With a Little Help From My Friends (on how to treat Partnerships)

Thursday, November 12, 2015

To follow up on our recent coverage of the “Allocation and Accounting Regulations”, (here, and here) we wanted to point out a helpful rule that that our friends at the IRS have provided the tax-exempt bond community.

Treas. Reg. § 1.141-3(g)(2)(v) (shown below) allows an issuer or conduit borrower to “look through” a partnership to a partner’s share of the property. By way of example, if a hospital enters into a 50-50 joint venture with its doctors to finance a project and tax-exempt bonds are issued to finance the hospital’s 50% share of the required capital, the doctors’ use of the project can be ignored in measuring private business use (“PBU”) and in determining compliance with the ownership requirement in Section 145(a)(1).

This “partnership” rule applies even if the arrangement is not a state-law partnership. The IRS broadly defines “partnership” in Code Section 7701(a)(2), and the term includes many limited liability companies, joint ventures, and can include a “P3 Project” where P3 means “Public/Private Partnership.” P3 projects range widely, and can include collegiate housing, design/build/operate transportation projects, and joint ventures between doctors and hospitals to improve patient care while hopefully reducing cost.

It is possible that the IRS will release future guidance on how to determine what is a “partner’s share” of property used by a partnership. As the preamble to the regulation notes, the IRS is treating the partnership as an “aggregate” of it is partners (i.e., not as an entity). For uncomplicated “straight-up” partnerships, this is simple to determine because each partner gets a fixed percentage of every item of income, gain, loss, deduction or credit. However, many partnership arrangements are more complex, and each partner’s shares may not be identical in all items, and may vary over time. For instance, partners may share profits differently from losses, or may share profits differently in later years or after achieving certain benchmarks. To allow the rule to work for these more complex partnerships, the IRS looks to a partner’s greatest share of any partnership item to determine how much belongs to the nongovernmental partner. The problem of course is that it may not be possible to determine in advance what that greatest share is, and this may be why the IRS allowed itself some leeway to provide additional rules in the future.

Treas Reg. § 1.141-3(g)(2)(v) Special rule for partners that are nongovernmental persons—

(A) The amount of private business use by a nongovernmental person resulting from the use of property by a partnership in which that nongovernmental person is a partner is that nongovernmental partner’s share of the amount of use of the property by the partnership. For this purpose, except as otherwise provided in paragraph (g)(2)(v)(B) of this section, a nongovernmental partner’s share of the partnership’s use of the property is the nongovernmental partner’s greatest percentage share under section 704(b) of any partnership item of income, gain, loss, deduction, or credit attributable to the period that the partnership uses the property during the measurement period. For example, if a partnership has a nongovernmental partner and that partner’s share of partnership items varies, with the greatest share being 25 percent, then that nongovernmental partner’s share of the partnership’s use of property is 25 percent.
(B) An issuer may determine a nongovernmental partner’s share of the partnership’s use of the property under guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).