Historic Boardwalk Hall, LLC

– v. –

Commissioner of Internal Revenue

Background

- The New Jersey Sports and Exposition Authority (NJSEA) formed the Historic Boardwalk Hall, LLC and then later Pitney Bowes entered into a tax-equity partnership with the NJSEA.
- As part of the tax-equity partnership Pitney Bowes would benefit by receiving a 99.9% ownership interest in the Historic Boardwalk Hall, LLC entity and be allocated historic rehabilitation tax credits that were generated by the partnership entity.

Issue:

- The IRS accused the NJSEA of selling tax credits to Pitney Bowes. Stating that the Historic Boardwalk Hall, LLC entity was a sham and that Pitney Bowes was never really a partner and that the NJSEA never actually transferred the ownership interest of the East Hall to the Historic Boardwalk Hall, LLC entity.

Tax Court Rulings:

- The Tax Court ruled in favor of the NJSEA and Historic Boardwalk Hall, LLC.
- The Tax Court stated:
    - The Historic Boardwalk Hall, LLC did not lack economic substance and was not a sham;
    - Pitney Bowes was indeed a legitimate partner of the Historic Boardwalk Hall, LLC entity;
    - The NJSEA did transfer the ownership of the East Hall to the Historic Boardwalk Hall, LLC entity; and
    - Partnership anti-abuse regulations were not applicable.

United States Court of Appeals for the Third Circuit Rulings:

- The Third Circuit Court overturned the decision of the Tax Court.
- The Third Circuit Court stated:
    - Pitney Bowes was not a bona fide partner as it had no meaningful downside risk or upside potential within the partnership.
        - There was no meaningful downside risk as a result of:
            - Pitney Bowes was to make capital contributions in phases, but there was no requirement of such until the NJSEA had verified the amount of credits that would be eligible by the partnership;
            - The tax benefits guarantee removed any risk if Pitney Bowes would have failed to receive the tax credits; and
            - The project was entirely funded prior to when Pitney Bowes had agreed to make any contributions.
        - There was no meaningful upside potential as a result of:
            - Despite overly hopeful projections it was not likely that the partnership would generate any residual cash flow; and
            - There was a 'Consent Option' in place allowing the NJSEA to retain any residual cash flow by compensating an amount nonrelated to FMV.

Takeaways from United States Court of Appeals Rulings:

- Capital contributions should be a necessity of funding to the project;
- Capital contributions should avoid being tied directly to the generation of tax credits;
- Tax benefit guarantees SIGNIFICANTLY reduce the downside risk of a tax equity investor; especially in cases where the guarantor is solid financially;
- An investor who is provided a majority share of residual cash distributions is not to be considered participating in upside potential when the portion of cash distributions is unlikely or a nominal amount;
- If there are residual positive cash flows earned by the partnership, the agreement documents should not include an option where the equity investor can be deprived of such upside potential;
- The use of options and other agreements that effectively guarantee a preferred return and removes the risk of not receiving a preferred return is no longer downside risk;
- All participants should have documentation and support to project realistic financial projections; and
- Thought should be given to documents and documentation and avoid characterizations of a "SALE" of tax credits.

Revenue Procedure 2014-12:

- Issued: December 30, 2013
- Issued as a result of the Historic Boardwalk Hall, LLC v. Commissioner of Internal Revenue.
- The goal was to create a "safe harbor" for the historic tax credit market in which to operate.
  - The IRS was adamant that even if a deal varies from the safe harbor it does not mean that it is invalid; also
  - They were cautious and advocated against trying to look to deep into the new guidelines for the broader tax equity market.
- Structure compliance for partnership-flip and inverted lease transactions of history tax credit, tax equity deals"
  - 20% of the tax equity investor's anticipated total investments should be put in at inception;
  - The balance can be paid in over time, but 75% of the total anticipated investment must be a fixed amount;
  - The tax equity investor must be able to meet the funding requirements of their fixed portions as such arises; and
  - Economic benefits such as gains, losses, income, deductions, and credits should not be less than 5%over the life of the deal to the tax equity investor.
- Aside from tax benefits, the tax equity investor must have "a reasonably anticipated value commensurate with the investor's overall percentage of interest".
- Tax equity investors cannot just receive a preferred return with the inclusion of tax benefits on its investments, they should not be substantially protected from exposure to losses to the underlying business.
- The tax equity investor's value should shift with income and losses from the underlying business and not be fixed.
- The sponsor cannot be distributed cash from the partnership in excess of what a third-party would be paid for the same services for a non-tax credit deal in relation to developer, management and/or other incentive-based fees.
- Traditional business risks may be excised by the Sponsor. However, guarantees may not be funded.
- The Sponsor cannot remove the risk, of loss of credits, from the tax equity investor of the IRS challenging the structure of the transaction through a guarantee.
- There may not be an agreement to allow capital contributions to the partnership to ensure cash distributions to the tax equity investor.
- If the IRS challenges credits, the sponsor may not pay the tax equity investors costs.
- The partnership and the Sponsor should not have a CALL option to repurchase a tax equity investor's interest in the future; however, the tax equity investor may have a PUT option to require the Sponsor to repurchase their interest if it is not above FMV when such is exercised.