



# nerej

## **Relief, not a cure: IRS provides help for partnerships allocating historic rehabilitation tax credits**

January 23, 2014 - Retail

The Internal Revenue Service issued Revenue Procedure 2004-12 to provide partnerships and partners more predictability about allocating historic rehabilitation tax credits. Uncertainty produced by the Third Circuit Court of Appeals opinion in *Historic Boardwalk Hall, LLC v. Commissioner* (Historic Boardwalk) prompted the IRS to issue the Revenue Procedure. This article provides background and a general understanding about the reasons for taxpayer uncertainty and the IRS's response.

An historic rehabilitation tax credit of a tax partnership can be allocated only to the partnership's tax partners. Federal income tax law defines (broadly speaking) what it means to be a tax partner. It is not what you think. We think a partner means a general partner or a limited partner, and we think a partnership is a venture of general partners and, sometimes, limited partners. This, however, is the business meaning, not the tax law meaning. The tax law definition is, in some ways, narrower, preventing taxpayers from reducing taxes by creating a partnership (in the business sense) without actually jointly conducting a business, financial operation, or venture. In short, a person is a tax partner only if it bears some entrepreneurial risk and also shares meaningfully in profits. And that brings us to Historic Boardwalk.

The court in *Historic Boardwalk* determined that the credit investor who was allocated most of the historic rehabilitation tax credits was not a tax partner of a tax partnership because the credit investor had no meaningful stake in either the success or failure of the partnership venture. Through a series of funded accounts and contractual protections, the partnership, according to the court, effectively eliminated the investor's risk of investment loss. Further, the partnership distribution provisions provided what the court termed only a remote possibility that the investor would participate in partnership profits (other than the preferred return, which was fixed and guaranteed). Though a limited partner for business purposes, the credit investor was not a partner for income tax purposes. As a consequence, the tax credit could not be allocated to the credit investor.

Historic tax credit partnership structures commonly employ features to mitigate the investment risk of tax credit investors and also limit their share of certain profits. Historic Boardwalk and the prevailing arguments of the IRS left many searching for parameters of acceptable deal structure features. The IRS issued Revenue Procedure 2014-12 to provide some guidance and certainty for those structuring historic rehabilitation tax credit partnerships. It does provide guidance and certainty, but, only provisional guidance and limited certainty. The Revenue Procedure is not a statement of law. It states the IRS's administrative position; it can be changed at any time. Further, the Revenue Procedure applies only to tax partnerships structured according to the Revenue Procedure's safe harbor. If you stray at all from the safe harbor, you cannot rely on the Revenue Procedure.

Some of the key requirements of the Revenue Procedure (paraphrased) include:

- \* The tax credit investor's reasonably anticipated partnership interest value
  - must depend on the partnership's net income, gain, and loss,
  - cannot be substantially fixed in amount, and
  - must be commensurate with its overall percentage interest in the partnership;
- \* The tax credit investor cannot be substantially protected from losses from partnership activities;
- \* The tax credit investor's interest cannot be reduced in value by financial arrangements on terms that are not arm's length;
- \* The tax credit investor must maintain an investment in the partnership of at least 20% of its total investment for so long as it holds a partnership interest;
- \* All guaranties from the partnership, the general partner, or any related persons must be unfunded guaranties;
- \* No person may contract to make the tax credit investor whole for the value of the tax credit if the IRS determines that the tax credit investor is not a tax partner or is not otherwise entitled to the credit allocation.

While you may decline to use the safe harbor of the Revenue Procedure to structure the terms of your next historic rehabilitation tax credit partnership, the Revenue Procedure provides taxpayers some insight about the IRS's views on historic rehabilitation tax credit structures. The Revenue Procedure is not a panacea - and it's not meant to be - but, it is welcome guidance.

Christopher McLoon is an attorney at Verrill Dana LLP, which has offices in Maine, Mass., Conn., R.I. and Washington, D.C.