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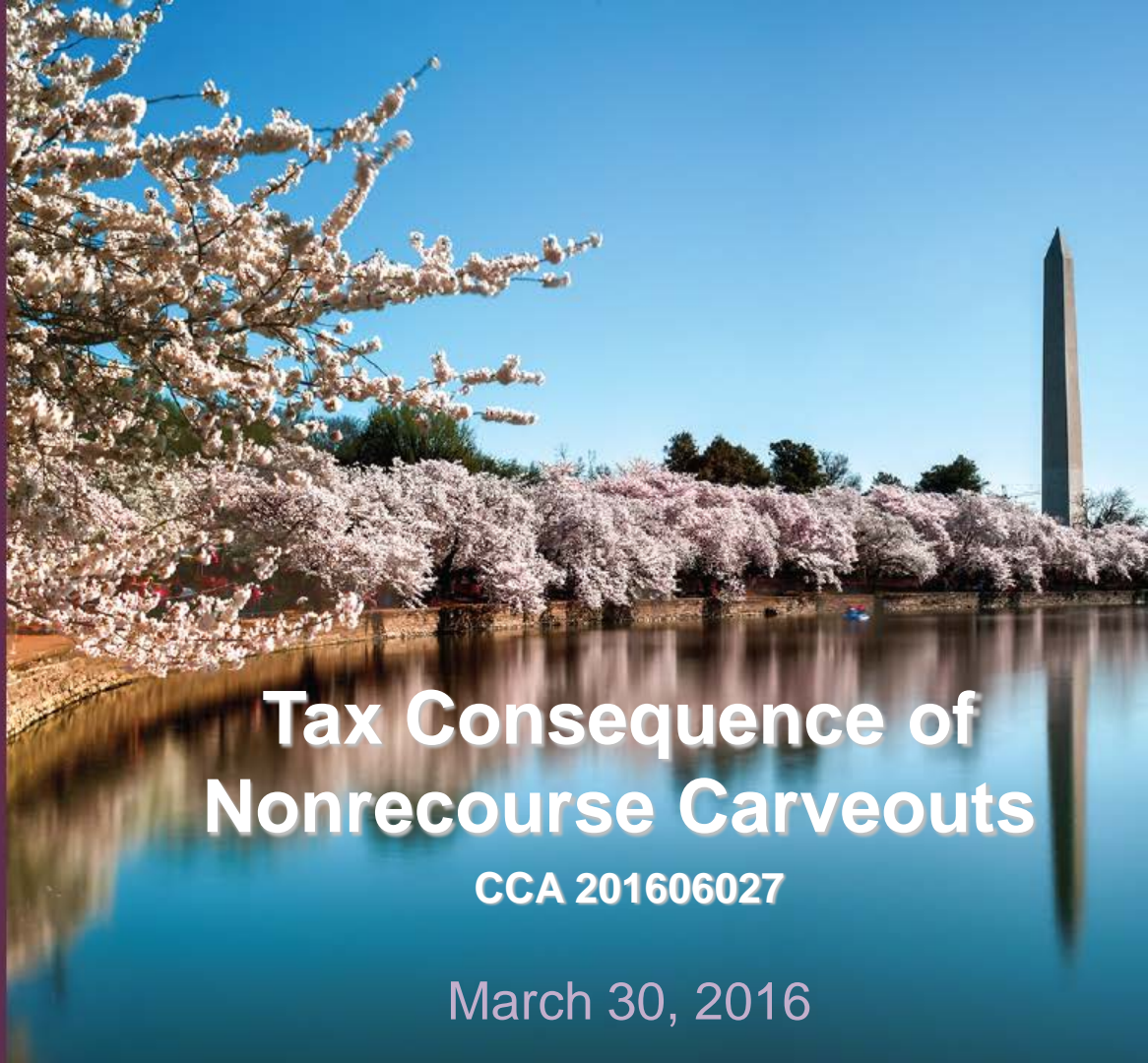
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Tax Consequence of Nonrecourse Carveouts

CCA 201606027

March 30, 2016



Presenter:

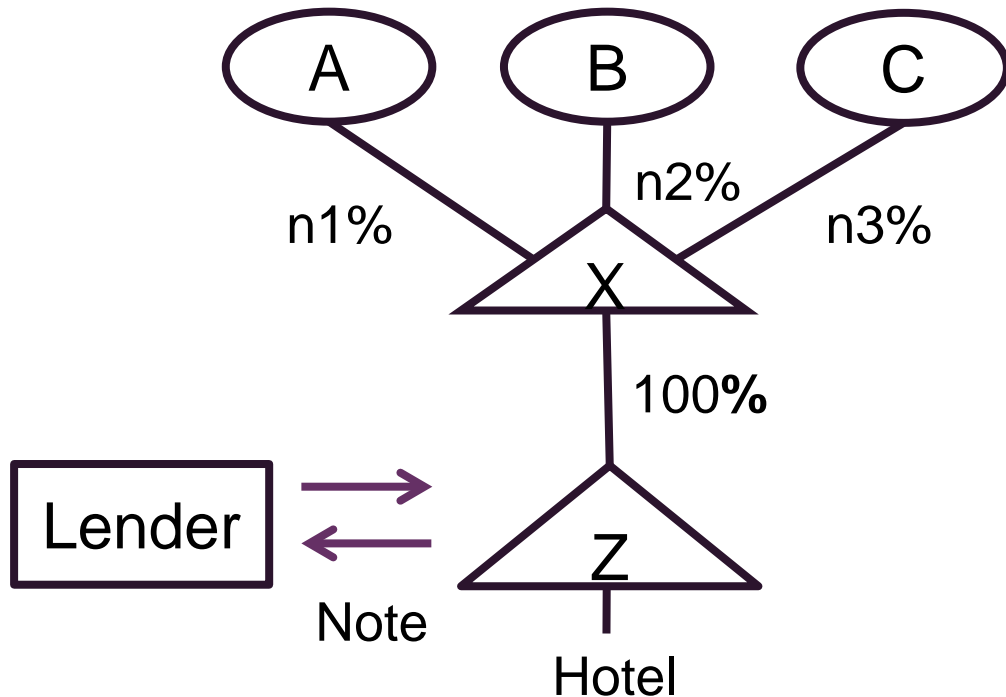
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The Structure



- Note secured by hotel.
- C executed 3 personal guarantees.



The Nonrecourse Carveout

- ◆ The entire amount due under the note due and payable if:
 1. the co-borrowers fail to obtain the lender's consent before obtaining subordinate financing or transfer of the secured property,
 2. any co-borrower files a voluntary bankruptcy petition,
 3. any person in control of any co-borrower files an involuntary bankruptcy petition against a co-borrower,
 4. any person in control of any co-borrower solicits other creditors to file an involuntary bankruptcy petition against a co-borrower,



The Nonrecourse Carveout

5. any co-borrower consents to or otherwise acquiesces or joins in an involuntary bankruptcy or insolvency proceeding,
6. any person in control of any co-borrower consents to the appointment of a receiver or custodian of assets, or
7. any co-borrower makes an assignment for the benefit of creditors, or admits in writing or in any legal proceeding that it is insolvent or unable to pay its debts as they come due.



The Regulations

◆ Treas. Reg. § 1.752-2(b)(4)

Contingent obligations. A payment obligation is disregarded if, taking into account all the facts and circumstances, the obligation is subject to **contingencies** that make it unlikely that the obligation will ever be discharged. If a payment obligation would arise at a future time after the occurrence of an event that is not **determinable with reasonable certainty**, the obligation is ignored until the event occurs.



Conclusions

- ◆ IRS concludes that the nonrecourse carveouts cause the note to be recourse to C.
- ◆ “We believe it is reasonable to assume that one or more of these conditions, more likely than not, would be met upon a constructive liquidation of X under § 1.752-2(b)(1). Accordingly, we believe that these ‘conditions’ do not fall within the definition of ‘contingencies’ as intended by § 1.752-2(b)(4).”



Conclusions

- ◆ “We nevertheless believe that the likelihood that X or any other co-borrower will ever meet any one of these conditions, in the aggregate, is not so remote a possibility that would cause the obligation to be considered ‘likely to never be discharged’ within the meaning of § 1.752-2(b)(4).”



Conclusions

- ◆ Real world borrowers understand that they do not have recourse liability on a loan with a nonrecourse carveout unless they engage in a voluntary or intentional “bad act.”
- ◆ Borrowers would not sign if they thought liability was “more likely than not”.
- ◆ If correct, liability (and deductions) would shift to NRCO signatory.
- ◆ Tax Returns?