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New 50(d) guidance

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The Internal Revenue Service (IRS) has recently issued temporary regulations with respect to income inclusion rules under Section 50(d) of the Internal Revenue Code (the Code). Guidance on Section 50(d) has been anticipated primarily in the historic tax credit (HTC) arena, due to its implications for the pass-through of tax credits under a master tenant structure.

Background

In a master lease structure, the lessor and lessee each make an election to treat the historic property as being acquired by the lessee, allowing the tax credits to be passed through to the lessee. However, when this election is made, the Section 50(d)(5) of the Internal Revenue Code requires the lessee to include the amount of the tax credits in gross income ratably over the shortest applicable depreciation period which could apply as determined under Section 168 of the Code (generally a period of 39 years). While it is clear when income under Section 50(d)(5) arises, the treatment of Section 50(d) income has been a hot topic for debate throughout the industry due to a lack of official guidance from the IRS prior to the recent issuance of temporary regulations.

What does the guidance provide?

The IRS' temporary regulations provide the following with respect to how income under Section 50(d) is to be treated:

- Section 50(d) income must be reported as a separately-stated item, pursuant to Section 702 of the Code.
- Section 50(d) income should be attributed to the "ultimate credit claimant," defined as the partner receiving the tax credits under the master lease structure.
- Because Section 50(d) income is treated as a separately-stated item, a partner reporting Section 50(d) income on its individual tax return is not entitled to increase its basis in its partnership interest (outside basis) as a result of Section 50(d) income inclusion.
- 50(d) income inclusion does not increase a partner's capital account.

In addition to providing guidance on how Section 50(d) income is to be treated, the temporary regulations also include an election for accelerating income in the event that the lease is terminated, or a disposition occurs after the end of the recapture period. The election is only available to the extent that no recapture event has occurred during the recapture period.

What are the implications of this guidance?

The temporary regulations will apply to properties placed in service on or after September 19, 2016. Given the prevalence of the master lease structure in historic tax credit transactions, the issuance of the temporary regulations by the IRS should have an overall positive effect in the historic tax credit arena by providing much-needed clarity and confidence to investors and developers as well as their advisors in structuring tax credit transactions.

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