

# **Bond Case Briefs**

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## **TAX - MISSOURI**

### **Gateway Hotel Partners, LLC v. C.I.R.**

**United States Tax Court - January 9, 2014 - T.C. Memo. 2014-5**

Limited liability company (LLC), which was taxed as partnership, petitioned for review of final partnership administrative adjustment (FPAA), which determined that LLC was required to recognize income from transfers of state tax credits, that LLC was required to include in income the return of funds it had previously contributed in connection with hotel redevelopment project, and that LLC was liable for accuracy-related penalty.

The Tax Court held that:

- LLC's transfer of certain state tax credits was nontaxable partnership distribution in redemption of member's preferred equity rights;
- LLC's transfer of certain other state tax credits was sale of full amount credits;
- All proceeds from LLC's sale of state tax credits were includible in LLC's income under assignment-of-income doctrine;
- Return to LLC of payment it made into deferred developer fees fund was nontaxable return of principal; and
- LLC was liable for accuracy-related penalty.

Owner of LLC's managing member, not LLC, was bridge loan borrower in form and substance, and thus lender's transfer of loan proceeds directly to LLC constituted deemed capital contribution by owner to member and then by member to LLC, and LLC's transfer of state tax credits to owner as member's assignee was nontaxable partnership distribution in redemption of member's preferred equity rights. Loan agreement indicated owner acted on its own behalf as borrower, not as LLC's agent, and owner was both legally obligated to repay loan and party to which lender looked for repayment.

Under Missouri law, member's waiver of rights under LLC operating agreement did not surrender member's discretion to prohibit LLC from distributing LLC's state tax credits to manager in satisfaction of manager's right to preferred return of capital. Member waived only rights that gave rise to payment obligation when it waived interest in "such rights...due and owing" to manager under section of operating agreement providing for manager's preferred return of capital upon issuance of credits to LLC, and member's discretionary right to prevent transfer of credits did not give rise to payment obligation.

Under Missouri law, LLC's financing statement, which listed LLC as debtor and lender as secured party, did not grant security interest in LLC's state tax credits to lender, which provided loan to owner of LLC's manager; financing statement merely described covered collateral, and it did not identify the obligation to be secured by the covered collateral.

LLC's transfer of state tax credits to managing member's assignee was not taxable sale under step transaction doctrine, but rather was distribution made pursuant to managing member's preferred-equity rights, which flowed from managing member's capital contribution. Capital contribution was

not a meaningless or unnecessary step in the transaction, and step satisfying the resulting preferred-equity rights was also legitimate.

All proceeds from LLC's sale of state tax credits were includible in LLC's income under assignment-of-income doctrine. Although LLC chose to divert some proceeds of sale to satisfy loan liability of manager's owner, LLC had the right to receive all of proceeds itself.