

ALERTS

Tax Law Alert - New IRS Guidance Takes Restrictive View Of Material Participation By Non-Grantor Trusts

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Recently published Technical Advice Memorandum 201317010 (the TAM) limits the circumstances in which a complex, non-grantor trust can materially participate in the activities of an S corporation. In the TAM, the IRS National Office concluded that a fiduciary's participation in the activities of a trust count only toward material participation to the extent the fiduciary participated in those activities in a fiduciary capacity. Although the TAM evaluated material participation for purposes of the alternative minimum tax rules, its reasoning would also apply to the passive activity loss and credit rules and the new 3.8 percent net investment income tax.

The TAM considered whether trust shareholders materially participated in the business activities of an S corporation and its subsidiaries. The trusts were complex trusts that had a Trustee and a Special Trustee. The Special Trustee was a beneficiary of the trusts, was a shareholder of the S corporation, and was the president of one of the S corporation's subsidiaries. The Special Trustee was permitted under the trust agreement to make all decisions regarding the sale or retention of the stock and all voting of the stock. The trusts argued that all of the Special Trustee's time spent in the activities of the S corporation (as fiduciary, shareholder, and employee) should be considered. The IRS National Office concluded that only time spent by Special Trustee in his fiduciary capacity (for example, voting the trusts' S corporation stock) counted toward the trusts' material participation in the S corporation's activities.

The TAM's conclusion is at odds with the only judicial authority on this issue in *Mattie K. Carter Trust v. U.S.*, 256 F.Supp.2d 536 (N.D. Tex. 2003). Although technical advice memorandums like the TAM are not precedential, given the lack of authoritative guidance on how trusts materially participate, any new pronouncement is significant because it shows that this issue is far from resolved. The TAM also highlights the increasing importance of the issue of material participation by trusts due to the 3.8 percent net investment income tax.

We have experience dealing with this issue. For more information, contact the Barnes & Thornburg attorney with whom you work, or Randal Kaltenmark at randal.kaltenmark@btlaw.com

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