Planning for the Taxable Disposition of Overleveraged Property

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PLANNING FOR THE
TAXABLE DISPOSITION OF
OVERLEVERAGED PROPERTY

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September 1, 1995
THE PROPERTY

VALUE $100

BASIS $40

NONRECOURSE DEBT (10 YRS.) $99

REMAINING DEPRECIABLE LIFE 10 YEARS

NEW DEPRECIABLE LIFE 39 YEARS
INSTALLMENT SALE
SUBJECT TO FIRST MORTGAGE

• BUYER TAKES PROPERTY SUBJECT TO $99 FIRST MORTGAGE, AND GIVES SELLER $1 NOTE PAYABLE $.10/YR. FOR 10 YRS.

SELLING PRICE = $100

GROSS PROFIT = $ 60

CONTRACT PRICE = $ 60

GROSS PROFIT RATIO = 60

PAYMENT IN YR. 1:

DEBT $59.00
CASH .10
TOTAL $59.10

GAIN IN YR. 1: $59.10

GAIN IN YRS. 2-10: $ .90
INSTALLMENT SALE
WRAPAROUND MORTGAGE

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

SELLING PRICE = $100

GROSS PROFIT = $60

CONTRACT PRICE = $100

GROSS PROFIT RATIO = \frac{60}{100}

PAYMENT IN YR. 1: $10

GAIN IN YR. 1: $6

GAIN IN YRS. 2-10: $54
PARTNERSHIP ADMISSION WITH BOOK-UP

OLD PTNRS

1%

NEW PTNRS

99%

$1

PSHP.

TAX

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

BOOK

Prop. 100 | 100 Debt
Cash 1    | 1 New
0 Old     | 0 Old
PARTNERSHIP ADMISSION
WITH BOOK-UP
704(c) CONSEQUENCES

• TRADITIONAL METHOD

- NEW PARTNERS RECEIVE $4/YR. DEPRECIATION FOR 10 YRS.

- OLD PARTNERS RECOGNIZE $6/YR. KG IN YEARS 1-10 UNDER SECTION 752 (b) / 731. 734(b) ADJUSTMENT REDUCES 704(c) GAIN.
PARTNERSHIP ADMISSION
WITH BOOK-UP
704(c) CONSEQUENCES

• CURATIVE METHOD

  ▪ NEW PARTNERS RECEIVE $10/YR. DEPRECIATION FOR 10 YRS.

  ▪ OLD PARTNERS RECOGNIZE $6/YR. OI IN YEARS 1-10.
PARTNERSHIP ADMISSION
WITH BOOK-UP
704(c) CONSEQUENCES

• REMEDIAL ALLOCATION METHOD

  • NEW PARTNERS RECEIVE $5.54/YR. DEPRECIATION IN YRS. 1-10; $1.54/YR. IN YEARS 11-39.

  • OLD PARTNERS RECOGNIZE $1.54/YR. OI IN YRS. 1-39.
PARTNERSHIP ADMISSION WITH NO BOOK-UP

- **704(c) PRINCIPLES INAPPLICABLE**

- **NEW PARTNERS RECEIVE $4/YR. DEPRECIATION FOR 10 YRS.**

- **OLD PARTNERS DEFER GAIN UNTIL MINIMUM GAIN CHARGEBACK EVENT.**

- **UPON SALE OF PROPERTY, NEW PARTNERS HAVE $60 § 1231 GAIN, $60 KL. CHARACTER PROBLEMS UNDER § 1231(c) AND § 1250.**

- **TAXABLE CAPITAL SHIFT ISSUE?**