

Practising Law Institute's *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2007*

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As a new lawyer, I have typically approached partnership tax issues with caution, knowing that the smallest misstep could cause tremendous heartache for a client. The world of Subchapter K is filled with landmines, or somewhat less seriously, with sand traps that can trap the unwary. Quite apart from the usual attraction of partnership tax rules, there is a special cache now. The world of private equity has recently been in the news with the announcement of the Blackstone Group's initial public offering.

Thus, when I was given the opportunity to attend Practising Law Institute's *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2007* conference, I jumped at the chance. The two day conference, held in PLI's California Center in San Francisco on June 14 and 15, covered an enormous amount of material. Indeed, attendees were given two 900-page tomes including outlines and illustrations to go along with the speakers' presentations.

Even more impressive is the companion disc that includes thousands of additional pages of outlines, articles and slides. PLI used to print it all, providing attendees with 20-some volumes. More sensibly, PLI now provides the guts of the course in two volumes, but all the rest is on the disc. One helpful section of the books includes selected operating agreement tax allocation provisions for limited liability companies. When drafting LLC operating agreements, looking at this particular section is an absolute must.

The topics discussed during the conference were highly advanced and very technical. In the morning session of the first day, topics included partnership basis issues, the allocation of liabilities among partners, the drafting of partnership agreements for substantial economic effect, Internal Revenue Code Section ("Code Sec.") 704(c) and the formation of partnerships. In the afternoon session, mixing bowl transactions and partnership mergers

and divisions were discussed. On the second day, panelists discussed tax shelters, the practical problems of operating a joint venture, and international joint venture issues in cross border transactions.

The highlight of the conference for me was most certainly the lunch panel on the first day, which included William O'Shea, Associate Chief Counsel of the Internal Revenue Service. The discussion focused upon newly proposed regulations with regards to the taxation of profits interests. The taxation of carried interests of private equity funds has been a hot topic in the news recently, with the Blackstone Group's initial public offering and the Congressional outrage over the taxation of carried interests.

Private equity funds are generally organized as partnerships with investors taking limited partnership interests while the investment manager (or service provider) takes a general partnership interest. For the service of managing the investors' money, the manager typically receives a management fee and in addition, a carried interest. The carried interest is typically 20 percent of the gains stemming from appreciation in the value of the fund's investments.

Generally, carried interest has been taxed at capital gains rates, rather than at ordinary income rates. The IRS has typically allowed the capital gains treatment of the receipt of carried interest because the IRS has taken the view that the service provider takes the risk of investments increasing or decreasing in value.

The discussion opened with an explanation of the difference between a capital interest (an interest that entitles the owner to proceeds from a liquidation of assets of the partnership) and a profits interest (an interest that does not entitle the owner to any proceeds upon liquidation). The panel then discussed the history behind the taxation of partnership profits interests and the current law. In particular, the panel discussed

W.G. Campbell [CA-8, 91-2 USTC ¶150,420, 943 F2d 815 (1991).], in which the Eighth Circuit held that the receipt of a profits interest did not constitute taxable income because the value of a profits interest was extremely speculative.

The panel also discussed Rev. Proc. 93-27, where the IRS provided a safe harbor by ruling that a partnership profits interest is not taxable if the profits interest was received for services performed to or for the benefit for the partnership in a partner capacity or in anticipation of becoming a partner. The panel also discussed the exceptions to Rev. Proc. 93-27, which include profits interests that constitute a “substantially certain” revenue stream; profits interests that are disposed within two years; and profits interests that are limited partnership interests of a publicly traded partnership. Failure to meet the safe harbor requirements under Rev. Proc. 93-27 could trigger gain for both the service provider and the partnership.

A Whole New Ballgame

The panel discussion then turned to the new Rev. Rul. 2007-40, which treats the transfer of appreciated property to a partner in satisfaction of a Code Sec. 707(c) guaranteed payment obligation as a sale or exchange under Code Sec. 1001. Thus, such a transfer triggers gain to the partnership in the amount

of the difference between the adjusted basis of the transferred property and the property’s fair market value.

The panel also discussed newly proposed regulations which will apply Code Sec. 83 to the receipt of a profits or a capital interest for services performed for a partnership. The profits or capital interest received will be valued at the time it is given to the service provider and taxed to the service provider as ordinary income. The partnership will get a deduction in the amount of the value of the profits or capital interest given to the service provider. The panel discussion revealed that the IRS intends to re-litigate *Campbell* with the new regulations, and the new regulations are expected to be finalized by the end of the calendar year.

With such relevant topics and engaging speakers, the Practising Law Institute’s *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2007* conference was extremely engaging and very helpful. The current topics were literally hot off the presses, and I felt significantly more knowledgeable after the conference. I will certainly attend the conference again next year in 2008. For information about next year’s conference, as well as other events, programs, courses and books by PLI, visit www.pli.edu or call (800) 260-4PLI.