No. 11-1832

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

HISTORIC BOARDWALK HALL, LLC, NEW JERSEY SPORTS AND EXHIBITION AUTHORITY, TAX MATTERS PARTNER,
Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant

ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT

BRIEF FOR NATIONAL TRUST FOR HISTORIC PRESERVATION AS *AMICUS CURIAE* IN SUPPORT OF THE APPELLEES SUPPORTING AFFIRMANCE

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United States Court of Appeals for the Third Circuit

Corporate Disclosure Statement and Statement of Financial Interest

No. 11-1832

Historic Boardwalk Hall, LLC, New Jersey Sports & Exhibition Auth., Tax M

v.

Commissioner of Internal Revenue, Respondent-Appellant

Instructions

Pursuant to Rule 26.1, Federal Rules of Appellate Procedure any nongovernmental corporate party to a proceeding before this Court must file a statement identifying all of its parent corporations and listing any publicly held company that owns 10% or more of the party's stock.

Third Circuit LAR 26.1(b) requires that every party to an appeal must identify on the Corporate Disclosure Statement required by Rule 26.1, Federal Rules of Appellate Procedure, every publicly owned corporation not a party to the appeal, if any, that has a financial interest in the outcome of the litigation and the nature of that interest. This information need be provided only if a party has something to report under that section of the LAR.

In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate shall provide a list identifying: 1) the debtor if not named in the caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or the bankruptcy estate is not a party to the proceedings before this Court, the appellant must file this list. LAR 26.1(c).

The purpose of collecting the information in the Corporate Disclosure and Financial Interest Statements is to provide the judges with information about any conflicts of interest which would prevent them from hearing the case.

The completed Corporate Disclosure Statement and Statement of Financial Interest Form must, if required, must be filed upon the filing of a motion, response, petition or answer in this Court, or upon the filing of the party's principal brief, whichever occurs first. A copy of the statement must also be included in the party's principal brief before the table of contents regardless of whether the statement has previously been filed. Rule 26.1(b) and (c), Federal Rules of Appellate Procedure.

If additional space is needed, please attach a new page.

Pursuant to Rule 26.1 and Third Circuit LAR 26.1, National Trust for Historic Preservation (as amicus curiae) makes the following disclosure:
(Name of Party)

1) For non-governmental corporate parties please list all parent corporations:

National Trust for Historic Preservation ("National Trust" or "NT") has no parent corporation.

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock:

National Trust states that no publicly held corporation owns 10% or more of its stock.

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has as a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests:

NT states that it is not affiliated with any publicly owned corporation that has a financial interest in the outcome of the litigation.

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is active participant in the bankruptcy proceeding. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant.

N/A

s/ David B. Blair
(Signature of Counsel or Party)

Dated: 12/21/2011

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INTERESTS OF THE AMICUS CURIAE

It is the declared policy of the United States Congress to "preserve for public use historic sites, buildings and objects of national significance for the inspiration and benefit of the people of the United States." *See* 16 U.S.C. § 461. Congress created the National Trust for Historic Preservation (the "National Trust") in 1949 to further this policy and to facilitate public participation in the preservation of sites, buildings, and objects of national significance or interest. *See id.* §§ 468-468d.[1] The mission of the National Trust is to provide leadership, education, and advocacy to save America's diverse historic places and revitalize our communities.

With the strong support of almost 200,000 members nationwide, including over 7,300 members and supporters in New Jersey, the National Trust carries out a wide range of programs and activities in support of preservation of historic sites, buildings, and objects of national significance. These activities include promoting public policies, legal tools, and tax incentives that support the preservation of America's heritage. In light of its interest, involvement, and expertise, the National Trust also frequently participates, both as amicus curiae and as a party, in litigation relating to the application of laws that promote the preservation of historic sites, buildings, and objects.

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[1] The Attorney General of the United States is a statutory *ex officio* member of the Board of Trustees of the National Trust, as is the Secretary of the Interior. 16 U.S.C. § 468b.

The National Trust has a strong interest in ensuring the use, validity, and effectiveness of historic rehabilitation tax credit programs at the federal and state level, including the Historic Rehabilitation Tax Credit ("HRTC") under section 47 of the Internal Revenue Code (the "I.R.C." or "Code"). Through its subsidiary, the National Trust Community Investment Corporation, the National Trust has developed extensive experience in facilitating private investment in certified rehabilitation projects that qualify for the HRTC and state historic tax credits.

Importance of the Historic Boardwalk Hall Case

The Tax Court's recent decision upholds the validity of the well-established method of facilitating investment in historic rehabilitation projects by forming partnerships among investors and property owners to undertake rehabilitation activities and thereby earn HRTCs for the partners. Reversing the Tax Court's decision, as the Government requests, would undermine the authorities supporting investment in historic rehabilitation projects through partnerships, threatening the financing of future historic preservation projects.

The HRTC provides critical support to the National Trust's mission of promoting the rehabilitation of historic properties throughout the United States. In May 2011, the Center for Urban Policy Research at the Edward J. Bloustein School of Planning and Public Policy at Rutgers released its Second Annual Report on the Economic Impact of the Federal Historic Tax Credit ("Report"). *See*

http://historiccredit.files.wordpress.com/2011/01/2nd_annual_rutgers_report1.pdf (last visited Dec. 21, 2011). The Report found that through 2010, the 20 percent HRTC has encouraged approximately $90 billion in investment in historic rehabilitation. *See* Report at 9 (gathered through research conducted by Rutgers). Investment in these rehabilitation projects "has generated about 2.0 million new jobs and billions of dollars of total (direct and secondary) economic gains." *Id.* Limiting the ability of investors to earn HRTCs through partnerships structures could significantly reduce these positive impacts.

Partnerships such as the taxpayer here, Historic Boardwalk Hall, LLC ("HBH"), are a critical tool for parties seeking to join together the capital and expertise necessary to complete historic rehabilitation projects. The ability to earn tax credits through a partnership furthers the purpose of Code § 47 to create financial incentives to preserve and rebuild historic structures that would otherwise deteriorate or be destroyed. Indeed, the National Park Service ("NPS"), a division of the U.S. Department of the Interior, publishes analyses of the HRTC. These analyses, authored by employees of the Internal Revenue Service, reference the use of partnerships in financing and facilitating the rehabilitation of historic properties. *See* Mark Primoli & Tom Gavin (IRS), *National Park Service: Topical Tax Brief* --

Property Leased to a Tax-Exempt Entity at 2, http://www.nps.gov/tps/tax-incentives/taxdocs/IRS_tax_exempt.pdf (last visited Dec. 15, 2011).[2]

The National Trust intends to address two issues in this case: (1) the proper application of the economic substance doctrine to investments that Congress incentivizes through tax credits like the HRTC; and (2) whether the New Jersey Sports and Exhibition Authority ("NJSEA") and Pitney Bowes joined together as partners in a valid partnership for purposes of completing the historic East Hall rehabilitation project.[3]

Pursuant to Fed. R. App. P. 29(a), undersigned counsel have spoken with counsel for both the Appellant and the Appellees, and they have consented to the filing of an amicus curiae brief in this appeal. The National Trust hereby affirms that no person or entity, other than the National Trust and counsel, has contributed monetarily or otherwise to the preparation and submission of this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

1. When applying the economic substance doctrine, a court should not override Congress' clear policy of encouraging rehabilitation projects through the

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[2] The NPS plays a key role in approving or "certifying" all rehabilitation projects seeking the 20% rehabilitation tax credit through I.R.C. § 47.

[3] Although not specifically addressed in this brief, the National Trust also supports the Tax Court's determination that HBH was the owner of East Hall for federal tax purposes.

HRTC. This position is consistent with the case law, including an opinion of this Court. Moreover, legislative history to Congress' clarification of the economic substance doctrine specifies that the doctrine shall not be applied to deny Congressionally-sanctioned tax benefits, including the HRTC. *See* Staff of J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010", As Amended, In Combination With the "Patient Protection and Affordable Care Act"* (hereinafter "JCT RA 2010 Report") 152 n.344 (JCX-18-10 Mar. 21, 2010). The Government's approach of broadly applying economic substance principles to this situation would eviscerate the section 47 credit, thereby defeating Congress' purposes rather than furthering them.

2. HBH should be respected as a valid partnership for tax purposes. Pitney Bowes and NJSEA joined together as partners in the partnership in good faith and for the business purpose of rehabilitating the historic East Hall. The partnership's purpose is entirely consistent with the Congressional purpose of Code section 47, and the Court should not blunt the financial incentive of the HRTC by disregarding a partnership structure that has been commonly employed for decades by investors in historic rehabilitation projects.

ARGUMENT

I. PARTNERSHIP TRANSACTIONS LIKE THE ONE IN THIS CASE ARE CRITICAL TO FURTHERING THE CONGRESSIONAL PURPOSE UNDERLYING I.R.C. § 47 TO INCENTIVIZE REHABILITATION OF HISTORIC PROPERTIES

A. Congress Intended the Tax Credit to Incentivize Investors to Undertake Historic Rehabilitation Projects That Would Not be Economical on a Pre-Tax Basis

In 1981, Congress adopted a tax credit for rehabilitation of historic properties, although the origin of the credit dates back to the passage of the National Historic Preservation Act. *See* 16 U.S.C. §§ 470-470w (1966). It has maintained this credit in one form or another ever since. Congress amended and re-enacted the credit as part of the Tax Reform Act of 1986 (the "1986 Act"), even as Congress withdrew many other tax credits. *Compare* Economic Recovery Tax Act of 1981 ("ERTA"), Pub. L. No. 97-34, § 212, 95 Stat. 172, 235-40 (enacting HRTC) *with* Tax Reform Act of 1986, Pub. L. No. 99-514, § 251, 100 Stat. 2085, 2183-89 (amending and continuing HRTC).[4]

Congress specifically intended the HRTC to incentivize investment in projects that would not be economical on a pre-tax basis. Indeed, Congress explained its decision to re-enact the credit as part of the 1986 Act as follows: "the

[4] The brief for Petitioner-Appellee provides a full description of the historic evolution of the HRTC as a preservation incentive. *See* Brief for Petitioner-Appellee New Jersey Sports and Exposition Authority ("Pet.-App.'s Br.") (filed Dec. 15, 2011) at 26-32.

incentives granted to rehabilitation in 1981 remain justified. Such incentives are needed because the social and aesthetic values of rehabilitating and preserving older structures *are not necessarily taken into account in investors' profit projections*." Staff of J. Comm. on Tax'n, 99th Cong., *General Explanation of the Tax Reform Act of 1986* ("Gen. Expl.") 149 (JCS-10-97 J. Comm. Print 1987) (emphasis added). Congress concluded that "A tax incentive is needed because market forces might otherwise channel investments away from such projects because of the extra costs of undertaking rehabilitations of older or historic buildings." *Id.*

The HRTC has been highly effective in serving this Congressional purpose. In connection with the 25th anniversary of the HRTC, the Department of the Interior touted the HRTC for saving 29,000 historic buildings and spurring $25 billion in private investment. *See* National Park Service, *Twenty-Fifth Anniversary Report: Federal Tax Incentives for Rehabilitating Historic Buildings*, at 3 (Nov. 2001). Fran P. Mainella, Director of the National Park Service, noted that the HRTC "helped historic buildings to attract major private investment for the first time" and "[b]efore the tax incentives, few accepted the idea that reusing historic buildings could be profitable." *Id.* at title page. As noted above, the Historic Tax Credit Coalition found that, through 2010, the HRTC has encouraged approximately $90 billion in such investment. *See* Report at 9.

In 2010, Congress again noted the importance of preserving the HRTC when codifying the economic substance doctrine. Following enactment of Code § 7701(o), the Joint Committee on Taxation released a technical explanation stating, "If the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed to effectuate, *it is not intended that such tax benefits be disallowed* [under the economic substance doctrine]." *See* JCT RA 2010 Report at 152 n.344 (emphasis added). Further, the technical explanation specifically mentions the "section 47 (rehabilitation credit)" as the type of benefit falling within this rule. *See id.* Moreover, the IRS's internal guidance to IRS Agents makes a similar point. *See* Heather C. Maloy, LB&I Directive: *Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties* (July 15, 2011), http://www.irs.gov/businesses/article/0,,id=242253,00.html (last visited Dec. 21, 2011) (economic substance doctrine likely inapplicable to tax credits designed to encourage transactions that would not take place but for the credits).

B. Partnerships Commonly Invest in Historic Rehabilitation Projects Because These Entities Facilitate Bringing Together The Diverse Resources Necessary to Complete These Projects

Partnership structures are a common feature in many historic rehabilitation projects. *See, e.g.*, Joint Appendix ("JA") 1681-82. The partnership form is an effective mechanism for bringing together, in a shared business relationship,

parties with the expertise necessary to manage, develop, and operate a historic rehabilitation project, and parties with the financial resources to fund restoration of historic buildings. *See generally* Novogradac & Co. LLP, *Historic Rehabilitation Handbook* § 2.01 (3d ed. 2007) (noting that partnerships, limited liability companies taxed as partnerships, and S corporations comprise the "majority" of historic tax credit ownership mechanisms). As intended by Congress, the investors seek an economic return resulting not only from the partnership's operation of the property after completion of the project, but also from the HRTCs and other tax benefits that the partnership earns by completing the project.

Partnerships are not liable for federal income tax. Instead, the partners are required to report on their respective returns their distributive shares of the partnership's items of income, gain, loss, deduction or credit. *See* I.R.C. §§ 701, 702, 704.[5] Under this pass-through tax treatment of partnerships, HRTCs are allocated to the partners' respective distributive shares. Treasury regulations governing partnerships expressly require the allocation of tax credits to the partners in a partnership under the terms of the partnership agreement and the regulations.

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[5] Accordingly, an allocation of partnership items among the partners' distributive shares is not the same as a sale or transfer from the partnership to the partners. *Compare* I.R.C. § 702 (partner must take into account its distributive share of partnership items) *with* I.R.C. § 707 (governing transactions between a partnership and a partner acting other than in a partnership capacity).

See Treas. Reg. § 1.704-1(a) ("A partner's distributive share of any item or class of items of income, gain, loss, deduction, or credit of the partnership shall be determined by the partnership agreement, unless otherwise provided by section 704 and paragraphs (b) through (e) of this section.").

The agencies responsible for administering the credit freely acknowledge the role of partnerships in creditable historic rehabilitation projects. The HRTC is jointly administered by the U.S. Department of the Interior, through the National Park Service, and the Department of the Treasury, through the Internal Revenue Service. The National Park Service publishes an informational brochure on its website about the HRTC, in which it acknowledges the common "partnership" and "limited partnership" forms used by parties in rehabilitating historic buildings on projects incentivized by the HTC. *See* Mark Primoli & Tom Gavin (IRS), *National Park Service: Topical Tax Brief -- Property Leased to a Tax-Exempt Entity* at 2, http://www.nps.gov/tps/tax-incentives/taxdocs/IRS_tax_exempt.pdf (last visited Dec. 15, 2011); JA 1681-82; *see also* Pet.-App.'s Br. at 30-32 (discussing IRS publications acknowledging use of partnerships between taxable and tax-exempt entities to earn HRTCs). In such a partnership, the tax credits may be allocated between the partners in compliance with the partnership allocation rules under Section 704(b) of the Code.

The East Hall rehabilitation is an example of how the availability of HRTCs to partnerships and their partners can be highly effective at attracting equity investors to rehabilitate historic properties. NJSEA faced significant costs in completing the rehabilitation of East Hall on its own, but potential private investors faced the possibility of only modest profits, or even losses, if the rehabilitated East Hall failed to generate sufficient income. Indeed, the "social and aesthetic value" of a rehabilitated East Hall may exceed its pure economic value. *See* Gen. Expl. at 149 (noting that the HRTC was needed "because the social and aesthetic values of rehabilitating and preserving older structures are not necessarily taken into account in investors' profit projections"). With the ability to earn HRTCs through the HBH partnership, however, investing funds in the East Hall rehabilitation project became more attractive to potential investors. Accordingly, the HRTC operated in this case to advance Congress' purpose "because market forces might otherwise channel investments away from such projects because of the extra costs of undertaking rehabilitations of older or historic buildings." *Id.* In recognition of the inability of individual investors to fully fund historic rehabilitation, institutional equity investors are needed to finance large projects.

C. Congress Contemplated the Potential Creation of Public/Private Partnerships That Earn Historic Rehabilitation Tax Credits

The Government attempts to divert the Court's attention from the purpose of the HRTC to what it characterizes as NJSEA's attempt to "monetize" the value of

the East Hall project's HRTCs. *See* Brief for the Appellant ("Gov't Br.") at 52. On the one hand, the Government rightly concedes that Congress intended the section 47 tax credit to encourage historic rehabilitation projects like HBH's restoration of East Hall. On the other hand, the Government asserts that Congress could not have intended rehabilitation projects to earn credits when conducted through a partnership between a private party like Pitney Bowes and a government instrumentality like the NJSEA. *Id.* at 59. The Government's argument, however, is purely speculative and runs contrary to the plain meaning of the statute.

The Government is wrong in asserting that the tax laws do not contemplate public/private partnerships that earn historic rehabilitation credits. The statute specifically contemplates extending credits to partnerships between taxable partners and tax-exempt government instrumentalities. *See* I.R.C. §§ 50(b)(4)(D), 168(h)(6); *see also* Rev. Rul. 78-268, 1978-2 C.B. 10 (public/private partnership did not prevent taxable partner from claiming its allocable share of investment tax credit); Rev. Rul. 80-219, 1980-2 C.B. 18 (transfer of investment tax credit property to private/public partnership does not trigger recapture with respect to private partner's retained interest). Indeed, the Government fails to provide guidance as to what structure would be acceptable for the transaction at issue in this case. The provisions governing partnerships with tax-exempt government instrumentalities require that the credit be allocated among the taxable and tax-

exempt partners pursuant to a "qualified allocation." *See* I.R.C. § 168(h)(6)(B). The Government does not contest that HBH's allocations of the rehabilitation tax credits were qualified allocations. Accordingly, the Government's objection to the private/public partnership between Pitney Bowes and NJSEA is meritless.

II. THE ECONOMIC SUBSTANCE DOCTRINE SHOULD NOT BE APPLIED IN A MANNER THAT DEPRIVES TAXPAYERS OF THE INCENTIVE TO REHABILITATE HISTORIC PROPERTIES

A. Overview of Economic Substance Doctrine

At the heart of the Government argument is its assertion that the HBH transactions lacked economic substance because Pitney Bowes did not contemplate earning a profit on its partnership interest. This Government position cannot be reconciled with the facts. As found by the Tax Court, Pitney Bowes did anticipate earning a profit from its interest in HBH, both through a three percent preferred return, and through the HRTCs that HBH would earn upon completion of the East Hall rehabilitation. *See* JA 41. In an attempt to avoid at least the latter portion of Pitney Bowes' profit expectations from its investment in HBH, the Government argues that the economic substance doctrine should be applied exclusively on a pre-tax basis—*i.e.*, without regard to the HRTCs. Gov't Br. at 55-59. The difficulty with the Government's argument is that it violates Congress' purpose to increase the economic attractiveness of historic rehabilitation projects that might not be viable without the HRTC. Moreover, the Government's position disregards

the actual changes in economic position and legal relations among Pitney Bowes and its partner, NJSEA. *See infra*, Section II.B.

The economic substance doctrine is applied to prevent taxpayers from subverting Congress' statutory intent by engaging in transactions that lack economic reality to claim tax benefits that were not "the thing which the statute intended." *See ACM P'ship v. Comm'r,* 157 F.3d 231, 247 (3d Cir. 1998) (citing *Gregory v. Helvering*, 293 U.S. 465, 469-70 (1935)). The doctrine does not, however, authorize the Government to block taxpayers from claiming tax benefits that Congress specifically intended to change the economic calculus with respect to potential historic rehabilitation projects. HBH completed the historic rehabilitation of East Hall and qualified for the HRTC in the manner Congress intended. HBH's status as a partnership does not change these facts. Because HBH's actions were consistent with Congress' intent, application of the economic substance doctrine has no relevance to the outcome of this case.[6]

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[6] This Court has observed, "Economic substance is a prerequisite to the application of any Code provision allowing deductions." *See CM Holdings*, 301 F.3d at 102. This statement should not read as endorsing rote application of a rigid two-pronged analysis that precludes taxpayers from taking into account tax benefits that Congress intended to incentivize that might not otherwise occur. If the substance of the taxpayers' investment is consistent with Congress' intent, the economic substance doctrine is satisfied. This conclusion underscores why Congress' recent clarification limits application of the economic substance doctrine to "any transaction to which the economic substance doctrine is relevant." *See* I.R.C. § 7701(o)(1).

B. The HBH Transactions Satisfy the Requirements of the Economic Substance Doctrine

Even if the economic substance doctrine were relevant, the HBH transactions would pass muster under the doctrine. In the past, this Court has avoided a formulaic approach to measuring the economic substance of a transaction in favor of a factors-based analysis of whether a transaction has sufficient substance, apart from its tax consequences, to be respected for tax purposes. "[I]nquiry into whether the taxpayer's transaction had sufficient economic substance to be respected for tax purposes turns on both the 'objective economic substance of the transactions' and the 'subjective business motivation' behind them." *ACM P'ship*, 157 F.3d at 247 (citation omitted); *In re CM Holdings, Inc.*, 301 F.3d 96, 102 (3d Cir. 2002).

Under the objective economic substance inquiry, the main question is whether, absent the tax benefits, "the transaction affected the taxpayer's financial position in any way." *See CM Holdings*, 301 F.3d at 103. It is "well established that where a transaction objectively affects the taxpayer's net economic position, legal relations, or non-tax business interests, it will not be disregarded merely because it was motivated by tax considerations." *See ACM P'ship,* 157 F.3d at 248 n.31. In applying the subjective business purpose inquiry, courts generally ask whether the taxpayer entered into the transaction without an expectation of economic profit and with no purpose other than tax avoidance. *See id.* at 253

(citing *United States v. Wexler*, 31 F.3d 117, 122 (3d Cir. 1994)); *CM Holdings*, 301 F.3d at 106. Given that the economic substance doctrine is designed to further Congressional purposes, however, it is not appropriate to engage in a rote application of the two-factor economic substance analysis that would defeat a Congressional purpose to incentivize certain tax-favored activities.

Thus, the Ninth Circuit held in *Sacks v. Commissioner*, 69 F.3d 982, 990-91 (9th Cir. 1995), that a taxpayer was entitled to federal alternative energy investment tax credits and depreciation deductions arising out of the purchase and leaseback of solar water heaters, notwithstanding the Tax Court's finding that the investment would likely lose money without the tax credits. The *Sacks* court explained that "[a] tax advantage such as Congress awarded for alternative energy investments is intended to induce investments which otherwise would not have been made." *Id.* at 992. It further observed that, if "the government treats tax-advantaged transactions as shams unless they make economic sense on a pre-tax basis, then it takes away with the executive hand what it gives with the legislative." *Id.* The Government's position in the instant case would similarly undermine Congress' purpose in enacting the HRTC, taking away with the executive hand the investment incentive that Congress extended with the legislative hand.

In *In re CM Holdings, Inc.*, this Court cited approvingly to the principle underlying the *Sacks* opinion, where Congress has "specifically encouraged

investment in solar energy and thereby 'skewed the neutrality of the tax system.'" 301 F.3d 96, 106 (3d Cir. 2002) (citing *Sacks*, 69 F.3d at 991). Thus, this Court pointedly observed that "[i[f Congress intends to encourage an activity, and to use taxpayers' desire to avoid taxes as a means to do it, then a subjective motive of tax avoidance is permissible." *Id.* *CM Holdings* concluded that the principle of *Sacks* was inapplicable on the facts of that case because the taxpayer's plan to generate interest deductions through a program of debt-financed life insurance policies was not a transaction that Congress intended to encourage. *See id.* at 106-07; *see also ACM P'ship*, 157 F.3d at 257 n.49 (sale-leaseback transaction in *Sacks* distinguishable because it involved equipment used for legitimate business purposes and resulted in concrete changes in economic positions). But when the transaction in question is one that Congress sought to encourage, *Sacks* and *CM Holdings* caution against relying solely on a mechanical application of the two-factor economic substance analysis.

In any event, in the present case the Tax Court correctly found that both the subjective business purpose and the objective economic substance of the HBH transaction favored a finding that the transaction had economic substance. *See* JA 41. First, with respect to the subjective inquiry, it rejected the Government's allegation that Pitney Bowes invested in the HBH transactions solely to earn tax credits. Rather, the court explained, Pitney Bowes' three percent preferred return

should be viewed together with HBH's expected tax credits from rehabilitating East Hall. The Tax Court further found that "Pitney Bowes, NJSEA, and Historic Boardwalk Hall had a legitimate business purpose—to allow Pitney Bowes to invest in the East Hall's rehabilitation." *Id.* Accordingly, when the tax credits and expected three percent return are viewed together, "the Historic Boardwalk Hall and the East Hall transactions did have economic substance." *Id.*

Second, with respect to the objective economic substance inquiry, the Tax Court's factual findings showed that the HBH transactions did affect the parties' net economic positions, legal relations, and non-tax business interests. The court found that Pitney Bowes actually invested funds in the East Hall rehabilitation. It further found that this investment "provided NJSEA with more money than it otherwise would have had; as a result, the rehabilitation ultimately cost the State of New Jersey less." JA 42. The Tax Court found that the HBH partnership agreement imposed real obligations on both Pitney Bowes and NJSEA. "Pitney Bowes was required to make financial contributions, and NJSEA was required to manage the East Hall's rehabilitation and assure its completion." *Id.* The court further found that Pitney Bowes faced business risks as a result of joining the HBH partnership, including cash flow, non-completion, and environmental risks.

In attacking the Tax Court's conclusion that the transaction had economic substance, the Government focuses on the parties' efforts to control their business

risks. For example, the Government points to Pitney Bowes' limited liability with respect to excess development costs and operating deficits. *See* Gov't Br. at 51-53. It also points to NJSEA's indemnification of Pitney Bowes against undisclosed environmental liabilities with respect to East Hall, NJSEA's guarantee of completion of the rehabilitation project, and the HBH-NJSEA guarantee of Pitney Bowes' tax benefits. *See id.* at 41, 43, 46-47.

Looking at the risk-control efforts in context, the Tax Court properly found that these unremarkable contract terms were necessary to attract an equity investor in HBH. *See* JA 25-27, 43-45. Limited liability is fundamental to the concept of a limited partnership interest and a common characteristic sought by investors in rehabilitation projects. Few investors are interested in taking on the rehabilitation of a historic building without protection from pre-existing environmental hazards, and they commonly insist on indemnities with respect to such risks. Similarly, because Pitney Bowes was dependent on NJSEA, as the managing member of HBH, to complete the rehabilitation of East Hall, Pitney Bowes sought completion and tax benefits guarantees to ensure that NJSEA would perform its duties.[7] As

[7] Limited partners generally have little role in management. *See* Alan R. Bromberg and Larry E. Ribstein, *Bromberg and Ribstein On Partnership*, § 11.01(b) (2000) (in a limited partnership, "general partners hav[e] most or all of the control, and limited partners hav[e] little or none"). This does not mean that they are not partners for tax purposes.

the Tax Court found, these terms were fully consistent with the overall goal of the transaction to successfully complete the rehabilitation of East Hall. *See* JA 43.[8]

Accordingly, the facts as found by the Tax Court are distinguishable from the situation in *ACM Partnership*, where the taxpayer's purported business purposes for the transactions at issue would have defeated the stated goal of the overall transaction. *See ACM P'ship v. Comm'r*, 157 F.3d 231, 255-56 (3d Cir. 1998) ("ACM's asserted rationale of hedging against other assets within the partnership would 'defeat [the] very purpose' which Colgate had advanced for pursuing a debt acquisition partnership in the first place.") Instead, the guarantees the parties negotiated in the present case are fully consistent with prudent business practice for an equity investor in a historic rehabilitation project. *See Compaq Computer Corp. v. Comm'r*, 277 F.3d 778, 787 (5th Cir. 2001) ("The absence of risk that can legitimately be eliminated does not make a transaction a sham"); *IES Indus. v. United States*, 253 F.3d 350, 355 (8th Cir. 2001) ("We are not prepared to say that a transaction should be tagged a sham for tax purposes merely because it does not involve excessive risk."); *United Parcel Serv. of Am. v. Comm'r*, 254

[8] In addition, as illustrated during the financial crisis of 2008, obtaining a guarantee does not totally eliminate risk or insulate an entity from loss. Guarantors are not infallible and insurers do not always provide the expected coverage.

F.3d 1014, 1018 (11th Cir. 2001) (transaction that limits downside risk through reinsurance still has economic substance).

The Government further asserts that the HBH transaction was "an empty transaction that shuffles payments for the sole purpose of generating a deduction." Gov't Br. at 58 (quoting *Am. Elec. Power Co., Inc. v. United States*, 326 F.3d 737, 743-44 (6th Cir. 2003), and *In re CM Holdings, Inc.*, 301 F.3d 96, 105 (3d Cir. 2002)). This assertion cannot be reconciled with the facts in this case. The Tax Court specifically found that Pitney Bowes' investment in HBH made available additional funds to complete the rehabilitation project. Accordingly, the investments in this case are fundamentally different from the shuffling of empty payments to create deductions, such as those at issue in *American Electric Power* and *CM Holdings*. Moreover, the HBH transaction involved a purpose beyond merely generating tax credits: the purpose of rehabilitating East Hall. This is a purpose that Congress sought to incentivize with the HRTC, and acceptance of the Government's arguments here would severely weaken that purpose.

III. THE TAX COURT PROPERLY RECOGNIZED HBH AS A PARTNERSHIP AND PITNEY BOWES AS A PARTNER FOR TAX PURPOSES

As the Government acknowledges, its argument that HBH is a sham partnership closely tracks its economic substance attack. *See* Gov't Br. at 50-51. Accordingly, its sham partnership attack must fail in light of the Tax Court's

findings that the HBH transaction had a legitimate—including a Congressionally approved—business purpose, and impacted the partners' net economic positions, legal relations, and non-tax business interests. The Government's argument also seeks to introduce a business purpose requirement "for the use of the partnership form." *See id.* at 50 (citing *Southgate Master Fund, LLC ex rel. Montgomery Capital Advisers, LLC v. United States*, 2011 WL 4504781, at *13, 659 F.3d 466, 483-84 (5th Cir. Sept. 30, 2011)). The Government, however, is wrong; as discussed below, Treasury regulations specifically provide that taxpayers are free to elect partnership treatment for a business entity that is otherwise recognized for tax purposes.

A. HBH is Not a Sham Partnership

For income tax purposes, the term "partnership" includes "a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate." *See* I.R.C. § 761(a). Early in the evolution of the tax laws governing partnerships, the Supreme Court addressed attempts by taxpayers to assign their income to family members through purported partnerships. *See Comm'r v. Tower*, 327 U.S. 280 (1946); *Comm'r v. Culbertson*, 337 U.S. 733 (1949). In so doing, the Supreme Court articulated a test for identifying partnerships and partners: "[W]hether,

considering all the facts, . . . the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *See id.* at 742.[9]

Treasury later simplified identifying partnerships through the so-called "check-the-box" regulations. Under these regulations, a business entity that is recognized for federal tax purposes and has at least two members is classified as a partnership, unless the entity is a trust, a corporation, or elects to be taxed like a corporation. *See* Treas. Reg. §§ 301.7701-2(c) and 301.7701-3(a), (b); Treas. Reg. § 1.761-1(a).

A threshold question under the check-the-box regulations is whether the entity is recognized as separate from its owners for tax purposes. Thus, a corporation is recognized as a separate taxpayer from its owner, and a sole proprietorship is not. Courts have long recognized the separate existence of a business entity, including a partnership, for tax purposes if the business entity was formed for a business purpose or carried on business activity. *See Bertoli v. Comm'r*, 103 T.C. 501, 511-12 (1994) (citing *Moline Props., Inc. v. Comm'r*, 319

[9] Subsequently, Congress made it easier to identify partners by adding section 704(e)(1) to the Code, which provides: "A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person."

U.S. 436 (1943), applies to issue of recognizing partnership's existence); *Madison Gas & Elec. Co. v. Comm'r*, 72 T.C. 521, 562 (1979), *aff'd*, 633 F.2d 512 (7th Cir. 1980) (joint construction and operation of power plant to earn profits from power generation created partnership); *Seminole Flavor Co. v. Comm'r*, 4 T.C. 1215, 1235 (1945), *acq*., 1945 C.B. 6 (shareholders of corporation formed partnership that was separate from corporation); *see also* Treas. Reg. § 301.7701-1(a) (contractual arrangement may constitute separate tax entity).[10] However, where an entity has no business purpose and carries on only tax-avoidance activities, it will not be recognized for tax purposes. *See ASA Investerings P'ship v. United States*, 201 F.3d 505, 512 (D.C. Cir. 2000).[11]

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[10] When it is in the Government's interest to do so, the IRS has argued the opposite of the Government's position in this case—*i.e.*, that business entities, whether formal or informal, must report income or expenses on their own, separate tax returns. *See, e.g.*, *Moline Props.*, 319 U.S. at 438 (gain from sale of property reported on corporation's return subject to corporate income tax); *Madison Gas & Elec.*, 72 T.C. at 564 (start-up activities of partnership are not expenses of the partners' separate businesses); *Seminole Flavor*, 4 T.C. at 1235 (partnership income cannot be consolidated with income of corporation owned by same interests).

[11] The Fifth Circuit's opinion in *Southgate* relies on *ASA Investerings* in reaching the conclusion that a taxpayer must have a business purpose for selecting the partnership "form" for its business entity. *See Southgate*, 2011 WL 4504781, at *13 n.33, 659 F.3d at 479. However, the *ASA Investerings* court never made that statement. The *ASA Investerings* court addressed the issue of whether the taxpayer had entered into a bona fide partnership for tax purposes—not whether a business purpose supported the taxpayer's election of the partnership form. *See ASA Investerings*, 201 F.3d at 512-13. The Internal Revenue Code provides distinct tax

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In the present case, HBH is recognized as a separate entity because it had both business purpose and non-tax business activities. The Tax Court found that Pitney Bowes and NJSEA had a common goal in entering into their joint venture: the rehabilitation of East Hall. *See* JA 44-45. The partnership's business activities in successfully completing this project cannot be dismissed as tax-avoidance activities. The Tax Court found that both partners received net economic benefit from HBH's successful completion of the project. JA 45.

In addition, HBH was an LLC duly organized under New Jersey law, had two members, and did not elect to be taxed as a corporation. As the Tax Court recognized, HBH was classified as a partnership under the check-the-box regulations. *See* JA 50; Treas. Reg. § 301.7701-3(b).[12] Indeed, Treasury regulations and published IRS guidance would not allow HBH to elect out of partnership treatment even if it wanted to do so.[13]

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treatment to various forms of entities, and it is well established that parties may elect one form over another, so long as the substance of their transaction is consistent with that form. *See* Treas. Reg. § 1.7701-3(a).

[12] Moreover, the two members were partners in HBH under Code section 704(e). Capital was a material income producing factor in HBH, and the members held capital interests distributable to them upon liquidation. *See* JA 198 (Partnership Agreement § 11.03); Treas. Reg. § 1.704-1(e).

[13] Pitney Bowes' preferred interest does not meet the requirements for exclusion from subchapter K under Code § 761(a) or Treas. Reg. § 1.761-2. For example, in 1984, the IRS published guidance stating that low-risk partnerships investing in tax

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Although HBH and its partners clearly satisfied the technical requirements for recognition under the cases, Code, and regulations, the Tax Court also addressed whether Pitney Bowes should be recognized as a partner under the Supreme Court's *Culbertson* test: *i.e.*, whether the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise. This is a factual inquiry that takes into consideration the parties' agreement, conduct, statements, testimony of third parties, the parties' respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts indicating their intent to join together in the conduct of an enterprise. *See* 337 U.S. at 742.

The Tax Court found that Pitney Bowes and NJSEA, in good faith and acting with a business purpose, joined together in the present conduct of a business enterprise, making them partners under *Culbertson.* The Tax Court found that the HBH partnership agreement accurately represented the substance of the transaction. *See* JA 50-51. It found that the parties carried out their responsibilities under the partnership agreement. JA 51. It found that the parties' investigation and documentation, including due diligence with respect to

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exempt bonds with two classes of interest holders were not eligible for exclusion from partnership treatment. *See* Rev. Proc. 2003-84, § 2, 2003-2 C.B. 1159, 1160.

environmental hazards, supported a finding that the parties intended to join together in rehabilitating East Hall. JA 50-51. HBH was held out as a partnership to third parties, contracts related to the rehabilitation work were assigned to HBH, and HBH was added as an insured on NJSEA's environmental liability insurance. *See, e.g.*, JA 13-15, 28-29. Finally, the Tax Court found that HBH's rehabilitation of East Hall was a success, and that investing in the partnership provided net economic benefits to Pitney Bowes in the form of the three percent preferred return and HRTCs, and to NJSEA in the form of additional capital that reduced NJSEA's costs of completing the project. JA 51. Accordingly, the Tax Court's finding that the HBH transactions met the *Culbertson* test has ample factual support.

The Tax Court also found that the partnership agreement imposed real obligations on both partners: Pitney Bowes to make capital contributions, and NJSEA to manage the rehabilitation project to completion. *See* JA 51. It found that Pitney Bowes took on risks as a partner in HBH, including that HBH would not complete the rehabilitation project and qualify for the HRTCs, and potential environmental liability from HBH's environmental remediation efforts at East Hall. JA 51-52. It also observed that the partners' interests were aligned with the common goal of rehabilitating East Hall. JA at 50. NJSEA wanted the rehabilitation to be successful so that East Hall would attract crowds to Atlantic City for concerts and events, and Pitney Bowes wanted the rehabilitation to be

successful so that it could earn the rehabilitation credits and three percent preferred return. JA 50-52. This unity of purpose is not surprising given that the parties' expectations for the East Hall formed the basis of the partnership in the first place. Without them, the partnership would never have been formed and the operating agreement—designed to protect these expectations—would have been worthless.

B. *Castle Harbor* and *Virginia Historic* Are Distinguishable

In attacking the Tax Court's finding that Pitney Bowes was a partner in HBH for federal income tax purposes, the Government relies heavily on the Second Circuit opinion in *TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006) (hereinafter "*Castle Harbor II*"), and the Fourth Circuit's decision in *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011) (hereinafter "*Virginia Historic*"). *See* Gov't Br. at 34-40. These two cases, however, are inapposite.

In *Castle Harbor II*, the Second Circuit addressed whether partnership interests qualified as "bona fide equity" participation in a partnership. *See Castle Harbor II*, 459 F.3d at 224. Two Dutch banks advanced funds to the Castle Harbor partnership in exchange for a fixed annual return that was guaranteed regardless of the fortunes of the partnership's business. *See id.* at 239. If the partnership failed to make a payment, the banks could force dissolution and receive back their principal plus the fixed return. The partnership was precluded from using the

banks' funds in the partnership business. If the partnership property were to appreciate unexpectedly, the other partner, General Electric Capital Corp. (GECC), could unilaterally remove the property from the partnership, preventing the banks from sharing in the appreciation. The court ultimately concluded that the banks' interests were in the nature of a secured loan. *See id.* at 240. However, the Second Circuit remanded the case for a determination of whether the banks were nevertheless partners under Code section 704(e).[14]

The facts in the present case are different. If HBH had operated at a loss and had insufficient cash flow for a payment on Pitney Bowes' three percent return, Pitney Bowes could not have simply liquidated HBH and received back its investment plus interest. *See* JA 44-45. Moreover, Pitney Bowes had a stake in HBH's successful completion of the East Hall rehabilitation, which was necessary for HBH to qualify for the HRTCs. *Id.* HBH could not transfer assets out of the

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[14] On remand, the district court held that the banks were partners in Castle Harbor under section 704(e) and that the debt-like nature of their interest did not preclude holding that they were partners. *See TIFD III-E, Inc. v. United States,* 660 F. Supp. 2d 367, 386, 394-95 (D. Conn. 2009) (hereinafter *"Castle Harbor III*") (appeal pending). This holding in *Castle Harbor III* finds support in Code section 704(e)(1) and conforms to long-standing authority that a preferred interest may be treated as equity notwithstanding set returns and protections from risk. *See, e.g.*, *John Wannamaker Phila. v. Comm'r*, 139 F.2d 644, 647 (3d Cir. 1943) (preferred stock treated as equity rather than debt); *Jewel Tea Co. v. United States*, 90 F.2d 451, 452 (2d Cir. 1937) (Hand, J.) (the tax law has long distinguished preferred shareholders from creditors); Rev. Proc. 2003-84, 2003-2 C.B. 1159 (partnership that pays preferred returns must file as a partnership).

partnership to prevent Pitney Bowes from sharing in asset appreciation. Instead, NJSEA's option to buy Pitney Bowes' interest was based on the greater of the fair market value of Pitney Bowes' interest or any accrued and unpaid preferred return. *See* JA 25. Moreover, HBH applied approximately $14 million of Pitney Bowes' contributions to a development fee to NJSEA for rehabilitating East Hall. In sum, Pitney Bowes had a meaningful stake in the success or failure of HBH's business, and *Castle Harbor II* is inapplicable to the present case.

In *Virginia Historic*, the Fourth Circuit addressed whether often simultaneous transfers of state-law tax credits for cash were subject to the disguised sale rules of Code section 707(a). Here, the Government has not argued that the Pitney Bowes transaction is a disguised sale under Code § 707(a), so the holding in *Virginia Historic* has no application.

Moreover, the partnership in *Virginia Historic* did not perform the activities giving rise to the state credits. Instead, it purchased approximately one-third of those credits from third parties, and obtained the remainder from lower-tier partnerships that had already completed projects and received the state certifications necessary to claim the credits. *See* 639 F.3d at 135. Accordingly, the exchange of state tax credits for cash could occur simultaneously with a third-party investor's "admission" to the partnership. *See id.* at 135. A threshold question for the Fourth Circuit was whether transfers of state tax credits were transfers of

"property" within the meaning of the disguised sale rules of Code section 707, which apply to exchanges of money or property between a partnership and a partner that is not acting in its capacity as a partner. Ultimately, the court determined that transfers of state tax credits could be the subject of a disguised sale. *See id.* at 141-42.

Instead of a disguised sale question, the issue in the present case is whether, when partnership-level activities give rise to partnership income, gain, loss, or credit, those partnership items are properly allocated to the partners under Code §§ 702 and 704. As discussed above, the partners must separately take into account their distributive shares of the partnership's income, gain, loss, deduction, or credit. *See id.* §§ 702, 704. The Code's allocation of the partnership's tax credit to the partners' distributive shares is not an accession to wealth that gives rise to income for the partners. *See Tempel v. Comm'r*, 136 T.C. 341, 350 (2011) (government agreed that receipt of credit under state tax law does not give rise to income); Rev. Rul. 79-315, 1979-2 C.B. 27 (same); C.C.A. 201147024 (Nov. 25, 2011) (same). Holding that the Code's tax treatment of an item is itself a taxable item would create intolerable circularity in the tax laws, which may explain the

Fourth Circuit's statement that "we are not deciding whether tax credits always constitute 'property' in the abstract." *See Va. Historic,* 639 F.3d at 141 n.15.[15]

Not only did *Virginia Historic* involve a different legal issue, the facts of the HBH partnership differ from those in the *Virginia Historic* case. The Fourth Circuit found that the parties there agreed to exchange the pre-existing state tax credits for cash payments. Although the transactions were papered as investments in partnerships, the court of appeals emphasized that the investors' purported partnership interests were nominal. Moreover, the court found that the parties failed to respect the formalities for creating valid partnership interests; the partners' allocation of state credits did not correlate to their purported partnership interests; they were told to expect no share of partnership profits; and their highly transitory partnership interests were redeemed for a "proverbial pittance" within months. *See id.* at 134 n.5, 144.

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[15] The Fourth Circuit declined to apply the Supreme Court's holding in *Randall v. Loftsgaarden*, 478 U.S. 647, 657 (1986), that the receipt of a federal deduction or credit as income is not, itself, a taxable event because the investor receives no income for purposes of the Code. The Fourth Circuit explained that "we are not asked in this case to decide whether tax credits *in general* constitute 'property' or 'income.' Instead, we are asked only to determine whether a party's decision to exchange its tax credits for money, rather than to utilize them, means that the 'payment in cash' the party receives should be categorized as 'income.'" *Va. Historic*, 639 F.3d at 141 n.15.

In contrast, Pitney Bowes and NJSEA created a partnership in form and substance and respected their obligations under the partnership agreement. Moreover, Pitney Bowes remained a partner. Over the years, Pitney Bowes looked to the partnership's ongoing rehabilitation project and other activities to generate the items of partnership income, gain, loss, and credit that were allocated under the Code and Treasury Regulations to Pitney Bowes. These facts are the opposite of the situation in *Virginia Historic*, where the purported partners paid cash in a simultaneous exchange for pre-existing state tax credits, failed in the eyes of the court of appeals to respect the form of their transactions, and promptly redeemed their purported partnership interests for an amount described as a "pittance."

CONCLUSION

The judgment of the Tax Court should be affirmed.

Respectfully submitted,

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CERTIFICATE OF BAR MEMBERSHIP

Pursuant to Local Appellate Rule 28.3(d), it is hereby certified that at least one of the attorneys whose names appear on the brief is a member of the bar of this Court, or has filed an application for admission to that bar.

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CERTIFICATE OF COMPLIANCE

1. Pursuant to Fed. R. App. P. 29(a), undersigned counsel have spoken with counsel for both the Appellant and the Appellee, and they have consented to the filing of an amicus curiae brief in this appeal.

2. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because the brief contains 6,936 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and L.A.R. 29.1(b).

3. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because the brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14 point Times New Roman.

4. The undersigned further certifies that the foregoing brief filed electronically with the Court is in PDF searchable format, that the text of the PDF copy is identical to the text of the paper copy, that the PDF version has been electronically scanned for viruses using Trend OfficeScan 10.5.1766, and that, according to the program, no viruses were detected.

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CERTIFICATE OF SERVICE

I hereby certify that on December 21, 2011: (1) ten copies of this brief as amicus curiae were sent by first class mail to the Clerk; (2) a PDF copy was filed electronically by CM/ECF; and (3) service of the brief was made upon counsel for the appellant and counsel for the appellee by CM/ECF and by U.S. Mail at the following addresses:

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