IRS ADDRESSES TREATMENT OF PARTNERSHIP PROFITS INTEREST FOR SERVICES.

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Citations: Rev. Proc. 93-27; 1993-2 C.B. 343

Clarified by Rev. Proc. 2001-43

Rev. Proc. 93-27

SECTION 1. PURPOSE

This revenue procedure provides guidance on the treatment of the receipt of a partnership profits interest for services provided to or for the benefit of the partnership.

SEC. 2. DEFINITIONS

The following definitions apply for purposes of this revenue procedure.

.01 A capital interest is an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership. This determination generally is made at the time of receipt of the partnership interest.

.02 A profits interest is a partnership interest other than a capital interest.

SEC. 3. BACKGROUND

Under section 1.721-1(b)(1) of the Income Tax Regulations, the receipt of a partnership capital interest for services provided to or for the benefit of the partnership is taxable as compensation. On the other hand, the issue of whether the receipt of a partnership profits interest for services is taxable has been the subject of litigation. Most recently, in Campbell v. Commissioner, 943 F.2d 815 (8th Cir. 1991), the Eighth Circuit in dictum suggested that

the taxpayer's receipt of a partnership profits interest received for services was not taxable, but decided the case on valuation. Other courts have determined that in certain circumstances the receipt of a partnership profits interest for services is a taxable event under section 83 of the Internal Revenue Code. See, e.g., Campbell v. Commissioner, T.C.M. 1990-236, rev'd, 943 F.2d 815 (8th Cir. 1991); St. John v. United States, No. 82-1134 (C.D. Ill. Nov. 16, 1983). The courts have also found that typically the profits interest received has speculative or no determinable value at the time of receipt. See Campbell, 943 F.2d at 823; St. John. In Diamond v. Commissioner, 56 T.C. 530 (1971), aff'd, 492 F.2d 286 (7th Cir. 1974), however, the court assumed that the interest received by the taxpayer was a partnership profits interest and found the value of the interest was readily determinable. In that case, the interest was sold soon after receipt.

SEC. 4. APPLICATION

.01 Other than as provided below, if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the Internal Revenue Service will not treat the receipt of such an interest as a taxable event for the partner or the partnership.

.02 This revenue procedure does not apply:

(1) If the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease;

(2) If within two years of receipt, the partner disposes of the profits interest; or

(3) If the profits interest is a limited partnership interest in a "publicly traded partnership" within the meaning of section 7704(b) of the Internal Revenue Code.

DRAFTING INFORMATION

The principal author of this revenue procedure is Ann Veninga of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ann Veninga on (202) 622-3080 (not a toll-free call).