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Disposing of Overleveraged Real Estate: Thinking Outside the Box

Blake D. Rubin

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Disposing of Overleveraged Real Estate: Thinking Outside the Box

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The Property
VALUE $100
BASIS $40
NONRE COURSE DEBT $99
(10 YRS.)
RE MAINING DEPRECIABLE LIFE 10 YEARS
NEW DEPRECIABLE LIFE 39 YEARS

Outright Sale
AMOUNT REALIZED:
CASH PROCEEDS $1.00
DEBT $59.00
TOTAL $60.00
ADJUSTED BASIS $40.00
GAIN $60.00
TAX RATE x .25
TAX LIABILITY $15.00
AFTER-TAX PROCEEDS ($14.00)
### Installment Sale Subject to First Mortgage

- **BUYER** TAKES PROPERTY SUBJECT TO $99 FIRST MORTGAGE, AND GIVES SELLER $1 NOTE PAYABLE, $.10 PER YEAR FOR 10 YEARS.

### SELLING PRICE

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit</td>
<td>$60</td>
</tr>
<tr>
<td>Contract Price</td>
<td>$60</td>
</tr>
<tr>
<td>Gross Profit Ratio</td>
<td>60/60</td>
</tr>
</tbody>
</table>

### Payment in Year 1:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>$59.00</td>
</tr>
<tr>
<td>Cash</td>
<td>.10</td>
</tr>
<tr>
<td>Total</td>
<td>$59.10</td>
</tr>
</tbody>
</table>

### Gain in Year 1

$59.10

### Gain in Years 2-10

$.90
Installment Sale Wraparound Mortgage

- BUYER GIVES SELLER $100 "WRAPAROUND" MORTGAGE; SELLER AGREES TO PAY $99 FIRST MORTGAGE

Installment Sale Wraparound Mortgage

SELLING PRICE $100
GROSS PROFIT $60
CONTRACT PRICE $100
GROSS PROFIT RATIO 60/100
PAYMENT IN YEAR 1:
DEBT $0
CASH $10.00
TOTAL $10.00

Installment Sale Wraparound Mortgage

PAYMENT IN YEAR 1 $10.00
GROSS PROFIT RATIO x .60
GAIN IN YEAR 1 $6.00
GAIN IN YEARS 2-10 $54.00
Pre-Foreclosure
Like-Kind Exchange

A
$10 Value
$40 Basis
$100 Liab.

B
$100

Bank

Q.I.
Pre-Foreclosure
Like-Kind Exchange

A $10 CASH
Prop. B Value $120
B $10 CASH
$60 Basis Liab. $100

Q.I.
1. Partnership holds Prop. B with low basis; Q.I. recognizes no gain on foreclosure.
2. Is there an "exchange" when Prop. A has no equity value?

Partnership Admission
With Book-Up

Old Partners
1%
Partnership

New Partners
99%
$1

Partnership

ARNOLD & PORTER LLP

Partnership Admission
With Book-Up

<table>
<thead>
<tr>
<th>TAX</th>
<th>BOOK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prop. 40 100 Debt</td>
<td>Prop. 100 100 Debt</td>
</tr>
<tr>
<td>Cash 1</td>
<td>Cash 1</td>
</tr>
</tbody>
</table>

| | |
| 1 New | 1 New |
| (60) Old | 0 Old |

ARNOLD & PORTER LLP
Sec. 704(c) Consequences: Traditional Method

- NEW PARTNERS RECEIVE $4/YEAR DEPRECIATION FOR 10 YEARS
- OLD PARTNERS RECOGNIZE $5.54 CAPITAL GAIN IN YEAR 1, $5.94/YEAR CAPITAL GAIN IN YEARS 1-10 UNDER SECS. 752(b) AND 731

Sec. 704(c) Consequences: Traditional Method

- SEC. 734(b) ADJUSTMENT REDUCES SEC. 704(c) GAIN
- “CYCLOTRON” PROBLEM? REDUCTION IN SEC. 704(c) GAIN REDUCES SECOND TIER SEC. 752 ALLOCATION, TRIGGERING ADDITIONAL GAIN, WHICH TRIGGERS ADDITIONAL 734(b) ADJUSTMENT, ETC., ETC., ETC.

Sec. 704(c) Consequences: Curative Method

- NEW PARTNERS RECEIVE $9.90/YEAR DEPRECIATION FOR 10 YEARS
- OLD PARTNERS RECOGNIZE $5.90/YEAR ORDINARY INCOME IN YEARS 1-10
Sec. 704(c) Consequences: Remedial Method

- NEW PARTNERS RECEIVE $5.48/YEAR DEPRECIATION IN YEARS 1-10; $1.52/YEAR IN YEARS 11-39
- OLD PARTNERS recognize $1.48/YEAR ORDINARY INCOME IN YEARS 1-10, $1.52/YEAR ORDINARY INCOME IN YEARS 11-39

Partnership Admission With No Book-Up

- CAPITAL SHIFT ISSUE?
- SEC. 704(c) PRINCIPLES INAPPLICABLE
- NEW PARTNERS RECEIVE $3.96/YEAR DEPRECIATION FOR 10 YEARS
- OLD PARTNERS DEFER GAIN UNTIL MINIMUM GAIN CHARGEBACK EVENT

Summary: Where Do You Want To Go Today?

<table>
<thead>
<tr>
<th>Install.</th>
<th>Wrap Gain</th>
<th>Pshp.-</th>
<th>Pshp.-</th>
<th>Pshp.-</th>
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</thead>
<tbody>
<tr>
<td>Sale</td>
<td>Note</td>
<td>Trad'l.</td>
<td>Curat.</td>
<td>Remed.</td>
<td>Book-Up</td>
</tr>
<tr>
<td>Year 1</td>
<td>KG</td>
<td>KG</td>
<td>Ol</td>
<td>Ol</td>
<td></td>
</tr>
<tr>
<td>KG</td>
<td>5.10</td>
<td>6</td>
<td>5.54</td>
<td>5.90</td>
<td>1.48</td>
</tr>
</tbody>
</table>

| Deprec. | Year 1   | 2.56   | 2.56   | 4      | 9.90   | 5.48   | 3.96   |
|         | In Years 1-10 |        |        |        |        |        |        |
## Summary:
Where Do You Want To Go Today?

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(Names and firm logos are not transcribed.)
**Summary:**
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