STRADLEY RONON

Tax Insights

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IRS Announces Changes to Some Corporate Transaction Letter Rulings

The IRS announced (http://www.stradley.com/~/media/Files/Publications/2017/10/201779811_TNTIRSdocs_IRSLTRstatement.pdf) that it is making changes relating to requests for private letter rulings on certain corporate transactions. Specifically, if, in connection with a Section 355 distribution, a distribution of stock, securities or other property to the distributing corporation's shareholders or creditors is substantially delayed, the IRS will continue to rule on whether the delayed distribution is tax-free under Section 355 or Section 361. (Section references are to the Internal Revenue Code of 1986, as amended.) However, rulings on such issues will not be based solely on the length of the delay. Instead, the IRS will rule on this issue based only on substantial scrutiny of the facts and circumstances (including the circumstances of the delay) and full consideration of the legal issues and the effects of a ruling on federal tax administration. Additionally, in determining whether a retention of stock or securities is in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax, within the meaning of Section 355(a)(1)(D)(ii), the IRS will continue to follow the guidelines in Appendix B of Rev. Proc. 96-30, even though Rev. Proc. 2017-52 has superseded it. Thus, the IRS will continue to rule in accordance with prior practice as to the application of Section 355 to the distribution of the stock, or stock and securities that are not retained. Finally, the IRS will increase its scrutiny and analysis of (1) "drop-spin-liquidate" and similar transactions, and (2) potential reorganizations that result in transfers of a portion of a subsidiary's assets to its corporate shareholder, if the transfer does not qualify under Section 332 or Section 355 but is intended to be tax-free.

RICs Granted Consent to Revoke Capital Gain Net Income Elections

In Private Letter Ruling 201741013 (https://www.irs.gov/pub/irs-wd/201741013.pdf), the IRS consented to the revocation of the elections made by certain RICs under Section 4982(e)(4)(A), effective for the calendar year, Year 1 and subsequent years. Each RIC had elected under Section 4982(e)(4)(A) to use its taxable year ending Dec. 31 in lieu of the one-year period ending on Oct. 31, for the purposes of calculating the required distribution under Sections 4982(b)(1) and 4982(e) in order to avoid payment of an excise tax under Section 4982(a). However, each RIC realized that the election created additional administrative complexities primarily due to time constraints in declaring required distributions to avoid the excise tax imposed by Section 4982. Furthermore, each RIC became aware of regulations that coordinate excise tax and Subchapter M rules that greatly reduce the administrative burden of having a tax year different from the period used for determining required distributions under Section 4982. The IRS further ruled that in calculating the RICs' required distributions for calendar year, Year 1, for purposes of Sections 4982(b)(1) and (e)(2), the capital gain net income will be determined on the basis of the capital gains and losses realized and recognized during the 10-month period from Jan. 1, Year 1, through Oct. 31, Year 1. Finally, the calendar year ending Dec. 31, Year 1, shall be considered the first taxable year in which the elections under Section 4982(e)(4)(A) will not apply for purposes of designating capital gain dividends, for determining post-October losses, and for determining earnings and profits.

REIT's Income From Distributed Antenna System Cables Qualifies as Real Property Rents

In Private Letter Ruling 201741002 (https://www.irs.gov/pub/irs-wd/201741002.pdf), the IRS

ruled that amounts received by a REIT under certain distributed antenna system agreements for the use of the distributed antenna system cables and the related distributed antenna system property interests qualify as "rents from interests in real property" under Section 856(d)(1)(A). The provision by the REIT of certain distributed antenna system user services and activities does not give rise to impermissible tenant service income, and will not cause any portion of the rents received by the REIT from users for use of the distributed antenna system cables and related distributed antenna system property interests to fail to qualify as "rents from real property" under Section 856(d).

LLC's Income From Producing Fertilizer Is Qualifying Income

In Private Letter Ruling 201741001 (https://www.irs.gov/pub/irs-wd/201741001.pdf), the IRS concluded that income derived by a limited liability company from the production, storage, transportation and marketing of a nitrogen-based fertilizer to both agricultural and nonagricultural customers is qualifying income for purposes of Section 7704(d)(1)(E) but only to the extent that the products in question are of a grade that is consistent with industry standards for agricultural uses as a fertilizer and such product in the form sold is commonly sold and used as a fertilizer. In addition, the IRS noted that the ruling does not apply to retail sales made directly to end users. The IRS also ruled that the flat rent and percentage rent paid by a lessee to the limited liability company's sole owner constitute rents from real property. Furthermore, the income from certain fees as payment for the enumerated services performed under an agreement in connection with the rental of real property constitutes rents from real property as charges for services customarily furnished or rendered in connection with the rental of real property under Section 856(d)(1)(B), without regard to whether such amounts are excluded as impermissible tenant service income under Section 856(d)(2)(C). Therefore, such fees constitute qualifying income under Section 7704(d)(1)(C) as "real property rents" within the meaning of that section.

IRS Releases Several International Practice Units

The IRS made several international practice units available:

- Describing land developers' and subcontractors' use of the completed contract method of accounting or the percentage of completion method (https://www.irs.gov/pub/int_practice_units/mat_c_71_02_01_03_02.pdf) for long-term contracts in the construction industry.
- Providing an overview of the entity classification regulations (https://www.irs.gov/pub/int_practice_units/ore_c_19_02_01.pdf) regarding how a corporation should be treated for U.S. income tax purposes.
- Discussing how to determine when a corporation (https://www.irs.gov/pub/int_practice_units/wit_c_15_02_05.pdf) is a U.S. real property holding corporation and the significance of making this determination. It addresses how interests in other businesses entities come into play and when determination dates are applicable, and defines what is meant by the cleansing rule.
- Providing an overview of withholding under the Foreign Investment in Real Property Tax Act of 1980 (https://www.irs.gov/pub/int_practice_units/wit_t_15_02_01.pdf) for sales by individuals.

Pennsylvania Supreme Court Holds Capped Net Loss Carryover Provision Violates Uniformity Clause

The Pennsylvania Supreme Court in Nextel Communications of the Mid-Atlantic Inc. v. Dep't of Revenue (http://www.pacourts.us/assets/opinions/Supreme/out/25654782.pdf?cb=1), No. 6 EAP 2016, ruled that the "net loss carryover" provision, as applied to Nextel Communications, violated Article 8, Section 1, of the Pennsylvania Constitution (the Uniformity Clause). The net loss carryover provision of the Pennsylvania Revenue Code in 2007 restricted the amount of loss a corporation could carry over from prior years as a deduction against its taxable income to whichever is greater, 12.5 percent of the corporation's taxable income or $3 million. However, the court also found that the portion of the net loss carryover which creates the violation – the $3 million flat deduction – may be severed from the remainder of the statute, while still enabling the statute to operate as the legislature intended. Thus, the court affirmed the Commonwealth Court's holding regarding the provision's violation of the Uniformity Clause, but reversed the Commonwealth Court's order eliminating any caps on net loss deductions for tax year 2007. Accordingly, the court ordered a refund of $3,938,220 to Nextel, which was the amount of its 2007 net income tax payment to the commonwealth.

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