Planning for the Taxable Disposition of Overleveraged Property

Blake D. Rubin
PLANNING FOR THE
TAXABLE DISPOSITION OF
OVERLEVERAGED PROPERTY

Blake D. Rubin
Steptoe & Johnson
Washington, D.C.

September 1, 1995
### THE PROPERTY

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>VALUE</td>
<td>$100</td>
</tr>
<tr>
<td>BASIS</td>
<td>$ 40</td>
</tr>
<tr>
<td>NONRECOVERY DEBT (10 YRS.)</td>
<td>$ 99</td>
</tr>
<tr>
<td>REMAINING DEPRECIABLE LIFE</td>
<td>10 YEARS</td>
</tr>
<tr>
<td>NEW DEPRECIABLE LIFE</td>
<td>39 YEARS</td>
</tr>
</tbody>
</table>
### 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.**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SELLING PRICE</strong></td>
<td>= $100</td>
</tr>
<tr>
<td><strong>GROSS PROFIT</strong></td>
<td>= $ 60</td>
</tr>
<tr>
<td><strong>CONTRACT PRICE</strong></td>
<td>= $ 60</td>
</tr>
<tr>
<td><strong>GROSS PROFIT RATIO</strong></td>
<td>= 60</td>
</tr>
</tbody>
</table>

**PAYMENT IN YR. 1:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEBT</strong></td>
<td>$59.00</td>
</tr>
<tr>
<td><strong>CASH</strong></td>
<td>.10</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$59.10</td>
</tr>
</tbody>
</table>

**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.

<table>
<thead>
<tr>
<th>TAX</th>
<th>BOOK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prop. 40</td>
<td>Prop. 100</td>
</tr>
<tr>
<td>Cash 1</td>
<td>100 Debt</td>
</tr>
<tr>
<td>1 New</td>
<td>1 New</td>
</tr>
<tr>
<td>(60) Old</td>
<td>(60) Old</td>
</tr>
</tbody>
</table>
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?