

Pass-Through Entity Tax Issues (Partnerships, LLCs & S-Corps)

Honorable Mark S. Wallace

Dennis Bean, CPA

Neil M. Goff, Esq. (Moderator)

Friday, June 6, 2014

8:30 – 9:30 A.M.

Pass-Through Entity Tax Issues (Partnerships, LLCs & S-Corps.)

I. Introduction to Pass-Through Entity Bankruptcy-Related Taxation

A. General Rules – Section 108

- 1. Actual Discharge**
- 2. Constructive Discharge Under Section 108(e)(10)
and the Cottage Savings Regulations – Treas. Reg.
§ 1.1001-3**

B. Procedural Rules

- 1. The Partnership**
- 2. The S Corporation**
- 3. The Entity Equity Owner**

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II. Representing the Partnership/Bankruptcy Trustee

A. Alternatives

- 1. Liquidating Bankruptcy**
- 2. Bankruptcy Reorganization**

III. Maximizing the Money!

- A. Deficit Restoration Obligation (DRO)**
- B. Qualified Income Offsets (QIO)**
- C. Charging Orders**

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IV. Representing the Partner – Minimizing the Tax!

A. General Rules

B. Is there an Exclusion Available?

V. Subchapter S Corporations

A. Key Differences

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- VI. Subchapter S Corporation Shareholders**
- VII. Examples**
- VIII. Questions?**

EXHIBIT A

CASE STUDY

This case study is about one of the members in a two member farming LLC that reports income and expenses as a partnership using the cash basis of accounting. We will call him member B. Historically, the LLC has deferred income from one crop year to the next and for the year in question received \$ 2.0 million of income from the prior year crop in January 2012. Typically, the LLC uses the deferred income to retire the prior year crop financing, make distributions to members for taxes and it borrows more money to fund the current farming operations. Both members signed personal guarantees which they used to support losses from the venture such that both have deficit or negative capital accounts.

EXHIBIT A (cont.)

Member B was also involved in developing real estate for housing. He got a loan from an out of town commercial bank for use in his real estate business. He secured the loan with real estate and with his membership interest in the LLC. When the housing market crashed, the loan went into default and the lender foreclosed on the real estate which had dropped in value leaving the bank with an unpaid loan balance of approximately \$ 1.2 million. The bank then filed a lawsuit and got a judgment they recorded against the member before he filed bankruptcy under Chapter 7. Faced with a deficit capital account, deferred income and the bank judgment, the Chapter 7 trustee abandoned the interest in the LLC. Shortly thereafter, the bank got a charging order enabling them to take possession of Member B's interest in the LLC which they did in mid-2012.

EXHIBIT A (cont.)

Briefly the tax consequences to the charging order and take over by the bank are summarized as follows:

As to the LLC, the foreclosure of Member B's interest in the LLC resulted in a technical termination of the LLC. The bank then became a substitute partner for tax purposes when they foreclosed on member B's interest. The acquisition by the bank will require the LLC to change from cash to accrual. Thus income will be bunched up as to member A- the 2011 crop income received in January plus accrual of the 2012 income in 2012. The LLC will file two short year tax returns the first to include member B and the second to include the bank as the substitute partner

EXHIBIT A (cont.)

As to member B, he will have to report his share of income received in January offset by farming expenses incurred up to the date his interest was foreclosed by the bank. In addition, he will have to report as a sale or exchange the foreclosure of his interest. The gain or loss to be recognized will depend on his outside basis at the time of the foreclosure. If his capital account is still negative, he will have gain to the extent of the LLC debt used to give him basis that was shifted entirely member A.

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B.S., University of Utah (1966); M.B.A., Golden Gate University Graduate Tax Program (1971); Certified Public Accountant, California (1969); Certified Insolvency Reorganization Advisor (1995), Member, American Institute of Certified Public Accountants, California Society of Certified Public Accountants, American Bankruptcy Institute and National Association of Bankruptcy Trustees, former President, Central California Bankruptcy Association and is a past Director Association of Insolvency and Restructuring Advisors. He is a Fellow of the American College of Bankruptcy. From 1966 until 1980, Mr. Bean was a Revenue Agent and a Field Audit Group Manager with the Examination Division of the Internal Revenue Service in San Francisco and Fresno, California. From 1980 until 1993, he was a shareholder in a large local CPA firm. In 1993, he began practice as Dennis Bean & Co., Certified Public Accountant. On January 1, 2009, Mr. Bean's firm merged with another accounting firm and became Bean Hunt & Company, Certified Public Accountants. On January 1, 2012 the firm's name was changed with the merger of another firm and the name changed to Bean Hunt Harris & Company. Bean Hunt Harris & Company provides audit, business valuation, tax planning and compliance, litigation support services and tax examination and collection representation. Mr. Bean has spoken on the subject of the taxation of bankruptcy and insolvency at numerous seminars and workshops throughout the country.

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NEIL M. GOFF

Neil is Co-Chair of the firm's Tax Group. In conjunction with the Corporate Group, Neil focuses his practice on structuring complex mergers, acquisitions, spin-offs, joint ventures, private equity fund work and business restructurings. His practice also includes tax litigation, public finance, real estate and like-kind exchanges.

Neil's extensive experience with the Internal Revenue Service, at the appellate and district counsel levels, makes him a valuable asset in tax matters. He has represented a great variety of clients before the United States Tax Court and has testified on behalf of clients as an expert witness. Neil is a licensed certified public accountant in Colorado and Alaska and is admitted in several state and federal courts.

REPRESENTATIVE MATTERS

Represented Workforce Insight, Inc. through the robust auction process through and including consummation of a sale of a majority of the issued and outstanding equity interests to an affiliate of Baird Capital Partners. The founders and selling shareholders retained approximately a 15% equity interest in the Company following the transaction.

Represented Victory Park Capital Advisors in the sale of its portfolio company, Global Employment Holdings, Inc., to TZP Group.

Represented Mexico Retail Properties and MRP Group, LP in the largest ever real estate transaction in Mexico's history consisting of the sale of 49 commercial properties and the sale of MRP Group's property management platform for an aggregate purchase price of approximately US \$2.2 Billion to FIBRA Uno, the first and largest real estate investment trust in Mexico.

Represented Icahn Associates corporation in the \$1.3 billion sale of its membership interests in American Casino and Entertainment Properties LLC, owner of the Stratosphere Hotel in Las Vegas and other gaming properties. The transaction was structured as a deferred like-kind exchange. The sale was to an affiliated private equity group of Goldman Sachs.

Assisted Miller Global Properties, LLC in the formation of Miller Global Fund VII, LLC, their seventh US-based real estate fund. The fund is a value-added real estate investment fund organized principally to acquire and develop a high-quality portfolio of real estate assets, comprised primarily of office buildings and hotels, as well as other real estate.

Represented Riviera Holdings Corporation, a Las Vegas casino operator, in negotiating the terms of the \$76 million sale of its Riviera Black Hawk casino in Colorado to an affiliate of Monarch Casino & Resort, Inc. The transaction was structured as a sale of 100% of the common stock of the Riviera subsidiary operating the Black Hawk casino.

Represented an investor group in rehabilitation of Union Station in Denver, Colorado, on structuring to qualify for related historic rehabilitation tax credits.

Represented a local private foundation in forming a public-private joint venture with a leading medical institution and a leading educational institution with seed and support funding provided by the foundation. The venture was approved by the Colorado Commission on Higher Education and represented the first time such a not-for-profit limited liability company was formed in Colorado.

PUBLICATIONS & PRESENTATIONS

"Recent Decision of the U.S. Court of Appeals for the First Circuit May Have Significant Implications for Private Equity Funds," *Brownstein Client Alert*, October 7, 2013

"Contracts for IRC Section 1031 Exchanges," Author, Chapter 3, Colorado Real Estate Forms Deskbook, Bradford Publishing Co., James G. Benjamin, General Editor

"Circular 230 Practice Standards Apply To In-House Tax and Benefits Attorneys," *Brownstein Tax Alert*, December 6, 2011

"Brownstein Tax Alert: Up to 25% of Tax-Exempt Organizations Predicted to Lose Tax Exemptions on May 15, 2010," *Brownstein Tax Alert*, May 7, 2010

United States Bankruptcy Judge Mark S. Wallace

Biographical Information

Appointment:

Appointed January 20, 2011 by the United States Court of Appeals for the Ninth Circuit (current term expires January 20, 2025) as a United States Bankruptcy Judge for the Central District of California. Judge Wallace maintains chambers at the Ronald Reagan Federal Building and United States Courthouse in Santa Ana, California.

Education:

Princeton University, A.B. 1976 (*summa cum laude*) in History, Phi Beta Kappa

Columbia University School of Law, J.D. 1977

Notes and Comments Editor, *Columbia Law Review*

Harlan Fiske Stone Scholar

Judge Wallace participated in the joint Princeton-Columbia Accelerated Interdisciplinary Legal Education Program, enabling him to complete college and law school in six years instead of seven. He is a member of the Princeton University Class of 1975.

Career Record:

1991-2011	Stutman, Treister & Glatt Professional Corporation
1979-1991	Meyer Hendricks Victor Osborn & Maledon
1977-1979	Judicial Law Clerk to the Honorable William B. Enright, United States District Judge, Southern District of California

Prior to taking the bench, Judge Wallace was a Chair of the Bankruptcy and Workouts Committee of the American Bar Association Section of Taxation and a Chair of the Taxation Section of the Beverly Hills Bar Association. He served as an Adjunct Professor at Loyola Law School from 2002 through 2010, where he taught a class in bankruptcy taxation. During the 1980s, he served as an Adjunct Professor at Arizona State University College of Law, where he taught classes in federal income taxation and business planning.