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Historic rehabilitation tax credit redux

December 24, 2014 - Front Section

In July 2013, this column noted that developers whose projects utilize historic rehabilitation tax credits had high hopes that the Internal Revenue Service would soon introduce guidance that would provide comfort to their investors. Earlier this year, the IRS did issue guidance in the form of Revenue Procedure 2014-12. Developers would be well advised to read that revenue procedure and obtain legal advice as to how to comply with it.

However, developers should also be aware that the IRS is still challenging partnerships that were formed prior to 2014 to determine whether they are "true partnerships" based upon a Third Circuit Appeals case. In August 2012, the United States Court of Appeals for the Third Circuit ruled in *Historic Boardwalk Hall v. Commissioner* that an investor in a syndicated partnership sharing in federal historic tax credits was not a bona fide partner and that the partnership was not a true partnership.

To be a bona fide partner, the investor was required to share in both the upside benefits and the downside risks of loss. The court determined that the investor in question lacked any meaningful downside risk for several reasons. First, the investor joined the partnership after the partnership had already committed sufficient funding to pay the costs of the project. Second, the investor did not make its capital contribution to the partnership until after the historic credits had been certified and were available to the investor. Third, the court focused on the fact that the partnership and the New Jersey Sports and Exhibition Authority had given guarantees which protected the investor from loss arising from failure to complete the construction, environmental liabilities and any loss or reduction of the tax credits.

Finally, a letter of credit secured the payment of the investor's preferred return and a loan made to the partnership by the investor.

While developers utilizing historic tax credits should primarily focus on the guidance set out in Revenue Procedure 2014-12, it is critical that they do not forget the Boardwalk Hall ruling. That ruling truly sets out the traps for the unwary developer and should be a constant reminder that the investors need to have some form of risk and benefit in the partnership.

John Varella is an attorney with Lourie & Cutler, Boston, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540