ALSTON & BIRD

WWW.ALSTON.COM

Federal Tax ADVISORY ■

JUNE 3, 2019

A New Theory of Code Definitions

CCA 201917007 concludes that a U.S. partnership is either a foreign partnership or an aggregate of its partners for purposes of taxing the deemed Section 367(d) royalty contributed to it by one of its partners.

Its unusual facts, which were no doubt planned into for purposes of tax reduction, will not be encountered by many other taxpayers in the normal course of business. But its reasoning could be brought to bear on a wide variety of more common transactions—in ways harmful to taxpayers.

The CCA applied the abuse of entity regulation and a special interpretation of Section 7701(a) definitions. The former is not so unusual: the IRS has been asserting the power to treat partnerships as aggregates for many years, but not always with success. And even though it has been backed up by regulatory authority for 25 years, no court has confirmed that authority in those 25 years. This CCA could be the test case.

One of the many problems with the IRS treating a partnership as an aggregate on audit in the case of a single taxpayer is that all other similarly situated taxpayers are likely to enjoy entity treatment. By choosing to use audit rather than published guidance to apply aggregate treatment, the IRS inevitably will discriminate against taxpayers singled out. Some taxpayer will argue that is wrong; maybe this one.

But the CCA's interpretation of Section 7701(a) is even more disturbing. It focuses on the introductory sentence that says the definitions in that subsection apply except as "manifestly incompatible" with other provisions of the Code. It found that treating the partners as domestic was manifestly incompatible with Section 367(d). However, Section 7701(a)(4) says that a domestic partnership will be treated as domestic unless otherwise provided in regulations; and there is a regulation, but it does not otherwise provide.

The CCA reasons that because the introductory sentence appears first in Section 7701, it supersedes the "except as otherwise provided" language. It also strongly implies that in every case that a taxpayer or the IRS applies the definitions, it must first run the manifestly incompatible analysis.

If so, that is a new approach never before applied to Section 7701. Taxpayers should beware, but also be prepared to use it to their benefit.

For more information, please contact Jack Cummings at 919.862.2302.

You can subscribe to future ***Federal Tax*** advisories and other Alston & Bird publications by completing our **publications subscription form**.

Click **here** for Alston & Bird's Tax Blog.
Stay engaged with the aftereffects of the Tax Cuts and Jobs Act with our new **resource page**.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

John F. Baron
Chair
704.444.1434
john.baron@alston.com

George B. Abney
404.881.7980
george.abney@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

Seth M. Buchwald
404.881.7836
seth.buchwald@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Stefanie Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Sam K. Kaywood, Jr.
404.881.7481
sam.kaywood@alston.com

Ryan J. Kelly
202.239.3306
ryan.kelly@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Daniel M. Reach
704.444.1272
danny.reach@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

Michael Senger
404.881.4988
michael.senger@alston.com

Edward Tanenbaum
212.210.9425
edward.tanenbaum@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650-838-2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333