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Key Tax Considerations In All Types of Ventures

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Let’s form a joint venture

- Capital vs. services
- Cash flow
- Preferred/common
- Exit planning
- General business issues

Overview

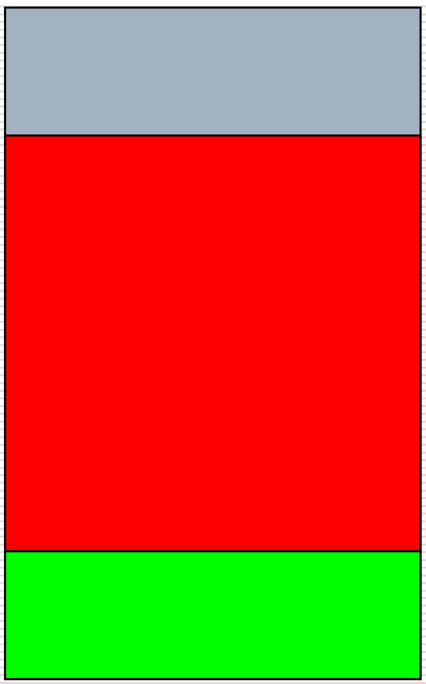
- What to think about:
  - Disguised Sales – section 707(a)
  - Built-in Gain allocations – section 704(c)
  - Mixing Bowls – sections 704(c)(1)(B)/737
  - Investment partnerships – section 721(b)
  - Cash in excess of basis – section 731(a)
  - Carried Interest Legislation

- When to think about it:
  - Formation of the partnership
  - Each year
  - Planning for exit

Learning by example – Basic facts

- Fund, a real estate LLC, owns the only profitable casino in Las Vegas, with a current fair market value of $500M, a current tax basis of $100M and nonrecourse debt of $400M encumbering the property.
- Although Fund has held the property for many years, Fund has made very few capital improvements to the property other than a $10M rehab to make the property LEED certified during the last year.

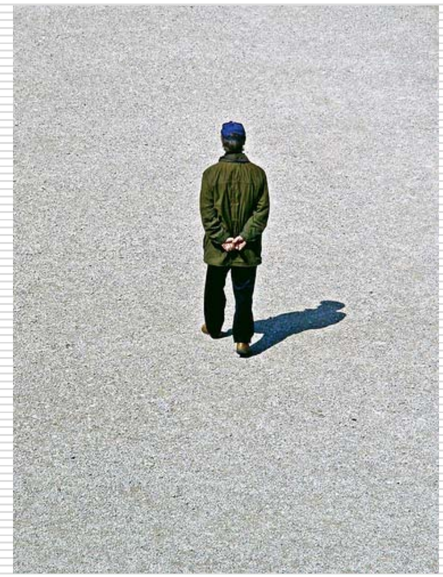
Fund – all by itself



FMV = $500M

Debt = $400M

Basis = $100M (including $10M capital improvement)



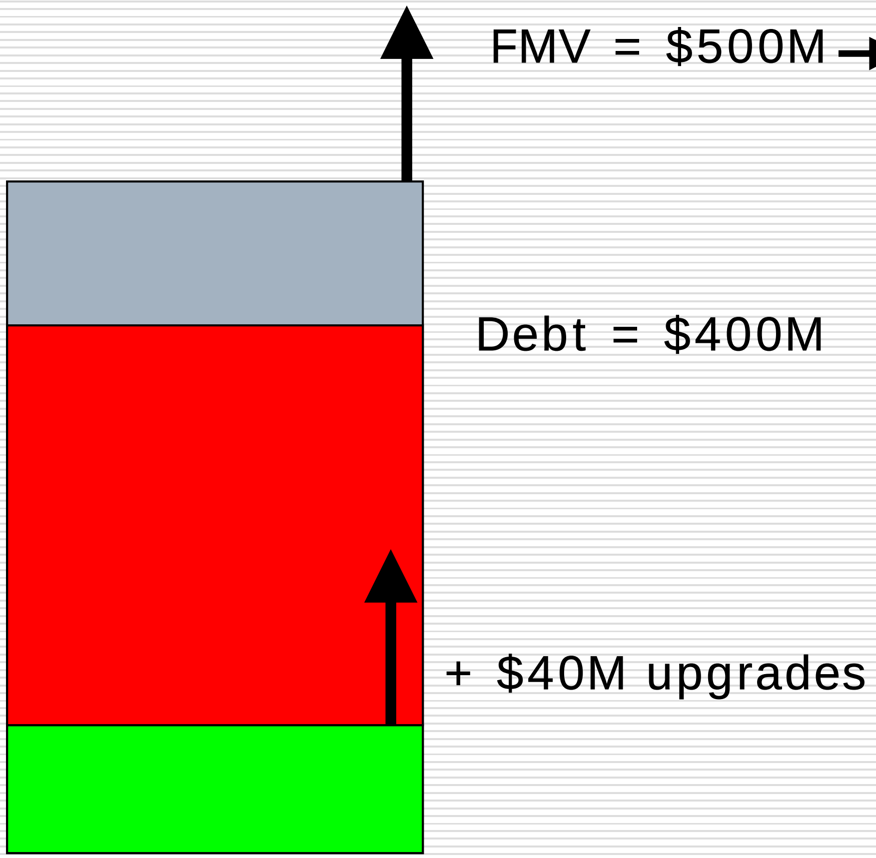
Example facts - continued

- Gush, a former British Petroleum CEO, approaches Fund and suggests that the two form a limited liability company joint venture ("LLC").

- According to Gush, LLC could increase the value of Fund’s casino from $500M to $600M merely by adding $40M in blow out protectors to the slot machines to prevent unnecessary money spills.

- Gush also states that, through his extensive public relations skills, he can attract worldwide attention to the casino under the theory that all press is good press.

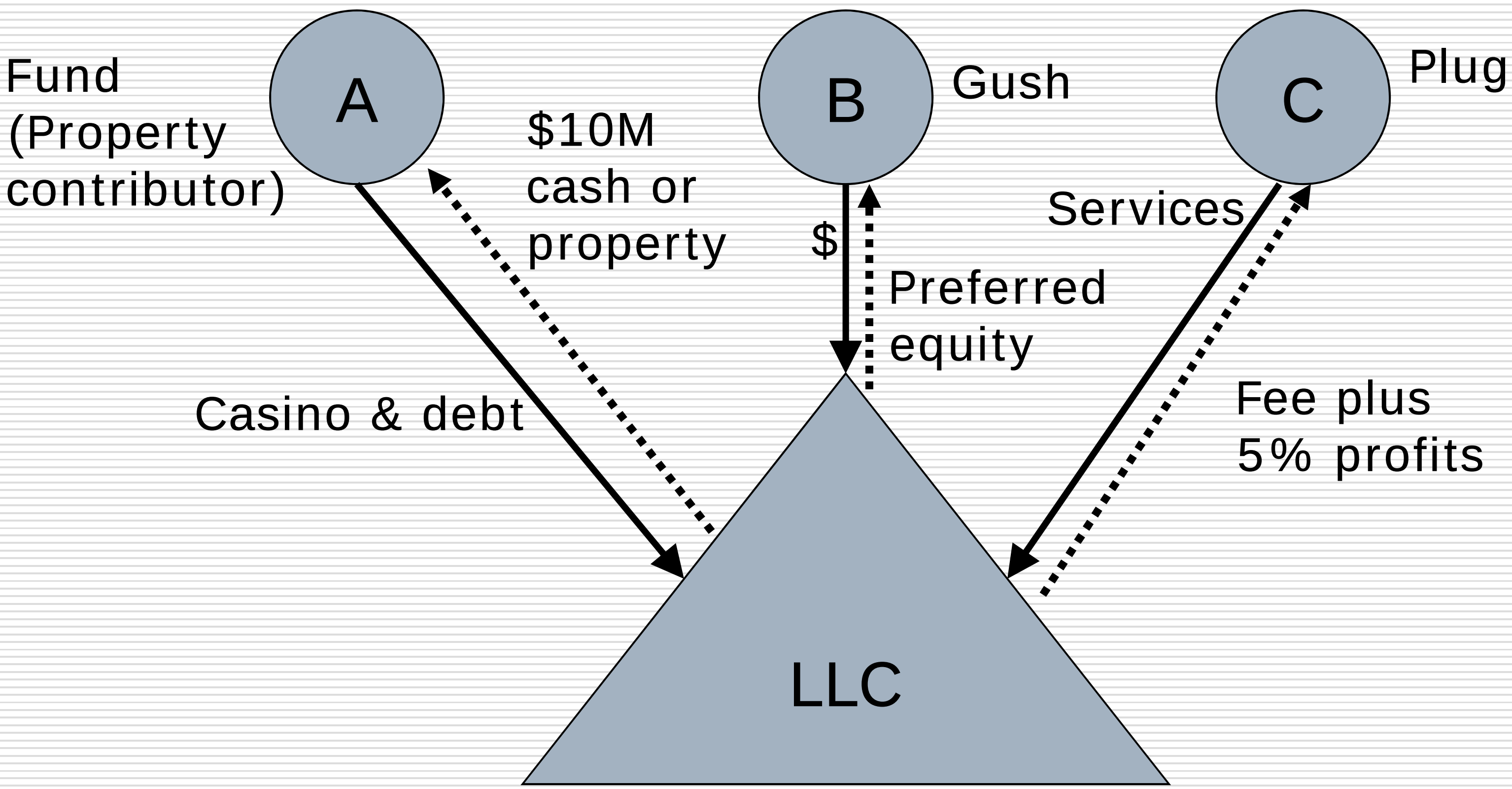
Fund + Gush = synergies



The Proposed Deal

- To entice Fund, Gush offers to pay for the improvements out of his severance (either by making contributions or by guaranteeing outside financing).
  - Gush suggests that LLC could distribute $10M in cash or property to Fund as part of the overall arrangement.
  - On the other hand, Gush insists that his interest be preferred over Fund's interest and that Gush serve as LLC manager.
- Gush also recommends that LLC hire Plug, a Saudi contracting company, to construct the improvements. To compensate Plug, Gush suggests paying Plug a development fee and issuing Plug a 5% Carried Interest in LLC.

Gush's proposal



Can Fund avoid gain?

- Investment Company
- Disguised Sale
- Mixing Bowl
- Cash in excess of basis

Tax considerations for Gush

- Preferred vs. common
- Section 704(c)
- Basis calculation and future amortization
- Withholding & FIRPTA

Tax considerations for Plug

- Developer fee
- Carried Interest
- Compensation considerations
- Estimated taxes and cash flow
- Withholding & FIRPTA

Exit Planning

- Timing – mixing bowl and disguised sales

- Section 1031

Disclaimer

- Pursuant to IRS Circular 230, please be advised that, to the extent this communication contains any tax advice, it is not intended to be, was not written to be and cannot be used by any taxpayer for the purpose of avoiding penalties under U.S. federal tax law.

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