

Basic Tax Considerations for Real Estate Developers



January 18, 2011

Rick Talkov

Steven Schneider

Goulston & Storrs, P.C.

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Real Estate Tax Structuring:

The Building Blocks of a Tax Efficient Structure



Basic Structuring

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- Choice of Entity: LLC/Partnership not C or S corporation
 - Loss flow through
 - Tax sheltered cash flow
 - Capital gains for asset sales
 - Carried Interest (for now)
 - Basis step-ups
 - Tax deferred exits
 - Sometimes REITs as partners
- Tax benefits from leverage
- When to use S corporations

The LLC/Partnership Agreement

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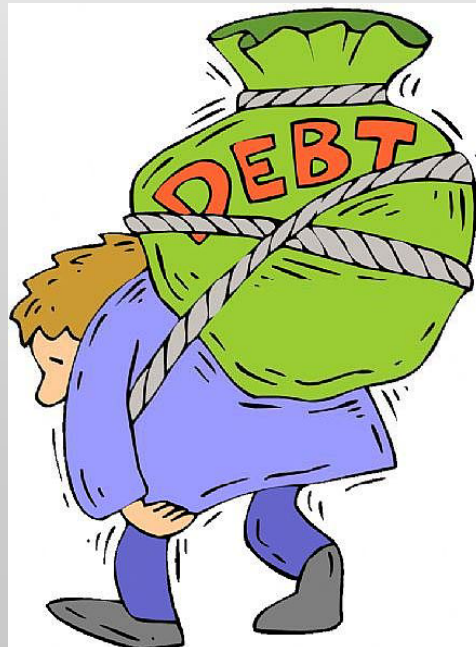
- Allocates taxable income or loss.
- Deductions generally follow partner at risk on debt or equity
 - Effect of debt guarantees
 - Special nonrecourse debt considerations
- Tax deferred asset contributions - but special considerations for contributions of built-in gain or loss property

Exit Planning

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- Generally capital gain taxes on exit with higher rate for gains that recover prior deductions
 - Sale of interest, asset, or redemption
- Tax-deferred exits: in-kind redemption; like-kind exchanges; UPREIT exit; dilution transactions; installment sales and master leases

Workouts & Distressed Debt Investing



What is COD and what types of restructurings trigger COD?

- Whenever a borrower's debt is satisfied for less than the full amount of the debt, Cancellation of Debt (COD) income is generated
- COD income is taxed at ordinary income tax rates
- Many typical workout techniques may cause COD
 - Examples:
 1. Loan Write Downs
 2. Borrower or affiliate acquires debt at a discount
 3. Debt for equity exchange at a discount
 4. Certain Debt Modifications

COD Exceptions: I'm Broke

- Bankruptcy exception
 - Make sure COD is AFTER filing bankruptcy
 - Taxes generally not discharged in bankruptcy
- Insolvency exception
 - Limited to amount insolvent
- Major Limitation – applied at PARTNER level

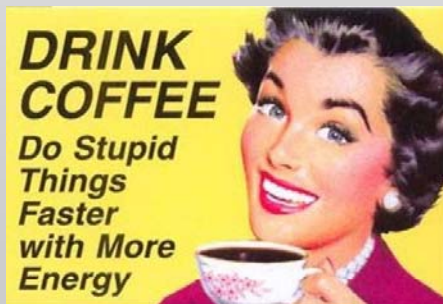
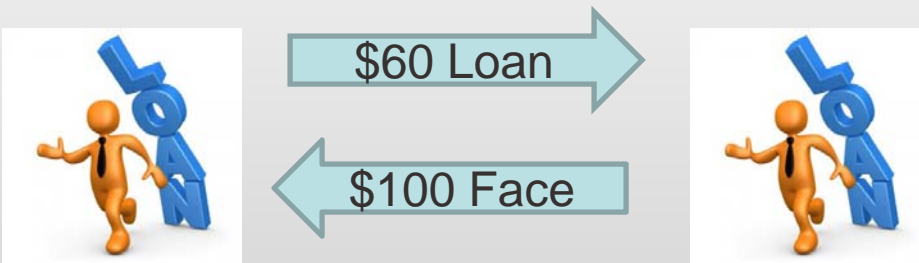
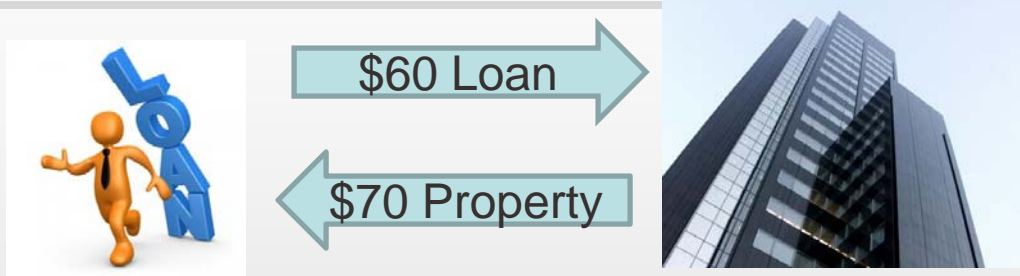
Real Property Exception

- Swap COD for write down of tax basis
- Avoids immediate tax (potential recapture later)
- Doesn't work if:
 - Debt isn't secured by the property
 - Debt wasn't used to buy or improve the property (refinance to pull out cash is bad)
 - Land/certain development property



Potential Phantom Income

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- Loan to Own - bidding the loan in an auction to get the property can cause IRS to tax you on the difference between what you paid for the loan and the bid price.

- Buying loan and working out can cause similar tax as IRS may see it as a taxable swap of the old loan for the face amount of the new loan.

- Buying property/.equity and then working out the loan can cause you to walk into taxable COD income.

Contact Information & CYA

Richard Talkov*
Goulston & Storrs, P.C.
Boston
617-574-6488
rtalkov@goulstonstorrs.com

Steven Schneider
Goulston & Storrs, P.C.
Washington DC
202-721-1145
sschneider@goulstonstorrs.com

* An accountant and not a lawyer

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