

Who Gets What When the Project is Sold

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Panel Members:
Bank of America
Centerline Capital Group
Pennrose

Partnership Capital Accounts

All Partners in a Partnership Have a Capital Account

Capital Account Maintenance Rules under IRC 704(b)

- All Capital Accounts Start at Zero
- Increased by Capital Contributions
- Increased by Income allocated
- Decreased by Losses allocated
- Decreased by Distributions
- Upon Liquidation, all Capital Accounts Return to Zero

Sample Partnership Agreement

Ultimate Partnership Profit, Loss & Cash allocations controlled by Partnership Agreement

- Section 5 – Allocations of Profits from Capital Transactions
- Section 6 – Distributions and Applications of Cash Flow from Capital Transactions
- Section 10 – Dissolution and Termination of the Partnership

Section 5 – Allocations of Profits from Capital Transactions

Profits from a Capital Transaction shall be allocated to the Partners in the following order of priority:

- A) To the LP to eliminate any negative capital account.
- B) To the GP to eliminate any negative capital account.
- C) The balance to the Partners in accordance with their sharing ratio of Section 6G.

Section 6 – Distributions and Applications of Cash Flow from Capital Transactions

Sale or Refinancing Proceeds shall be applied in the following order of priority:

- A) To the payment of all expenses of such sale or refinancing.
- B) To the payment of all debts and obligations of the partnership other than amounts owed to Partners.
- C) To establish any Reserves reasonably required by the GP.
- D) To repay any LP Loans.
- E) To repay any GP Loans.
- F) To repay any balance remaining on the Development Fee.
- G) The balance shall be distributed 20% to the LP and 80% to the GP.

Section 10 – Dissolution and Termination of the Partnership

10.1 Events which cause a Dissolution of the Partnership shall include:

- A) Election made by the GP with the consent of the LP
- B) Withdrawal of GP
- C) Sale or other disposition of all or substantially all of the assets of the Partnership.

10.2 Priority on Liquidation – To extent proceeds are sufficient, they shall be applied in the following order:

- A) In accordance with Section 6A through 6F
- B) The balance shall be distributed in accordance with positive Capital Accounts.

Sample 4% Deal Liquidation Calculation

Sample 4% Deal

Balance Sheet at the Beginning of Year One

| | | | |
|----------|-------------------|----------------------|-------------------|
| Land | 1,500,000 | 1st Mortgage Payable | 7,500,000 |
| Building | 8,500,000 | LP Tax Capital | 2,500,000 |
| | | GP Tax Capital | - |
| Total | <u>10,000,000</u> | | <u>10,000,000</u> |

Cumulative Losses Through year 15 (All Depreciation)

(4,600,000)

Balance Sheet at the End of Year 15

| | | | |
|--------------------|------------------|----------------------|------------------|
| Land | 1,500,000 | 1st Mortgage Payable | 7,500,000 |
| Building | 8,500,000 | LP Tax Capital | (2,099,540) |
| Accum Depreciation | (4,600,000) | GP Tax Capital | (460) |
| Total | <u>5,400,000</u> | | <u>5,400,000</u> |

Building Sold Beginning of Year 16 for \$ 11,000,000

Tax Gain Calculation

| | | |
|--------------------|--------------------|-------------------------|
| Sales Price | | 11,000,000 |
| Cost of Sales | | |
| Land | 1,500,000 | |
| Building | 8,500,000 | |
| Accum Depreciation | <u>(4,600,000)</u> | 5,400,000 |
| Net Gain | | <u><u>5,600,000</u></u> |

Net Cash Calculation

| | |
|-----------------|-------------------------|
| Sales Price | 11,000,000 |
| Mortgage Payoff | <u>(7,500,000)</u> |
| Net Cash | <u><u>3,500,000</u></u> |

Gain Allocations in Accordance with the Partnership Agreement

| | Balance Prior to Sale | Section 5A Allocation | Section 5B Allocation | Section 5C Allocation | Total Allocation |
|----------------|-----------------------------|--------------------------|--------------------------|--------------------------|---------------------|
| LP Tax Capital | <u>(2,099,540)</u> | 2,099,540 | - | 700,000 | 2,799,540 |
| GP Tax Capital | <u>(460)</u> | - | 460 | 2,800,000 | 2,800,460 |
| | <u><u>(2,100,000)</u></u> | 2,099,540 | 460 | 3,500,000 | 5,600,000 |

Cash Allocations in Accordance with the Partnership Agreement.

| | Beginning Capital Account | Total Gain Allocation | Capital Account Subtotal | Liquidating Distributions Section 10.2B | Ending Capital Accounts | Ultimate Cash Splits |
|----------------|---------------------------------|-----------------------------|--------------------------------|---|-------------------------------|----------------------------|
| LP Tax Capital | <u>(2,099,540)</u> | 2,799,540 | 700,000 | (700,000) | - | 20.00% |
| GP Tax Capital | <u>(460)</u> | 2,800,460 | 2,800,000 | (2,800,000) | - | 80.00% |
| | <u><u>(2,100,000)</u></u> | 5,600,000 | 3,500,000 | <u><u>(3,500,000)</u></u> | - | <u><u>100.00%</u></u> |

Sample 9% Deal Liquidation Calculation

Sample 9% Deal

Balance Sheet at the Beginning of Year One

| | | | |
|----------|-------------------|----------------------|-------------------|
| Land | 1,500,000 | 1st Mortgage Payable | 3,100,000 |
| Building | 8,500,000 | LP Tax Capital | 6,900,000 |
| | | GP Tax Capital | - |
| Total | <u>10,000,000</u> | | <u>10,000,000</u> |

Cumulative Losses Through year 15 (All Depreciation)

(4,600,000)

Balance Sheet at the End of Year 15

| | | | |
|--------------------|------------------|----------------------|------------------|
| Land | 1,500,000 | 1st Mortgage Payable | 3,100,000 |
| Building | 8,500,000 | LP Tax Capital | 2,300,460 |
| Accum Depreciation | (4,600,000) | GP Tax Capital | (460) |
| Total | <u>5,400,000</u> | | <u>5,400,000</u> |

Building Sold Beginning of Year 16 for \$ 11,000,000

Tax Gain Calculation

| | | |
|--------------------|--------------------|-------------------------|
| Sales Price | | 11,000,000 |
| Cost of Sales | | |
| Land | 1,500,000 | |
| Building | 8,500,000 | |
| Accum Depreciation | <u>(4,600,000)</u> | <u>5,400,000</u> |
| Net Gain | | <u><u>5,600,000</u></u> |

Net Cash Calculation

| | |
|-----------------|-------------------------|
| Sales Price | 11,000,000 |
| Mortgage Payoff | <u>(3,100,000)</u> |
| Net Cash | <u><u>7,900,000</u></u> |

Gain Allocations in Accordance with the Partnership agreement

| | Balance Prior to Sale | Section 5A Allocation | Section 5B Allocation | Section 5C Allocation | Total Allocation |
|----------------|-----------------------------|--------------------------|--------------------------|--------------------------|---------------------|
| LP Tax Capital | 2,300,460 | - | - | 1,119,908 | 1,119,908 |
| GP Tax Capital | <u>(460)</u> | - | 460 | 4,479,632 | 4,480,092 |
| | <u>2,300,000</u> | - | 460 | <u>5,599,540</u> | <u>5,600,000</u> |

Cash Allocations in Accordance with the Partnership Agreement.

| | Beginning Capital Account | Total Gain Allocation | Capital Account Subtotal | Liquidating Distributions Section 10.2B | Ending Capital Accounts | Ultimate Cash Splits |
|----------------|---------------------------------|-----------------------------|--------------------------------|---|-------------------------------|----------------------------|
| LP Tax Capital | 2,300,460 | 1,119,908 | 3,420,368 | (3,420,368) | - | 43.30% |
| GP Tax Capital | <u>(460)</u> | 4,480,092 | 4,479,632 | <u>(4,479,632)</u> | - | 56.70% |
| | <u>2,300,000</u> | 5,600,000 | 7,900,000 | <u>(7,900,000)</u> | - | <u>100.00%</u> |

What If the Ultimate Allocations of Cash Aren't What You Expected?

Stay out of the Liquidation Section of the Partnership Agreement

- Refinance instead of Selling
- Negotiate the purchase of the LP interest

Manage the Tax Capital accounts

Negotiate Targeted Tax Capital Account Provisions Up Front