRS's statutory authority grant in Section 721(c). The IRS was aware that certain taxpayers purport to be able to contribute – consistent with Section 704(b) (dealing with the determination of a partner's distributive share of a partnership's income, gains, losses, deductions and credits), Section 704(c) and Section 482 – property to a partnership that allocates the income or gain from the contributed property to related foreign partners that are not subject to U.S. tax. Many of these taxpayers choose a Section 704(c) method other than the remedial method and/or use valuation techniques that are inconsistent with the arm's-length standard. The regulations override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under Section 721(a) unless the partnership adopts the remedial method and certain other requirements are satisfied. The text of the temporary regulations also serves as the text of contemporaneously issued proposed regulations.

### IRS Issues Procedures for Filing Country-by-Country Report for Early Periods

In June 2016, the IRS issued country-by-country (CbC) reporting regulations requiring certain U.S. business entities that are the ultimate parent entity of a U.S. multinational enterprise (MNE) group to file Form 8975 annually with the IRS. Form 8975 requires the ultimate parent entity of a U.S. MNE group to report, on a CbC basis, information related to the group's income and taxes paid, together with certain indicators of the location of the group's economic activity. (See our prior coverage at http://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-july-6-2016.) The IRS has issued Revenue Procedure 2017-23, 2017-7 at https://www.irs.gov/pub/irs-drop/rp-17-23.pdf, describing the process for filing Form 8975, Country-by-Country Report, and accompanying Schedule A, Tax Jurisdiction and Constituent Entity Information, by ultimate parent entities of U.S. MNE groups. The revenue procedure applies to reporting periods beginning on or after Jan. 1, 2016, but before the applicability date of Treasury Regulation Section 1.6038-4 (early reporting periods).

### IRS Issues Updated Withholding Foreign Partnership and Foreign Trust Agreements

The IRS issued Revenue Procedure 2017-21, 2017-6 IRB at https://www.irs.gov/pub/irs-drop/rp-17-21.pdf, in which it updated versions of the withholding foreign partnership agreement (WP agreement) and withholding foreign trust agreement (WT agreement), which are agreements that allow a foreign partnership or foreign trust to assume the withholding and reporting obligations under Chapters 3 and 4 of the Code for certain payments of U.S. source income made to its direct partners, beneficiaries and, in some cases, certain other parties. The revenue procedure also provides guidance to foreign partnerships and foreign trusts for how to apply to enter into, or renew, a WP or WT agreement.

### IRS Clarifies Private Business Use Safe Harbor for Management Contracts

The IRS issued Revenue Procedure 2017-13, 2017-6 IRB at https://www.irs.gov/pub/irs-drop/rp-17-13.pdf, in which it provides safe harbor conditions under which a management contract will not result in private business use of property financed with governmental tax-exempt bonds under Section 141(b) or cause the modified private business use test for


© 2017 Stradley Ronon Stevens & Young, LLP

property financed with qualified Section 501(c)(3) bonds under Section 145(a)(2)(B) to be met. The new revenue procedure expands upon and clarifies a 2016 revenue procedure (Revenue Procedure 2016-44) (see our prior coverage at http://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-august-31-2016) on the same subject.

Revenue Procedure 2017-13 generally restates Revenue Procedure 2016-44, with the following revisions/clarifications:

- **Certain "Revenue Procedure 97-13 approved" compensation structures are acceptable**. Although capitation fees, periodic fixed fees, per-unit fees and combinations thereof, plus certain types of incentive compensation, likely were covered under Revenue Procedure 2016-44, the IRS has clarified that these compensation structures continue to be acceptable. Other compensation arrangements will have to be tested under the general compensation rules stated in Revenue Procedure 2016-44.

- **Deferred compensation**. Revenue Procedure 2017-13 continues to provide that the timing of payment of compensation cannot be contingent upon net profits or losses from the operation of the managed property. However, it provides additional guidance by clarifying that if there is a deferral of compensation due to insufficient cash flow of the managed property, compensation will not be considered contingent upon net profits or net losses provided that the contracts provide for annual payments, there are reasonable consequences for late payment, and the deferred compensation must be paid within five years of the original payment due date.

- **Life of land**. Revenue Procedure 2017-13 limits the term of a management contract to the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. Revenue Procedure 2017-13 also provides that land will be treated as having an economic life of 30 years if 25 percent or more of bonds that financed the managed property was used to finance the land. Revenue Procedure 2016-44 did not take land into account, which could reduce the permissible maximum duration of the management contract.

- **Approval of rates**. Under Revenue Procedure 2017-13, an issuer or 501(c)(3) borrower may satisfy the "approval of rates requirement" set forth in Revenue Procedure 2016-44 by approving a reasonable general description of the method used to set rates (e.g., hotel room rates set based on comparable properties) or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (e.g., physician's services negotiated with a medical insurance company).

Revenue Procedure 2017-13 applies to any management contract that is entered into on or after Jan. 17 and may be applied to any management contract that was entered into before that date. Additionally, the safe harbors in Revenue Procedure 97-13, as modified by Revenue Procedure 2001-39 and amplified by Notice 2014-67, may be relied upon for any management contract that is entered into before Aug. 18 and that is not materially modified or extended on or after that date (other than pursuant to a permissible renewal option).

## IRS Issues Guidance on Treatment of Service Contracts

The IRS has issued Revenue Procedure 2017-19, 2016-6 IRB at https://www.irs.gov/pub/irs-drop/rp-17-19.pdf, providing a safe harbor for energy savings performance contract energy sales agreements (ESPC ESA) between an energy service company and a federal agency so that the IRS will not challenge the treatment of sales agreements as service contracts under Section 7701(e)(3). If a service contract is treated as a lease of property for longer than six months and is used by the United States or any agency thereof, Section 50 would operate to disallow the Section 48 investment tax credit without the safe harbor provided by the revenue procedure.

## Bahrain-U.S. FATCA Agreement Available

The text is available of the agreement at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Bahrain-1-18-2017.pdf signed by Bahrain and the United States to improve international tax compliance and implement the information reporting and withholding tax provisions of the Foreign Account Tax Compliance Act.


© 2017 Stradley Ronon Stevens & Young, LLP