

Tax credit battle continues

June 25, 2015 - Front Section

The tax credit battle continues between the Internal Revenue Service and developers who allocated tax credits to investors. 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. As a result, the investor was not permitted to use its allocated tax credits. That decision led to an outcry from the historic tax credit industry, and, in response, the IRS issued guidance in 2014 that provided some helpful guidance to the industry but did not override the reasoning of the Third Circuit.

The Historic Boardwalk Court stated that, 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.

Now, the Third Circuit is considering another reasoning to unwind a tax credit partnership, the concept that the allocation of the credits was a disguised sale. In Route 231, LLC v. Commissioner, the Third Circuit is being asked to determine whether a multi-million dollar capital contribution made to a partnership by an investor should be treated as a disguised sale of state tax credits to the investor. If the Court determines that the capital contribution was, in fact, payment of purchase price in exchange for the tax credits, then ordinary income will need to be recognized on the sale- an unexpected and potentially disastrous result for the taxpayer.

This column will provide an update on this case as it evolves. Regardless of the decision in that case, however, it is apparent more than ever that complying with the partnership tax rules is incredibly important for securing tax credits.

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