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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

Blake D. Rubin
Arnold & Porter LLP
555 Twelfth Street, N.W.
Washington, D.C. 2004
blake_rubin@aporter.com

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The Property

VALUE	\$100
BASIS	\$ 40
NONRECOURSE DEBT (10 YRS.)	\$ 99
REMAINING DEPRECIABLE LIFE	10 YEARS
NEW DEPRECIABLE LIFE	39 YEARS

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Outright Sale

AMOUNT REALIZED:	
CASH PROCEEDS	\$ 1.00
DEBT	\$59.00
TOTAL	\$60.00
ADJUSTED BASIS	<u>\$40.00</u>
GAIN	\$60.00
TAX RATE	x .25
TAX LIABILITY	\$15.00
AFTER-TAX PROCEEDS	(\$14.00)

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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.

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Installment Sale Subject to First Mortgage

SELLING PRICE	\$100
GROSS PROFIT	\$ 60
CONTRACT PRICE	\$ 60
GROSS PROFIT RATIO	60/60
PAYMENT IN YEAR 1:	
DEBT	\$ 59.00
CASH	<u>.10</u>
TOTAL	\$ 59.10

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Installment Sale Subject to First Mortgage

PAYMENT IN YEAR 1	\$59.10
GROSS PROFIT RATIO	<u>x 1.00</u>
GAIN IN YEAR 1	\$59.10
GAIN IN YEARS 2-10	\$.90

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Installment Sale Wraparound Mortgage

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

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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	<u>10.00</u>
TOTAL	\$ 10.00

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Installment Sale Wraparound Mortgage

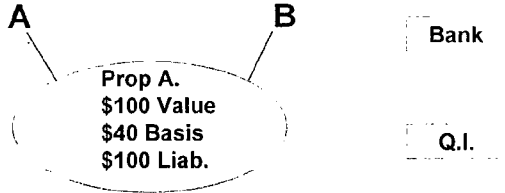
PAYMENT IN YEAR 1	\$10.00
GROSS PROFIT RATIO	<u>x .60</u>
GAIN IN YEAR 1	\$ 6.00
GAIN IN YEARS 2-10	\$54.00

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Pre-Foreclosure Like-Kind Exchange

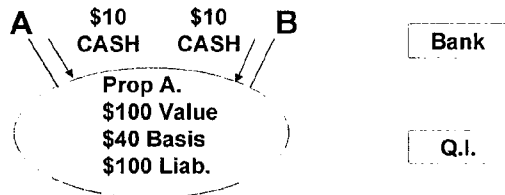


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Pre-Foreclosure Like-Kind Exchange

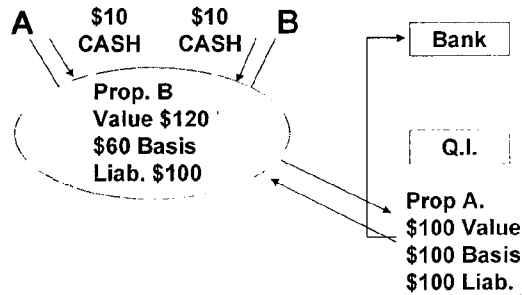


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Pre-Foreclosure Like-Kind Exchange

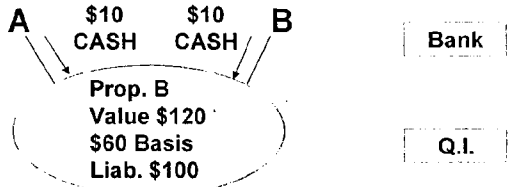


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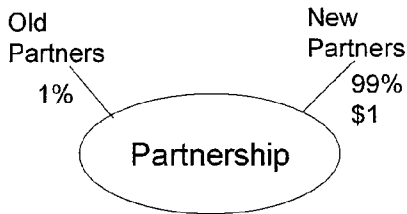
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Pre-Foreclosure Like-Kind Exchange



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



Partnership Admission With Book-Up

TAX		BOOK	
Prop. 40	100 Debt	Prop. 100	100 Debt
Cash 1		Cash 1	
	1 New (60) Old		1 New 0 Old

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

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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.

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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

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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

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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

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Summary:

Where Do You Want To Go Today?

	<u>Install.</u> <u>Sale</u>	<u>Wrap</u> <u>Note</u>	<u>Pshp.-</u> <u>Trad'l.</u>	<u>Pshp.-</u> <u>Curat.</u>	<u>Pshp.-</u> <u>Remed.</u>	<u>Pshp.-No</u> <u>Book-Up</u>
<u>Gain in</u> <u>Year 1</u>	59.10 KG	6 KG	5.54 KG	5.90 OI	1.48 OI	0
<u>Deprec.</u> <u>In Years</u> <u>1-10</u>	2.56	2.56	4	9.90	5.48	3.96

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