

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware



www.meritas.org

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Wyden Proposal Would Impact ETF and Mutual Fund Redemptions-in-Kind and PTPs

On Sept. 10, Senate Finance Committee Chair Ron Wyden, D-Ore., released [draft tax legislation](#) applicable to pass-through entities (primarily partnerships). One of the proposals included in Wyden's discussion draft relates to regulated investment companies. Wyden proposes the repeal of Section 852(b)(6), which calls off the recognition gain at the ETF or mutual fund level on a redemption-in-kind so that there is no gain to distribute to shareholders when appreciated assets are used to satisfy a shareholder's redemption request. (Section references are to the Internal Revenue Code of 1986, as amended.) ETFs, in particular, rely on redemptions-in-kind in their daily operations.

A [section-by-section summary of the discussion draft legislation](#) also was released. With respect to Section 852(b)(6), the summary states:

Section 17 of the Discussion Draft – IRC Section 852(b)(6)

In general, corporations must recognize gain when distributing appreciated property to their shareholders. However, Regulated Investment Companies (RICs) are exempt from this rule when distributing property in kind to a redeeming shareholder. This exception has led to a significant rise in the distribution of assets with built-in gain in the redemption of a shareholder in order to significantly reduce the future tax burden of current and future shareholders. Typically, a firm will make a strategic investment in a mutual fund with the intention that it will be redeemed with appreciated assets. The investment and related redemptions permit the fund to eliminate unrealized gain on the distributed assets completely tax-free, allowing the mutual fund's shareholders to defer economic gains until they liquidate their investments in the mutual fund.³⁶

³⁶ Jeffrey Colon, The Great ETF Tax Swindle: The Taxation of In-Kind Redemptions, 122 Penn St. L. Rev. 1 (2017) Available at https://ir.lawnet.fordham.edu/faculty_scholarship/722 ("The exemption in section 852(b)(6) from the recognition of gain on the distribution of appreciated property by RICs should be eliminated. It provides an unfair tax subsidy for ETFs and encourages the transfer of capital from other kinds of investment vehicles to ETFs. It also unfairly benefits high-net-worth owners of ETFs.")

The provision would repeal the exception for RICs, aligning RICs with the general requirement that gain be recognized upon distribution by a corporation of built-in gain property. The repeal would be effective for tax years beginning after Dec. 31, 2022.

Wyden also proposes to significantly amend the rules on publicly traded partnerships (PTPs) by eliminating the exception from PTP treatment for partnerships with passive-type income (e.g., interest; dividends; the exploration, development, mining or production, processing, refining, transportation or the marketing of natural resources, etc.) including MLPs. Such entities would be subject to a corporate level tax if the proposal is adopted. With respect to changes to the PTP rules, the section-by-section summary states:

Section 16 of the Discussion Draft – IRC Section 7704(c)

Current law permits certain publicly traded companies to opt into partnership status. Such partnerships often have hundreds of thousands of partners, and it is nearly impossible for the IRS to properly administer these entities. Furthermore, these entities do not pay corporate taxes and thereby erode the corporate tax base. The provision would repeal the exception from corporate tax treatment for all publicly traded partnerships. The provision would be effective for tax years beginning after Dec. 31, 2022.

IRS Memo Instructs Auditors on Statute of Limitation Issues Involving Transition Tax

The IRS's Large Business and International Division (LB&I) issued a [memo](#) instructing its auditors on statute of limitation issues involving centralized audits of partnerships where a transition tax (Section 965) issue has been identified.

IRS Issues Procedures for Reviewing Requests to Revoke an Election

The IRS has provided its employees with [updated procedures](#) to use when determining whether to approve or deny a partnership's request to revoke its Section 754 election to adjust partnership property basis.



Christopher C. Scarpa



Jacquelyn Gordon

For more information, contact Christopher C. Scarpa at 215.564.8106 or cscarpa@stradley.com or Jacquelyn Gordon at 215.564.8176 or jgordon@stradley.com.

IRS Will Not Issue Rulings on Self-Dealing Involving Certain Transactions

The IRS issued [Revenue Procedure 2021-40](#), in which it announced that it would no longer issue rulings on whether an act of self-dealing occurs when a private foundation owns or receives an interest in an LLC or other entity that owns a promissory note issued by a disqualified person.