

FLORIDA BAR TAX SECTION MEETING

Recent Developments Concerning Partnership Tax
Including Leveraged Partnerships, COD Income and Tax
Credits - October 13, 2012

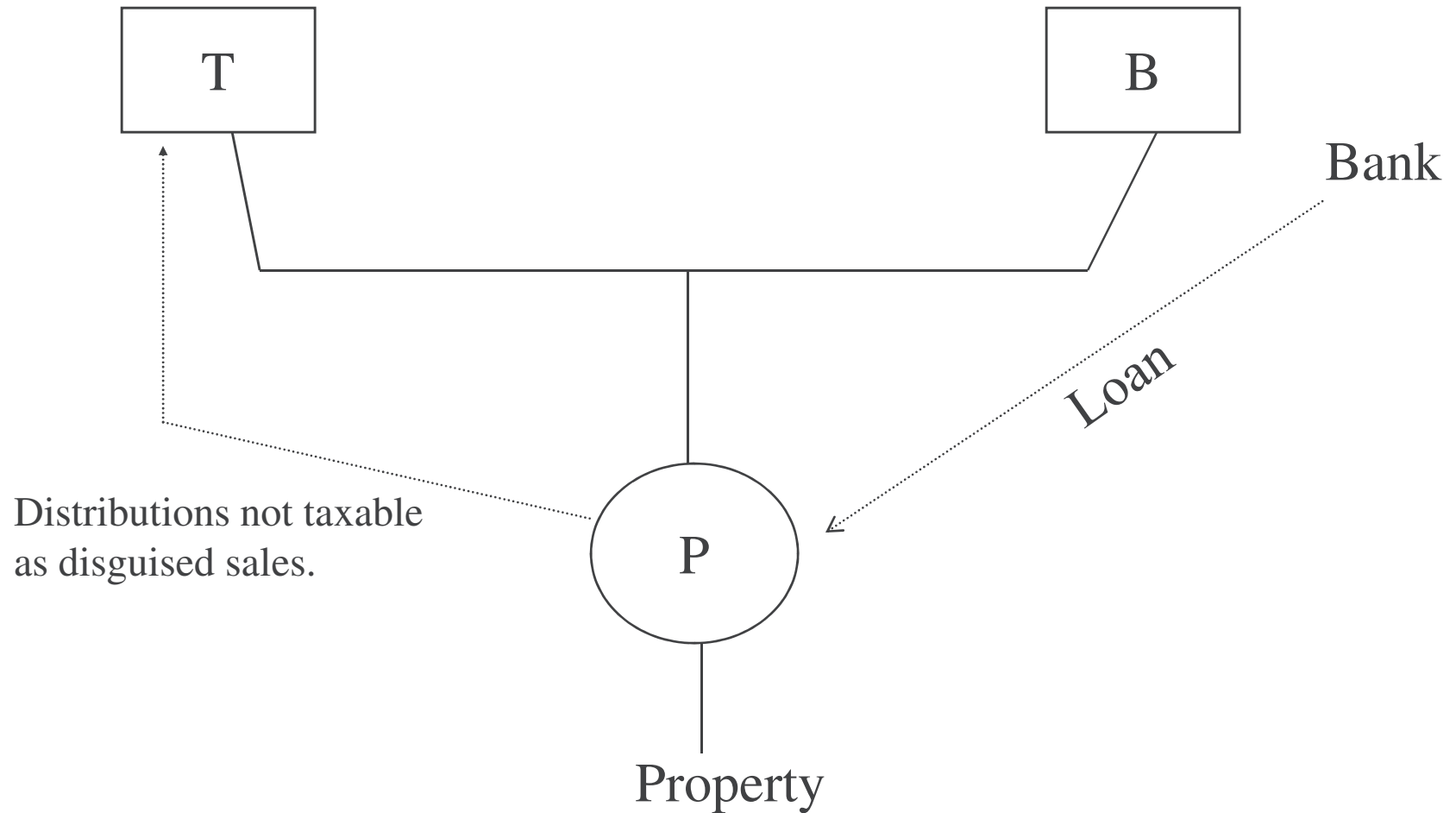
James Barrett, Esq., Baker & McKenzie LLP

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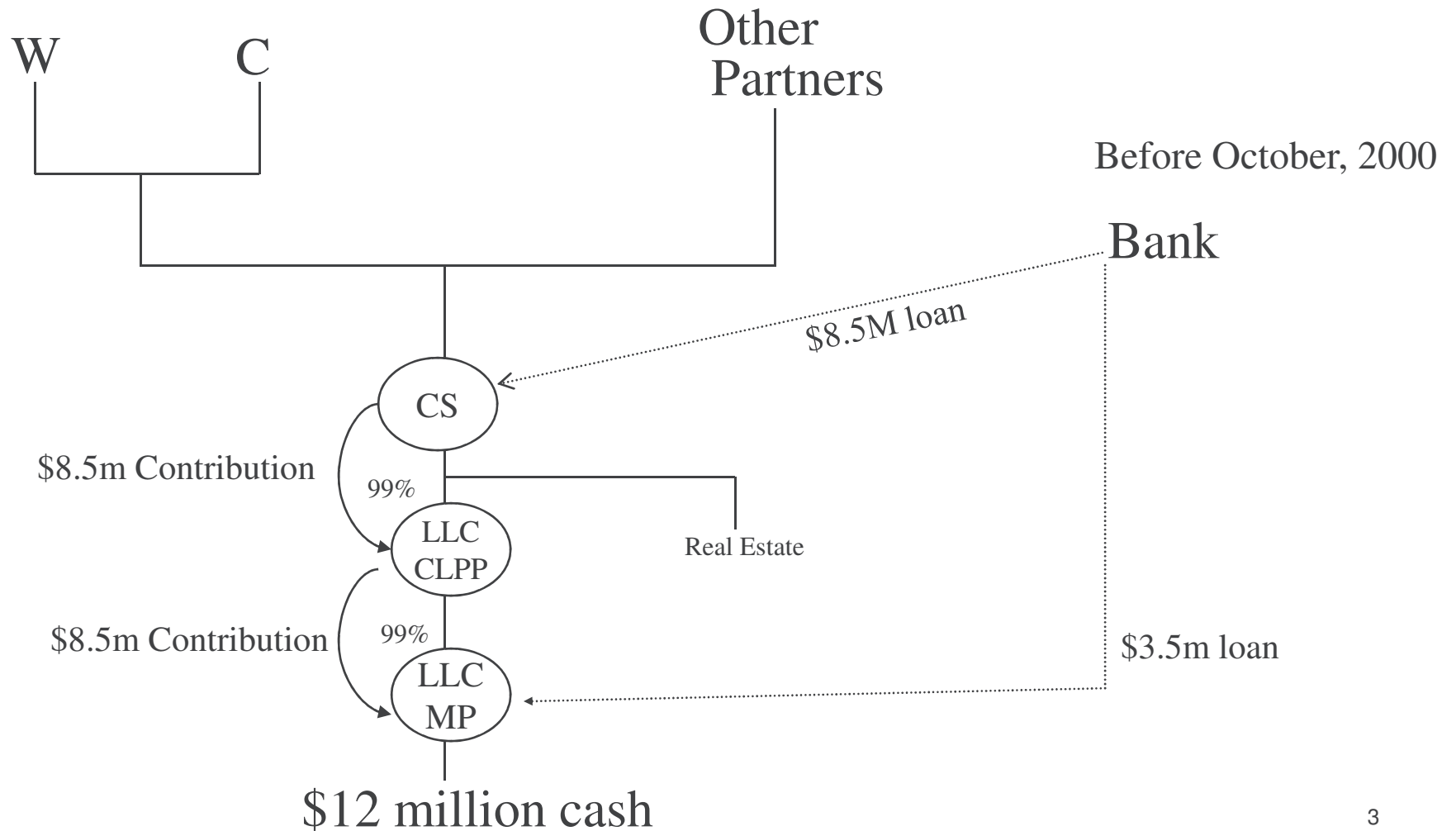
Distribution of In Kind Assets

Leveraging – Non Sale Distributions

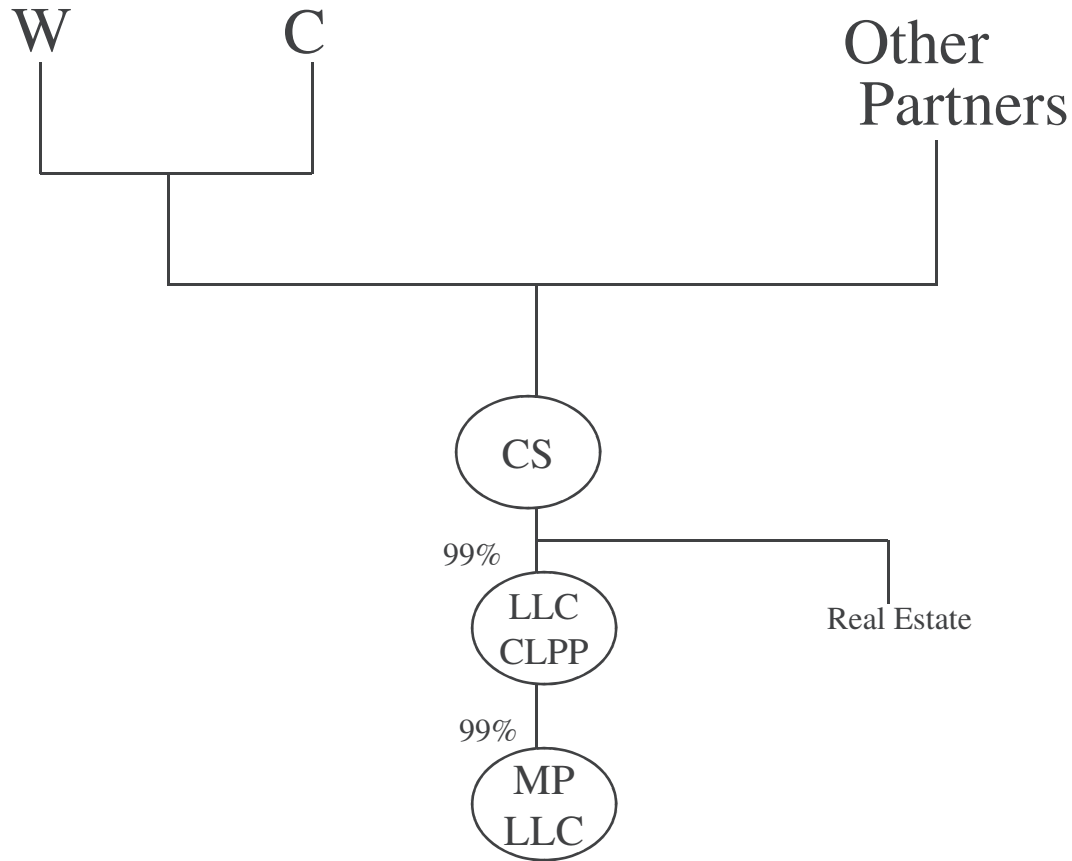
Code Sections 707, 731 and 752



Countryside Limited Partnership v. Commissioner, (U.S. Tax Court, January 2, 2008).



Countryside Limited Partnership

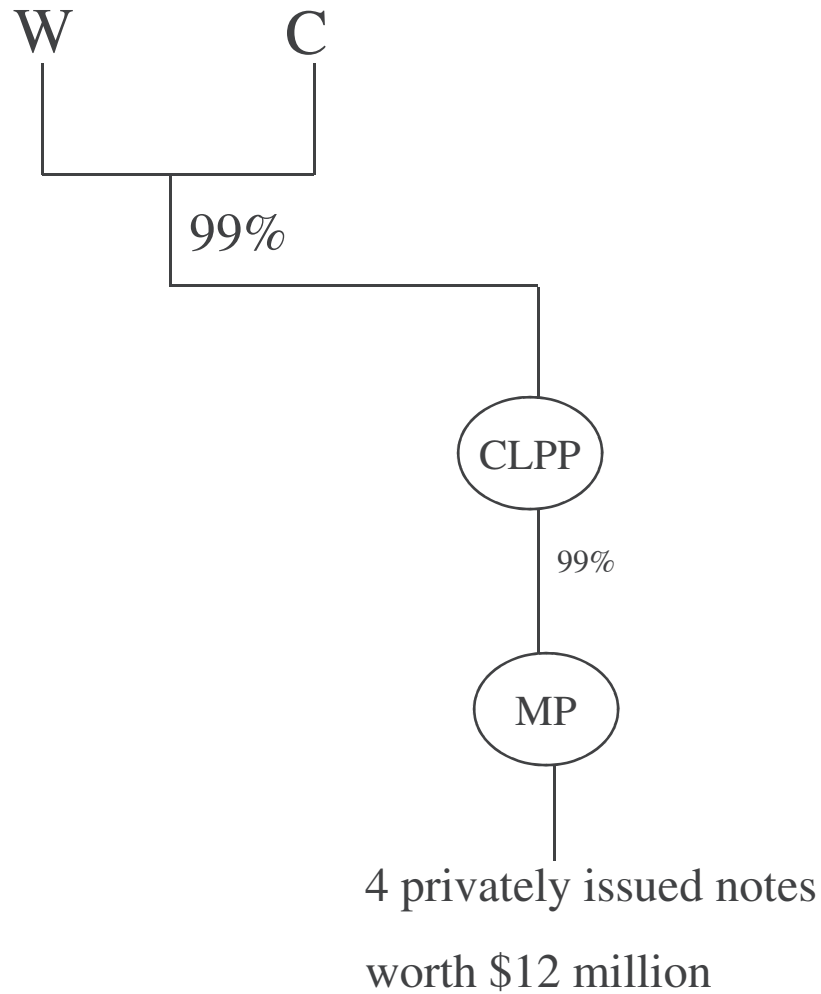


October, 2000

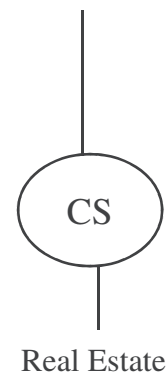
\$12 million

4 privately issued notes from AIG

Countryside Limited Partnership

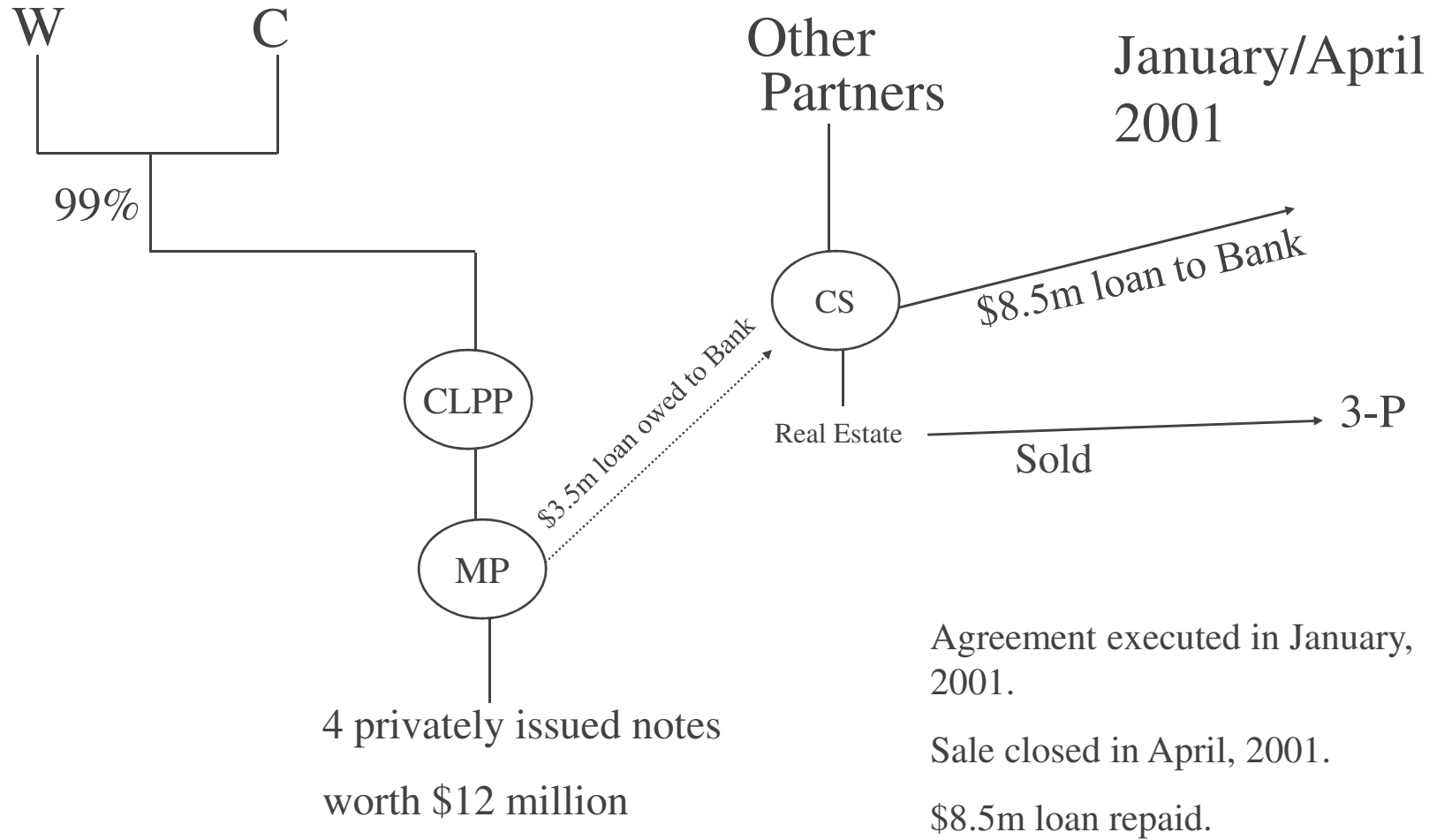


Other
Partners

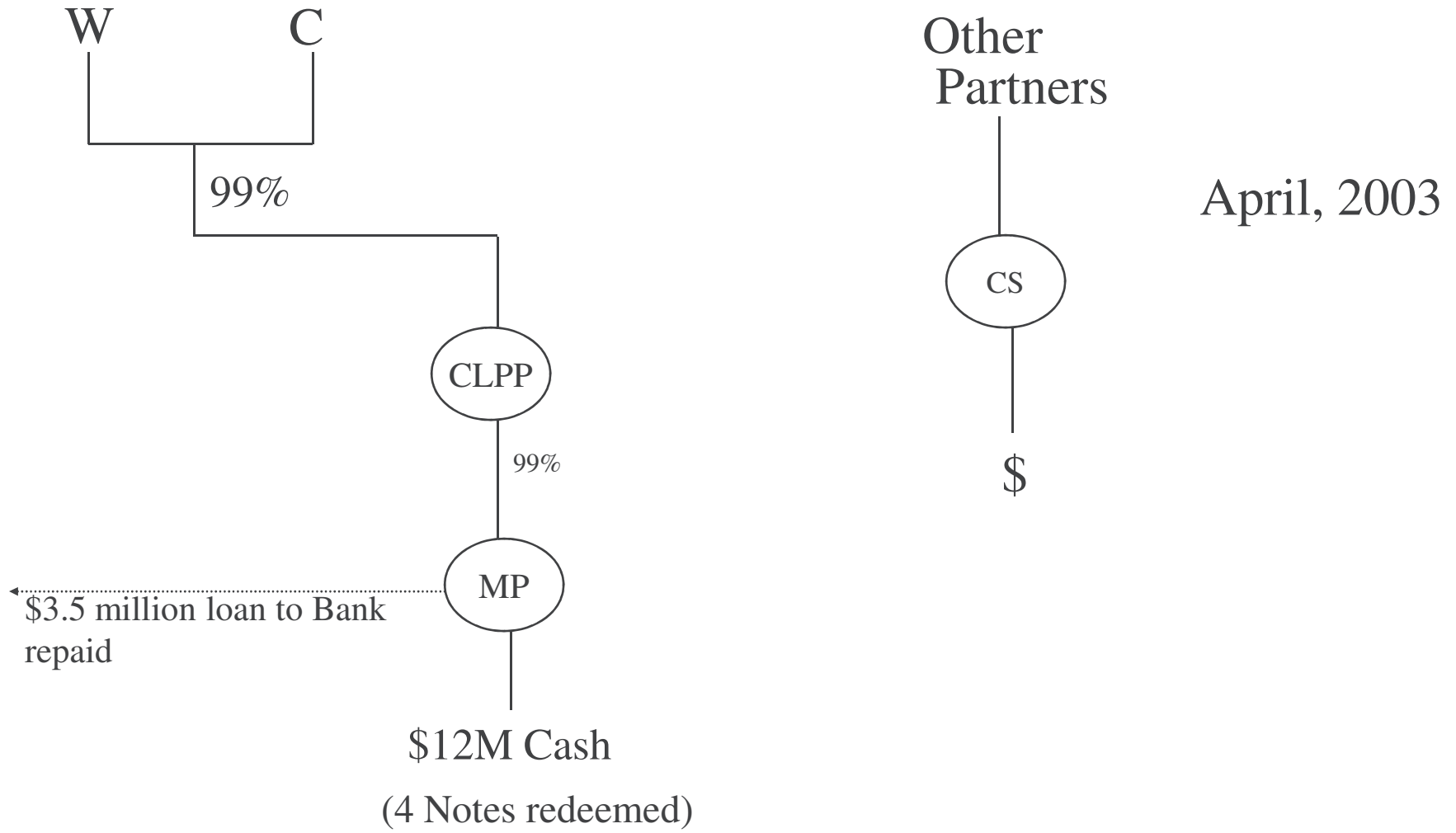


December, 2000

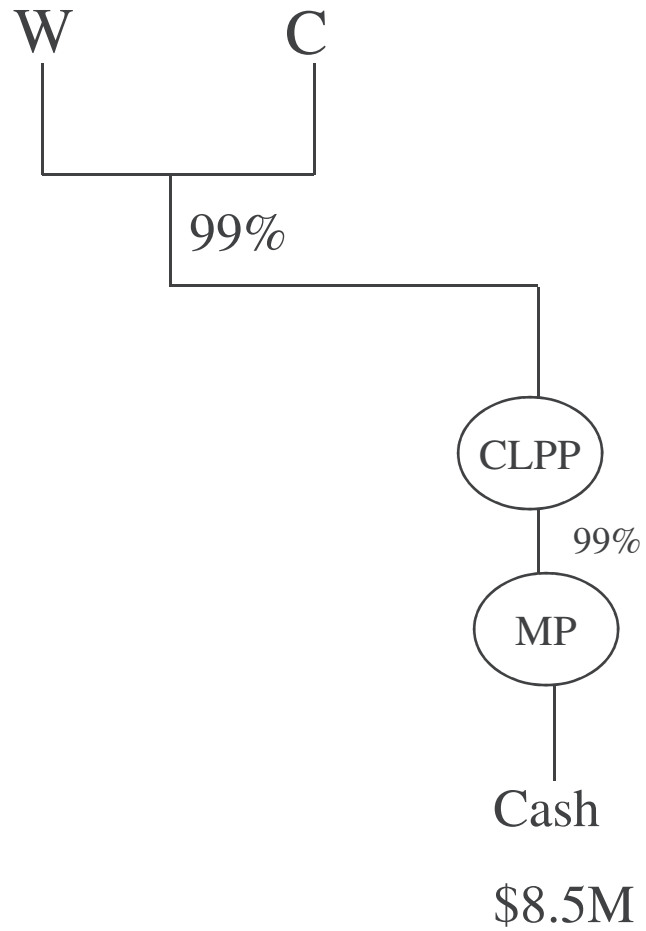
Countryside Limited Partnership



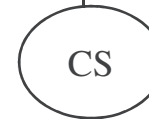
Countryside Limited Partnership



Countryside Limited Partnership



Other Partners




January, 2004

\$



Countryside Limited Partnership

- Transactions possessed sufficient economic substance –
 - Accomplished a legitimate business purpose
 - Resulted in a change in the partners' relative economic position
- Privately – issued notes were not marketable securities under Code § 731(c)

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- Cf. CCA 200650014 (September 7, 2006)
 - House purchased by partnership in a single member LLC
 - LLC with house to be refinanced and distributed to retiring partner
 - If unable to refinance, partnership to sell house and distribute net proceeds (after repayment of loan) to retiring partner
 - Partnership deemed not to be owner of house but to have distributed cash (i.e. funds used to purchase house) to retiring partner




CCA 200650014

- Reasons
 - House not beneficially owned by LLC
 - Partnership anti-abuse rules: Treas. Reg. § 1.702-1.
 - Step Transaction Doctrine

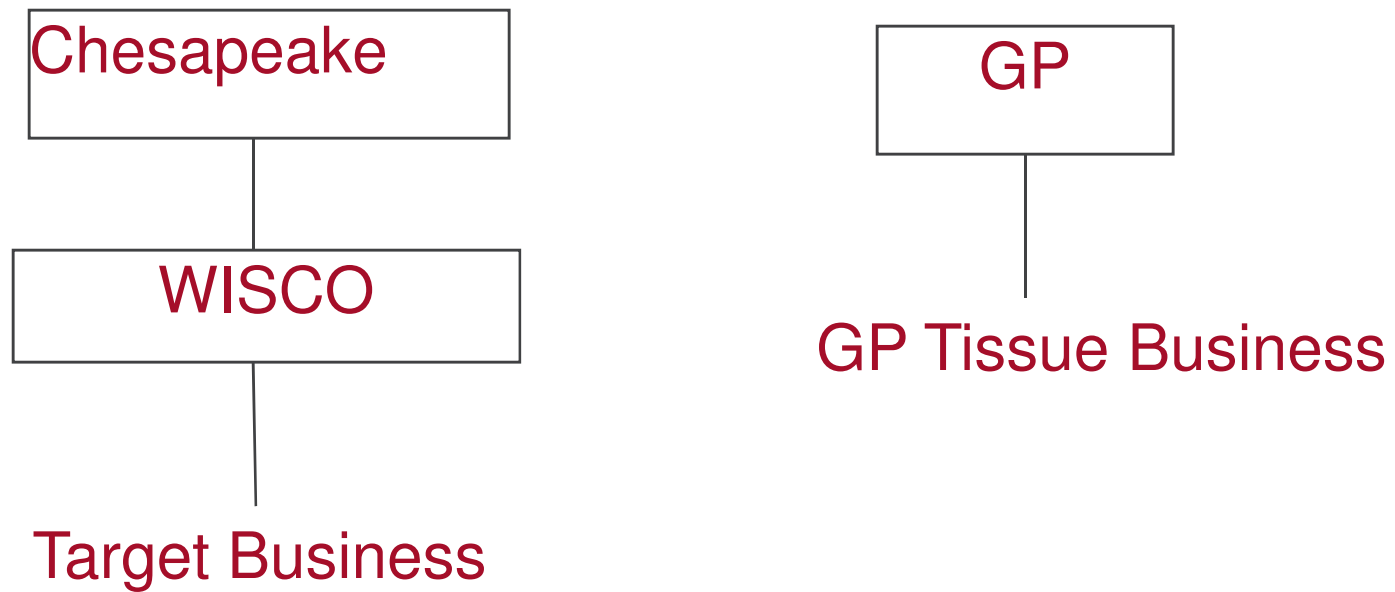


CCA 200650014

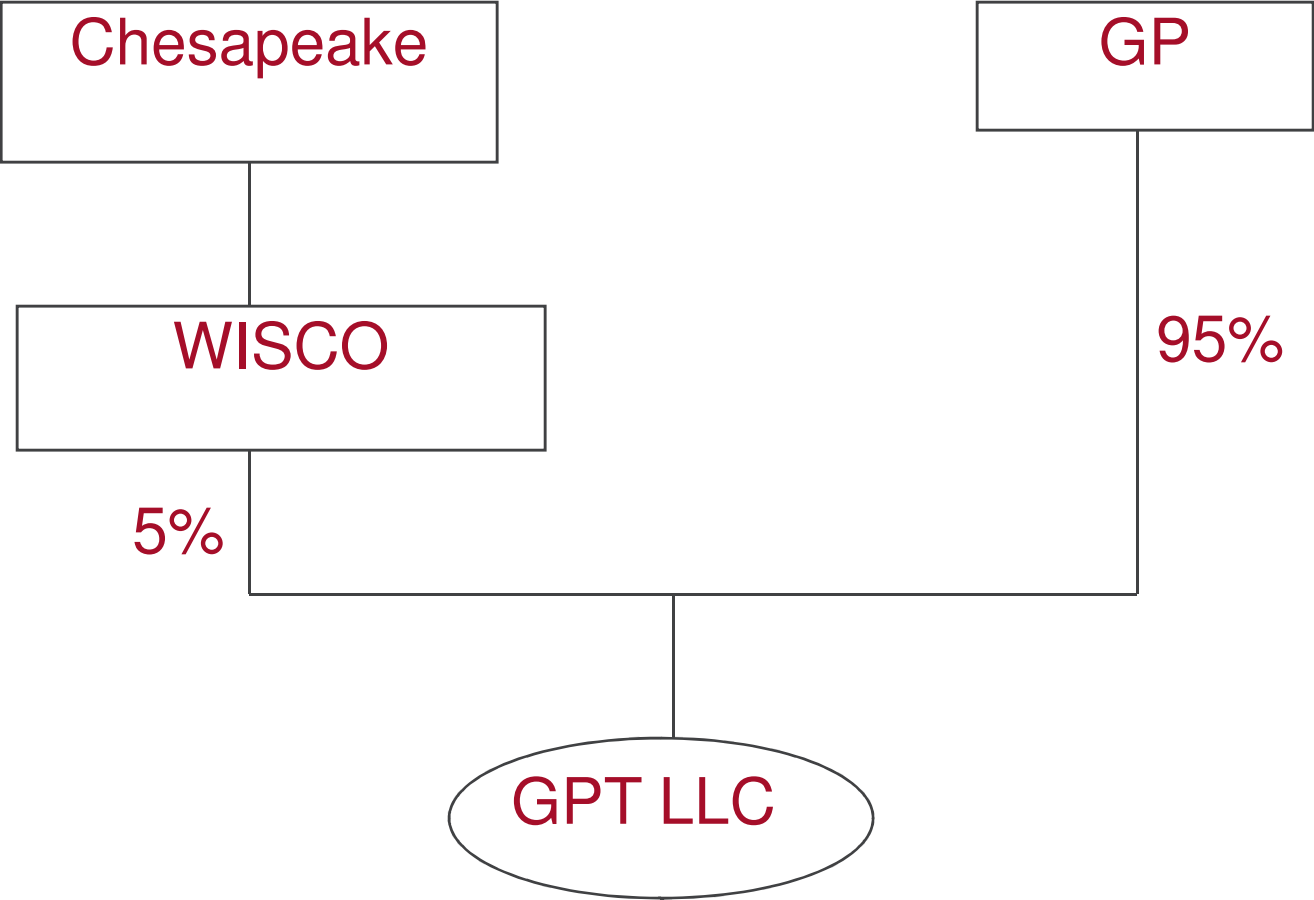
- Planning Thoughts
 - Timing of Property Purchase and Redemption Discussions
 - Indicia of Ownership for Partnership in distributed assets before distribution
 - Investment assets less conservative
 - Meaningful change in economic conditions of the partners

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- Note – *Canal Corporation v. Commissioner*, 135 T.C. No. 9 (2010). Recent case applying Code § 752 anti-abuse rule to thinly capitalized subsidiary [Treas. Reg. § 1.752-2 (j).]

CANAL CORP.



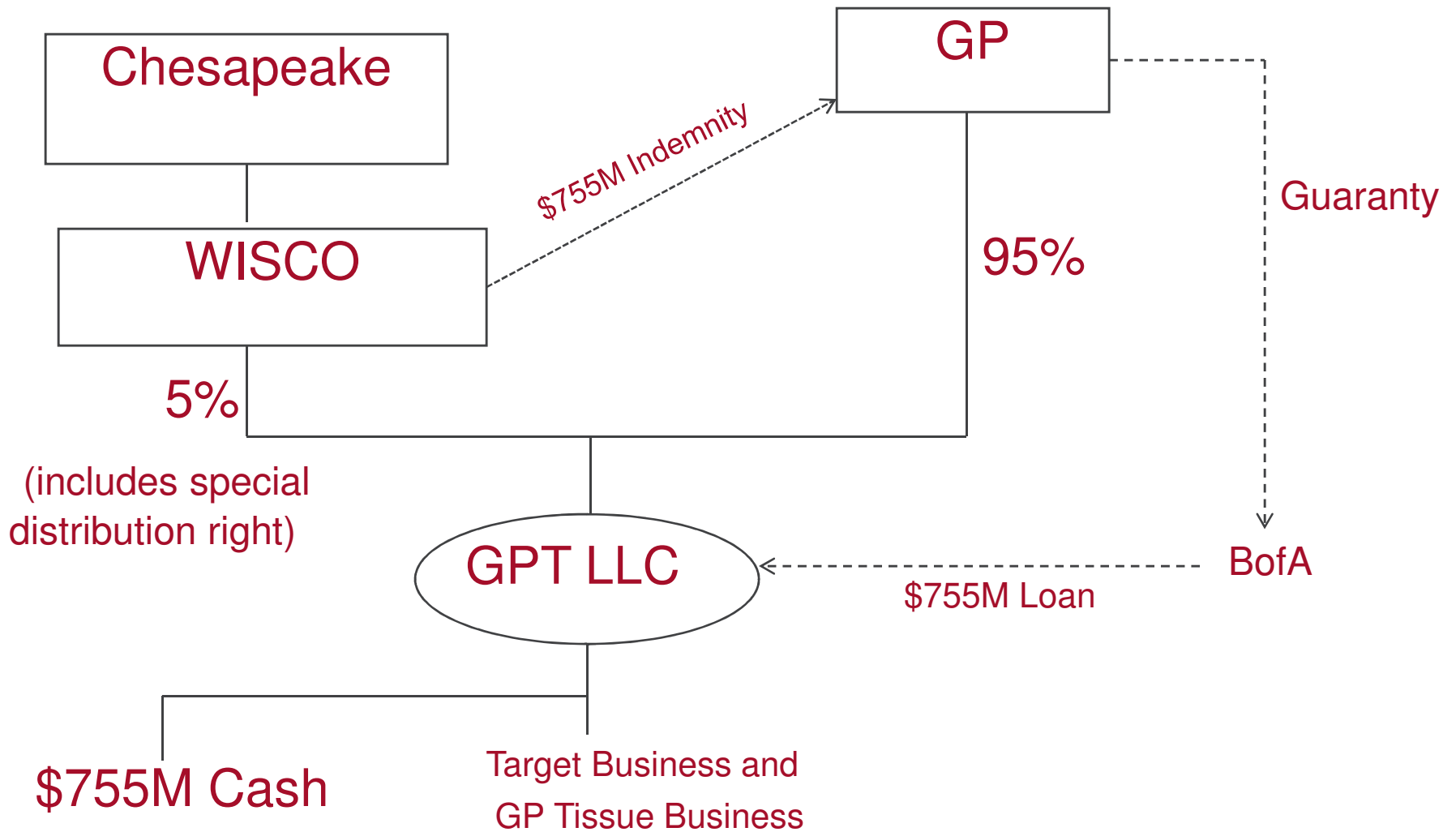
CANAL CORP.



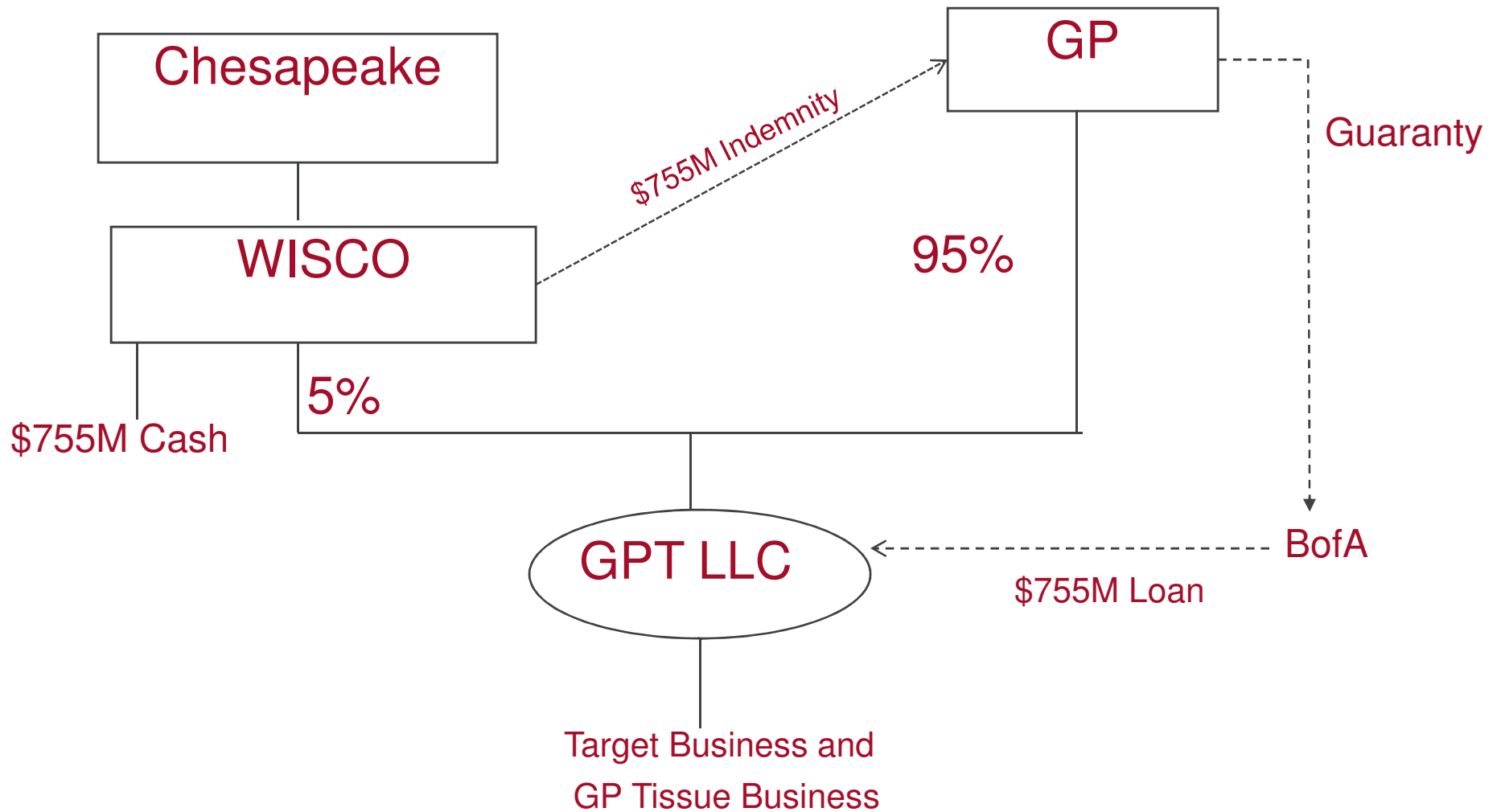
Target Business and GP Tissue Business

1999

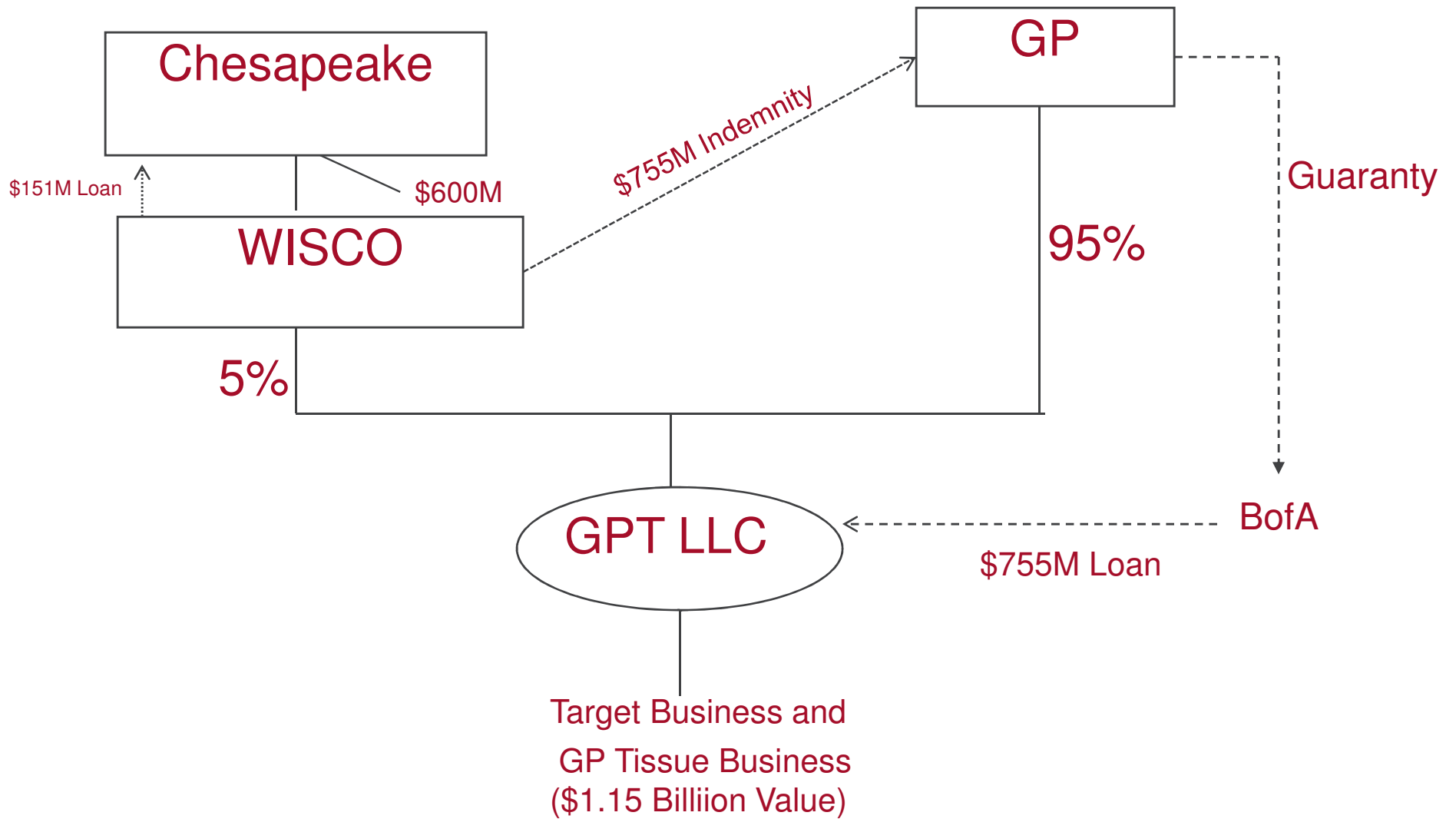
CANAL CORP.



CANAL CORP.

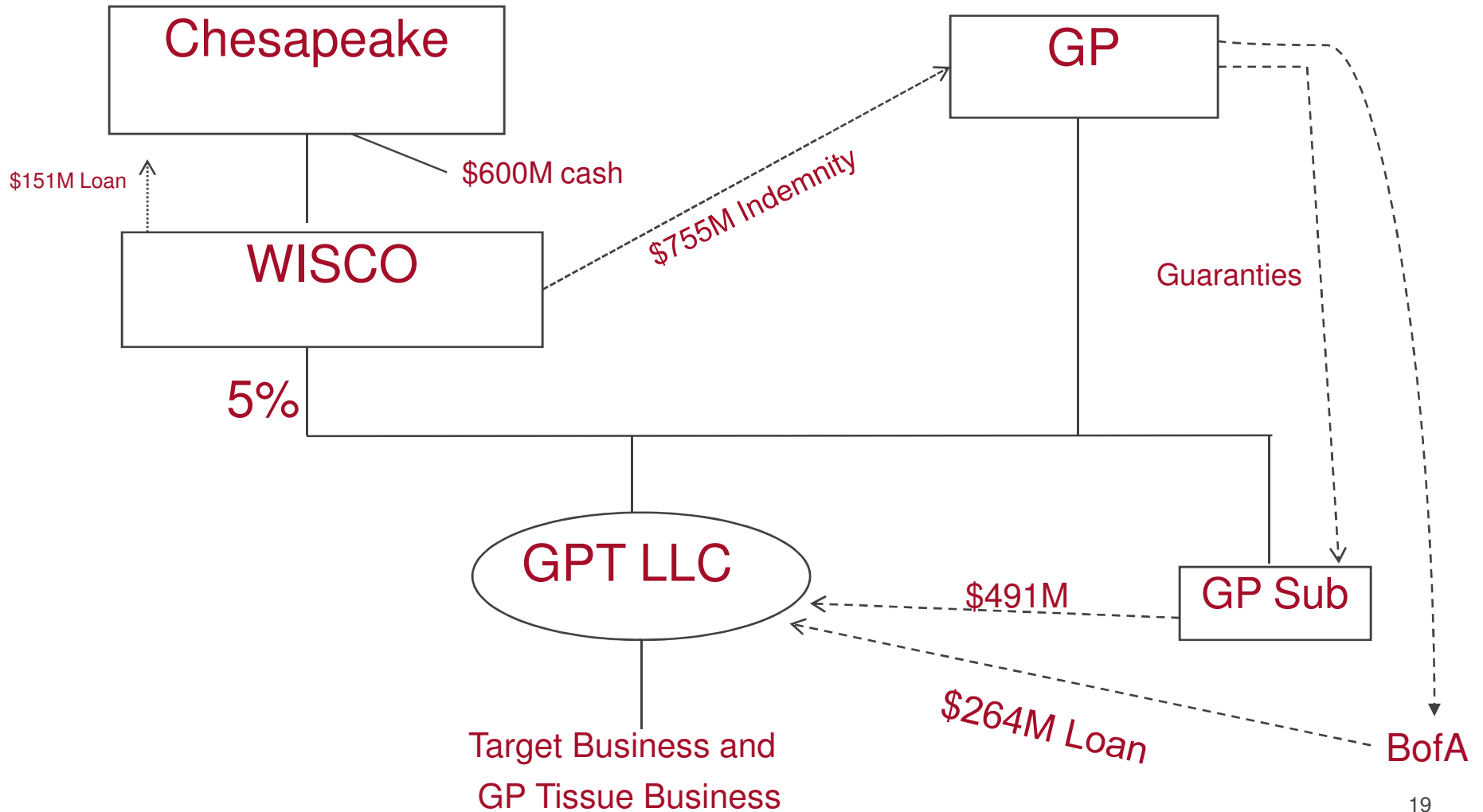


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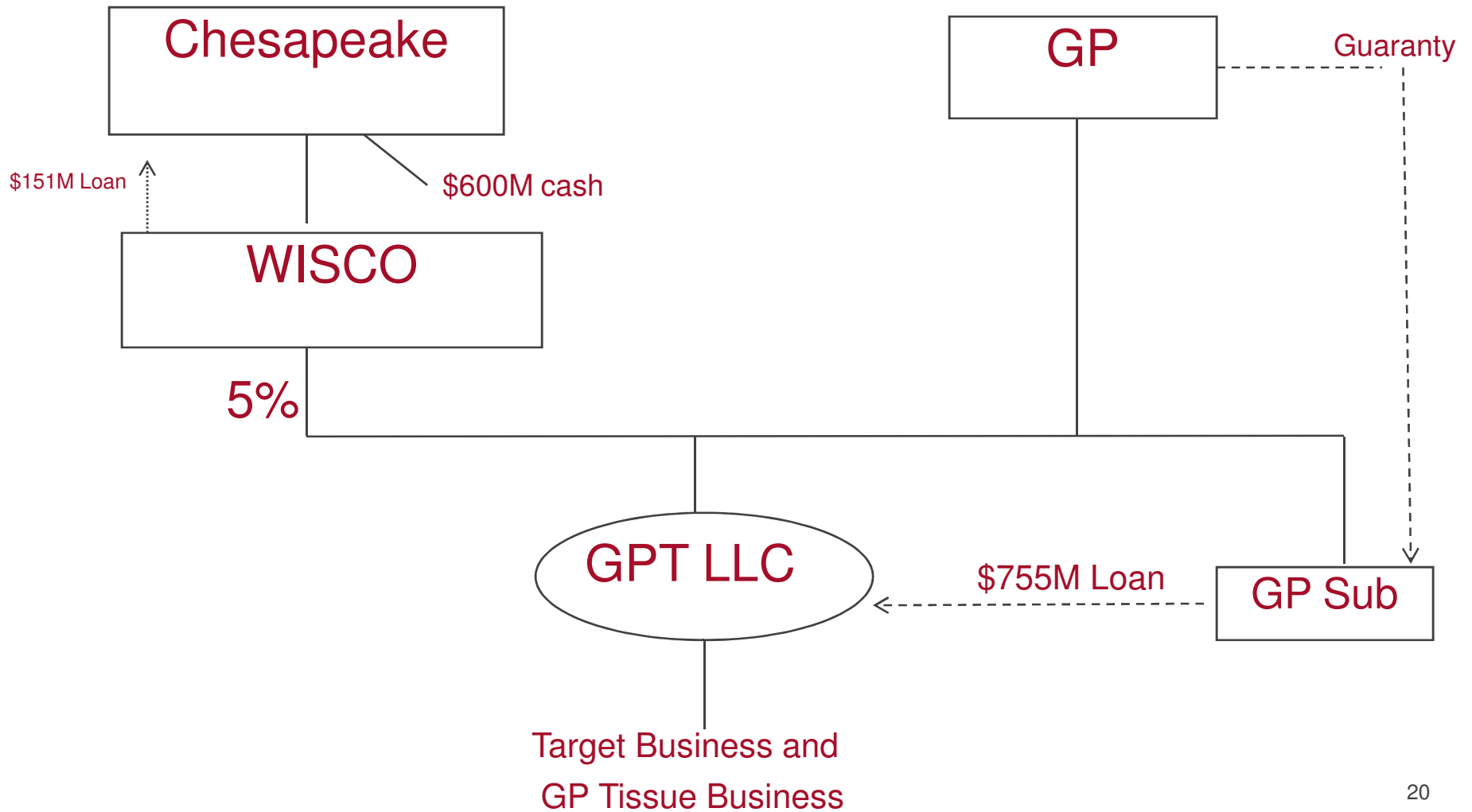
One Month Later

CANAL CORP.



One Year Later (2000)

CANAL CORP.





CANAL CORP.

Two Years Later (2001)

- For antitrust reasons, GP purchases WISCO's interest in GPT LLC for \$41M. GP then sells entire interest to unrelated third party.
- Triggered deferred gain of \$524M for WISCO.
- GP paid WISCO \$196M for lost tax deferral from termination of partnership.
- Chesapeake cancelled the \$151M loan to WICSO.

CANAL CORP.

Gain Accelerated to 1999

- Disguised sale of partnership interest Code § 707(a)(2)(B).
- WISCO not allocated \$755M liability under Code §752.
- WISCO's value only 21% of liability.
- WISCO's indemnity – only claimable after proceeding against GPT LLC's assets.
- Potential fraudulent conveyance claim against Chesapeake not relevant.

CANAL CORP.

COMMENTS

- Basic plan to borrow and distribute to WISCO viable.
- 100% net worth in indemnitor (i.e. WISCO and Chesapeake).
- Form of obligations necessary (i.e. fraudulent conveyance claim).
- Funding by qualified debt under Treas. Reg. § 1.707-5 should be considered:
 - incurred by partnership more than 2 years before redemption of partner.
 - property encumbering contributed property.
 - liability of partnership incurred to purchase capital assets.
 - ordinary course trade or business liability.

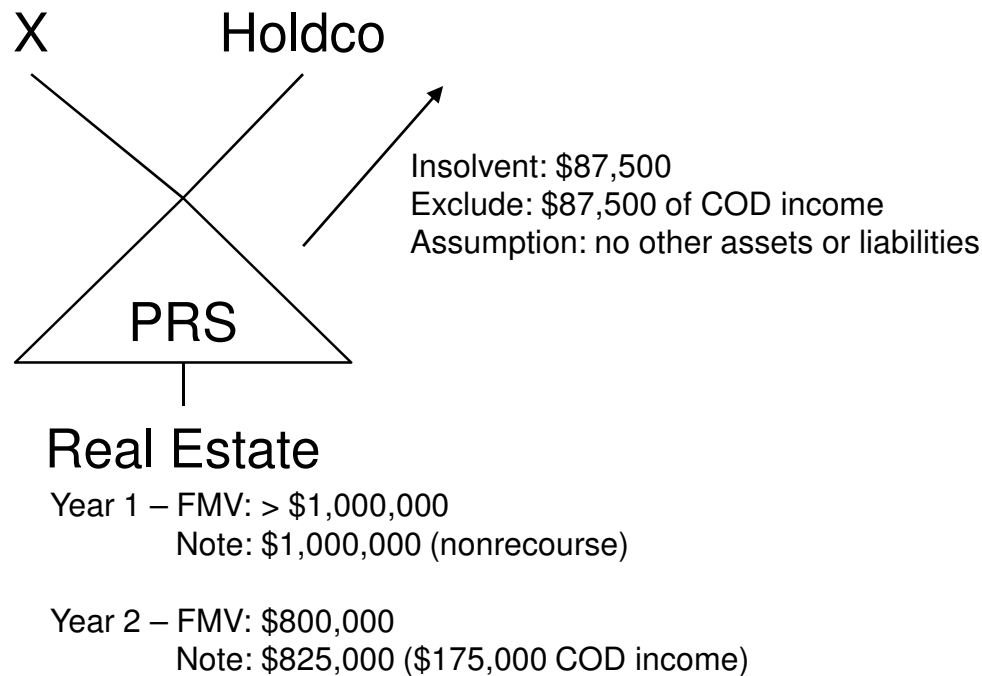
Income From Discharge of Indebtedness

Insolvency Exclusion §108

1. §61(a)(12) - Gross Income includes income from discharge of indebtedness.
2. §108(a)(1)(B) - Exclusion of discharged indebtedness from gross income if taxpayer insolvent.
3. §108(d)(3) - Insolvent means excess of liabilities over FMV of assets; "determined on the basis of the taxpayer's assets and liabilities."
4. §108(d)(1) - "indebtedness of the taxpayer" means indebtedness (i) for which taxpayer is liable, or (ii) subject to which the taxpayer holds property.
5. §108(d)(6) - in partnership context, look at partner level.
6. Rev. Rul. 92-53 - discharged excess nonrecourse debt treated as a liability.

Rev. Rul. 2012-14

Income from Discharge of Debt – Insolvency Exclusion



*For purposes of measuring the insolvency of the partners, PRS's discharged excess nonrecourse debt is treated as a liability of its partners based upon the COD income allocation. Thus X and Holdco treat their share of cancelled PRS excess nonrecourse debt as their own liabilities in determining whether, and to what extent, each is insolvent within the meaning of §108(d)(3).

CONTRIBUTION ISSUES

Excess Liability Allocations

- Non-recourse liability:
 - 3 – part test (Treas. Reg. § 1.752-3(a))
 - Minimum gain chargeback.
 - Code § 704(c) gain.
 - Excess nonrecourse liabilities - Profits – flexibility.

Historic Boardwalk Hall, LLC

110 AFTR 2d 2012 - _____ (August 27, 2012) (Third Cir.)

- Ability to claim historic rehabilitation tax credits (“HRTC’s”) – Code § 47.
- Renovation of East Hall in:
 - Atlantic City – investment by Pitney Bowes (“PB”).
 - Application of economic substance for policy driven tax credits:
 - Legislative history to 2010 Codification of Economic substance includes the following: If the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate, it is not intended that such tax benefits be disallowed...Thus, for example, it is not intended that a tax credit (e.g. Section 47[, which provides for HRTCs,]...) be disallowed in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage.



Historic Boardwalk

- Puts and Options to purchase PB interest after 12 months.
- Guaranteed by New Jersey Sports and Exposition Authority (a NJ state agency) (“NJSEA”).
- HRTC Tax Benefits from HRTC guaranteed by NJSEA.

Historic Boardwalk

- Substance – PB purchasing HRTC's from Historic Boardwalk LLC. See *Va. Historic Tax Credit Fund 2001 LP*, 639 F. 3d 129 (4th 2011).
 - No true entrepreneurial risk facing investor.
 - Tax benefit of tax credits guaranteed.
 - Finally funded construction before PB investment.
 - Lack of meaningful upside potential.
 - Application of substance over form.

Historic Boardwalk

- Tax Court Decision Reversed.
- Pitney Bowes not deemed a bona fide equity partner.
- Partnership: 2 partners, in good faith, and acting for a business purpose, intending to join together in the present conduct of the enterprise.
- Reasonable expectation of repayment without regard to success of entity.
 - ability by partnership to restrict upside. See *Castle Harbor*, 459 F. 2d 220 (2nd Cir. 2006).