**8773. What special rules apply in the tax treatment of a publicly traded partnership?**

A publicly traded partnership will be taxed as a corporation unless 90 percent of the partnership’s income is passive-type income and has been passive-type income for all taxable years beginning after 1987 during which the partnership (or any predecessor) was in existence. For this purpose, a partnership (or a predecessor) is not treated as being “in existence” until the taxable year in which it is first publicly traded (see Q 8771).[[1]](#footnote-1)

On the first day that a publicly traded partnership is treated as a corporation under these rules, the partnership is treated as though it transferred all assets (subject to its liabilities) to a new corporation in exchange for stock in the corporation, followed by a distribution of the stock to its partners in liquidation of their partnership interests.[[2]](#footnote-2)

In general, “passive-type income” includes interest, dividends, real property rents, gain from the sale of real property, income and gain from certain mineral or natural resource activities, and gain from sale of a capital or IRC Section 1231 asset.[[3]](#footnote-3) (“Passive-type income” for these purposes is different from income derived from a passive activity under the passive activity loss rules, see Q 8605).

The passive-type income exception is not available if the partnership would be treated as a regulated investment company[[4]](#footnote-4) if the partnership were a domestic corporation. The IRS has the authority to provide otherwise if the principal activity of the partnership involves certain commodity transactions.[[5]](#footnote-5)

A partnership that fails to meet the passive-type income requirement may be treated as continuing to meet the requirement if the following are true:

(1) the IRS finds that the failure was inadvertent;

(2) steps are taken so that the partnership once more meets the passive-type income requirement within a reasonable time after the discovery of the failure; and

(3) the partnership and each individual holder agree to make whatever adjustments or pay whatever amounts that the IRS may require with respect to the period in which the partnership inadvertently failed to meet the requirement.[[6]](#footnote-6)

A grandfather rule provided that partnerships that were publicly traded, or for which registrations were filed with certain regulatory agencies, on December 17, 1987 (“existing partnerships”), were exempt from treatment as a corporation until tax years beginning after 1997. Adding a substantial line of business to an existing partnership after December 17, 1987 would terminate the exemption. For purposes of the 90 percent passive-type income requirement above, an existing partnership is not treated as being in existence before the earlier of (1) the first taxable year beginning after 1997 or (2) such a termination of exemption due to the addition of a substantial new line of business. This means that an existing partnership was not required to meet the 90 percent requirement while it was exempt under the transitional rules in order to meet the 90 percent requirement when its exemption expired.[[7]](#footnote-7)

A publicly traded partnership taxed as a corporation under the above rules is treated, in general, as a taxable entity and tax benefits are taken at the entity level. Individual investors, therefore, are unable to realize certain tax benefits, such as depreciation deductions and tax credits, on their individual tax returns.

A publicly traded partnership that is taxed as a corporation should not be subject to the “at risk” rules (see Q 8597) or the “passive loss” rules (see Q 8603). Also, a publicly traded partnership would not qualify to make an election to be treated as an S corporation (see Q 8789).

See Q 8774 for safe harbor rules that can allow a partnership to avoid taxation as a publicly traded partnership. See Q 8779 for the tax rules that apply to corporations.

1. . IRC Sec. 7704(c)(1); Notice 98-3, 1998-1 CB 333. [↑](#footnote-ref-1)
2. . IRC Sec. 7704(f). [↑](#footnote-ref-2)
3. . IRC Sec. 7704(d)(1). [↑](#footnote-ref-3)
4. . See IRC Sec. 851(a). [↑](#footnote-ref-4)
5. . IRC Sec. 7704(c)(3). [↑](#footnote-ref-5)
6. . IRC Sec. 7704(e). [↑](#footnote-ref-6)
7. . TRA ’87, Sec. 10211(c), as amended by TAMRA ’88, Sec. 2004(f)(2). [↑](#footnote-ref-7)