# IRS Issues Proposed Rules on Income Inclusion under Section 50(d)(5)

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The IRS just published long-awaited temporary regulations under section 1.50-1T governing the section 50(d)(5) income inclusion rules. These rules apply to lessees of investment credit property when the lessor elects to treat the lessee as having acquired the property for its fair market value and pass through the investment tax credit available under section 46 (which includes the section 48 energy credit ("ITC")). When the lessor makes that election, the lessee must include in gross income 50% of the amount of the ITC ratably over the 5-year MACRS period for energy property in lieu of the basis adjustment that the lessor would have been required to make had it not made the pass-through election. The ITC amount included in gross income is determined regardless of the lessee's income tax situation, and the ratable income inclusion begins on the date that the property is placed in service.

The temporary regulations provide that when the lessee is a partnership, the income is taken by the "ultimate credit claimant," which is the partner(s) that claimed the tax credit and cannot be treated as an item of partnership income. Because this income goes to the partners proportionally based on their respective share of the ITC rather than the partnership, partners are not permitted to increase their tax basis in the partnership as a result of the Section 50(d) income inclusion and claim a loss on the disposition of their interest. The temporary regulations also apply to shareholders in S corporations.

If the lease is terminated triggering recapture under section 50(a), the lessee is required to include in gross income the difference between 50% of the unrecaptured ITC (in the case of energy property) and the total amount previously included in gross income. The temporary regulations provide an irrevocable election to include any remaining income required to be taken into account in the taxable year that the lease is terminated. After the recapture period has run, the temporary regulations similarly provide for an election in the event that a partner disposes of its entire interest in the partnership. In that case, the partner has the option to irrevocably elect to accelerate and take into account any remaining amount required to be included in gross income in the taxable year that the partner exits its investment. The elections are made by including the remaining gross income on the tax return for the year that the lease was terminated or the partner disposed of its partnership interest.

The intent of the temporary regulations is to treat the lessee partner the same as the lessor of the energy property would have been treated if the lease pass-through election had not been made by matching the burden of the income inclusion with the benefits of the tax credit. However, the interconnection of the rules under section 50(d) and subchapter K (and subchapter S in the case of S corporations) have led some partnerships to take the position that the credit income should be taken into account at the partnership level, thus increasing outside basis because section 705(a) requires partners to adjust their outside basis for all items of income and loss. The temporary regulations clarify the IRS's position that this tax treatment provides an unintended benefit that is not available to any other credit claimant; therefore, income includable under section 50(d) is not an item of partnership income to which the rules of subchapter K apply.

The temporary regulations became effective July 22, 2016, upon publication in the Federal Register, and apply to property placed in service on or after September 19, 2016. Written comments on the temporary regulations are due by October 20, 2016.



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