Tax-Deferred Real Estate Dispositions: Some Partnership Techniques

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Three Partnership Structures

Mixing bowls, leveraged partnerships, and freeze partnerships rely on basic partnership tax principles to defer tax.

Three Partnership Forms

- Described very briefly below are three related transactional forms.
- All involve the acquisition and disposition, through partnerships, of interests in assets.
- If successful, such transactions may achieve results somewhat similar to those of a like-kind exchange under Code § 1031.
  - These transactions are not subject to the limitations of a Code § 1031 exchange.
  - However, these transactions are difficult to plan and implement; they certainly do not offer an easy way around Code § 1031.

Three Partnership Forms

- All three forms are similar in that they involve a
  - ***tax-free partnership contribution*** (Code § 721),

  rather than a
  - ***taxable sale*** of the property.
- However, the contribution *must have substance.*
- The parties must be willing to continue as "partners" to some extent.
- It is not just a matter of "papering" a sale as if it were a contribution.

Three Partnership Forms

- One party (the "Owner" or "Seller") holds real property (the "Old Property") worth $100, with a tax basis of zero.
- Another party (the "Investor" or "Buyer") wants to acquire this property.
- Owner and Investor are willing to cooperate in making the transaction tax-free.
- In all three of the structures described below, Owner contributes the Old Property to a partnership with Investor.
- *The tax goal*: Instead of a taxable sale of the Old Property, structure the transaction as a tax-free contribution of the Old Property to a partnership.

Terminology

O:	Owner (or Seller).
Sub:	A wholly-owned subsidiary of O.
I:	Investor (or Buyer).
New Property:	Property that Investor contributes, or that is purchased with the cash that Investor contributes.
Old Property:	Property that Owner wants to unload.
Newco:	Newly formed LLC (or other business entity classified for tax purposes as a partnership).

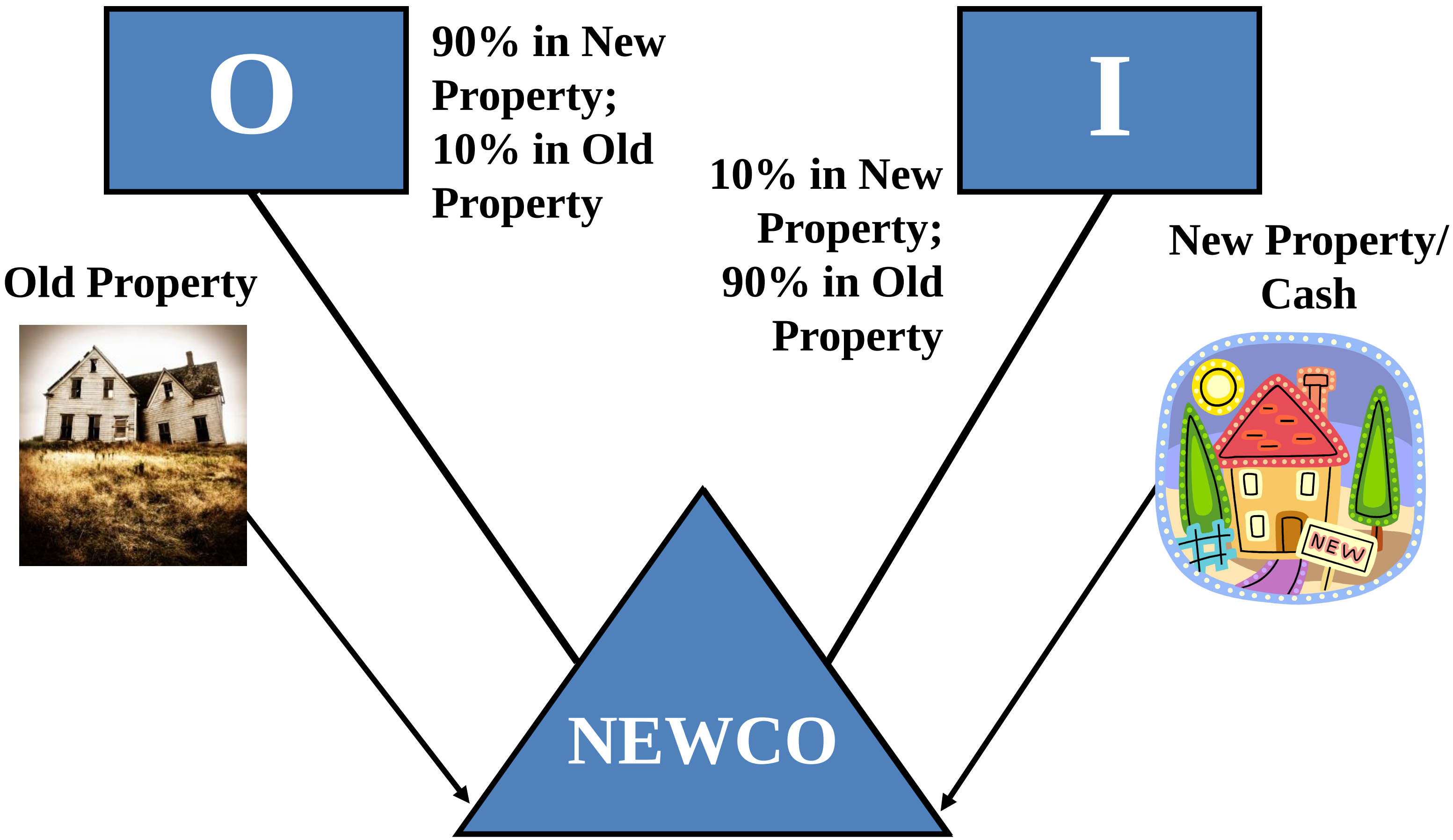
Basic Mixing Bowl Partnership

- O contributes Old Property to Newco.
- I contributes either:
  – Cash to Newco, and Newco uses the cash to buy New Property, or
  – New Property to Newco (but most likely it is Cash).

Basic Mixing Bowl Partnership

- O receives 90% of the income from New Property; I receives 90% of the income from Old Property.
- The effect is similar to a tax-free disposition of most of O's interest in Old Property, in exchange for most of the interests in New Property.

Basic Mixing Bowl Partnership



Freeze Partnership

- O contributes Old Property to Newco.
- I either:
  - Contributes cash to Newco, and Newco uses the cash to buy New Property, or
  - Contributes New Property to Newco.

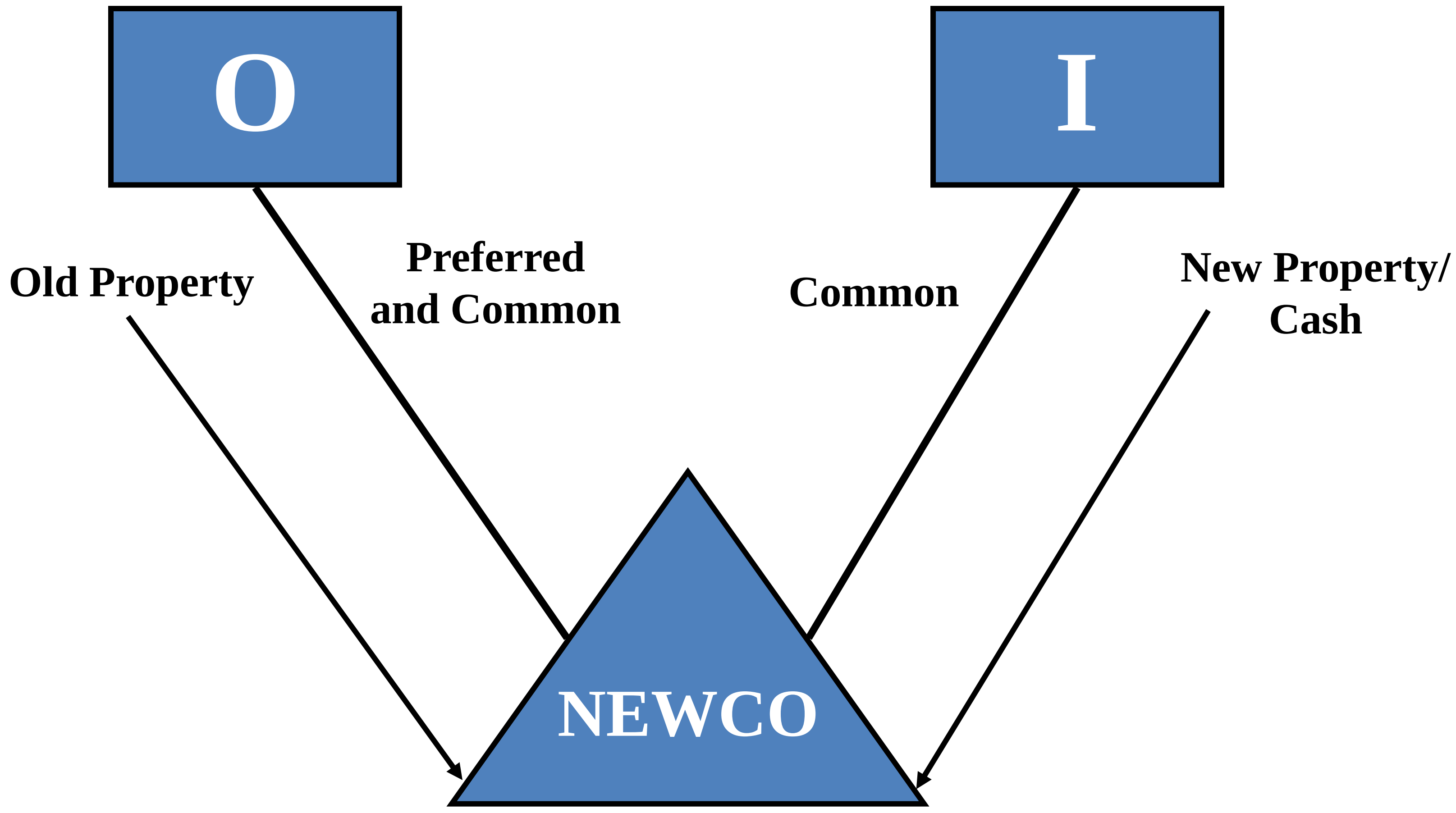
Freeze Partnership

- O receives 100% of Newco Preferred and 10% of Newco Common interests; most of the value is in the Preferred.
- I receives 90% of Newco Common.

Freeze Partnership

- The effect is similar to a tax-free disposition of most of O's interest in Old Property in exchange for a reasonably fixed return.
- For business reasons, O might like New Property to be low-risk investments generating a predictable income stream.
- For tax reasons, it might be preferable for New Property to be an active business.

Freeze Partnership Diagram



Leveraged Acquisition Partnership: First Step

First Step

- O contributes Old Property to Newco.
- I contributes either:
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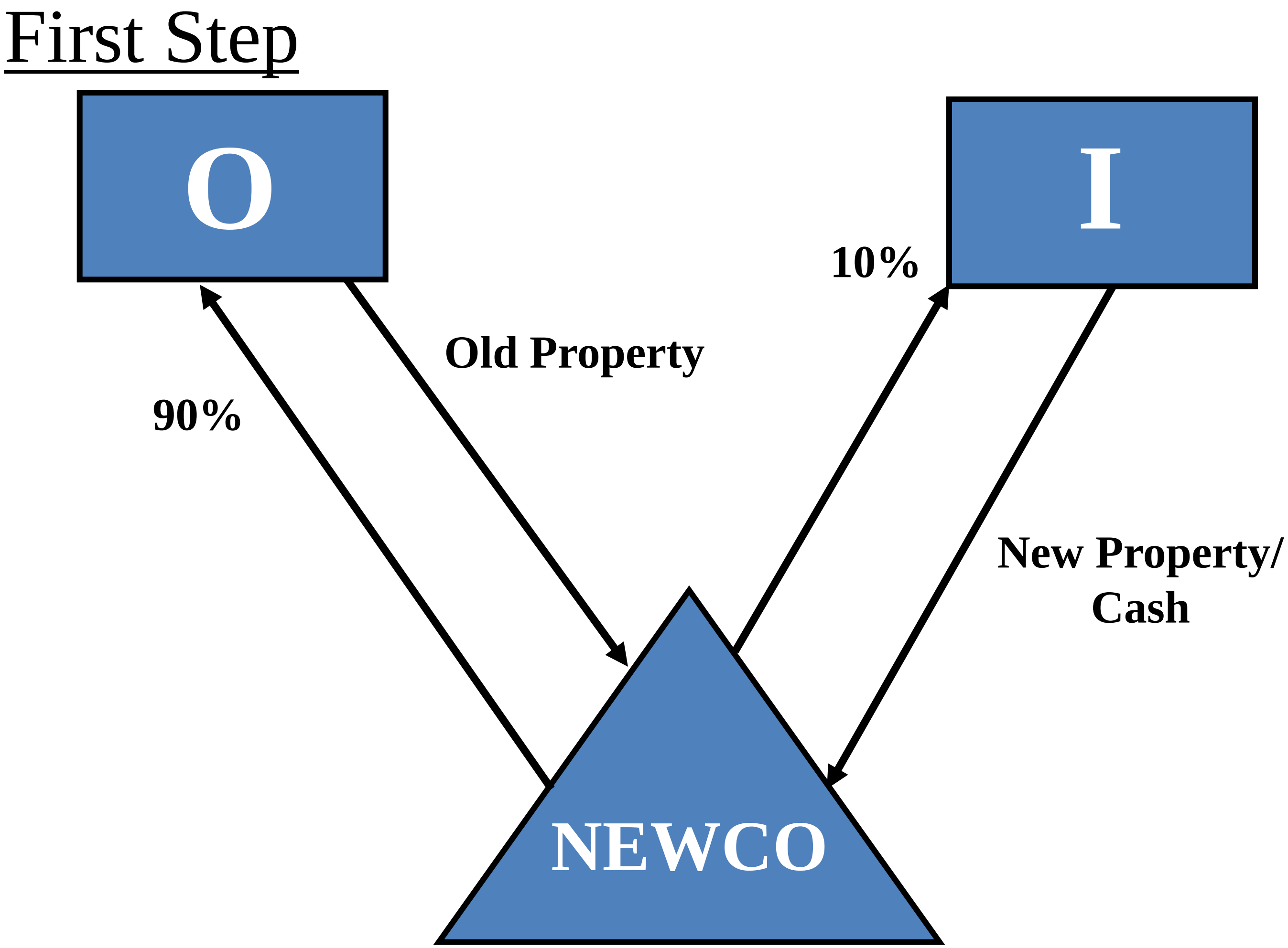
Leveraged Acquisition Partnership Diagram: First Step



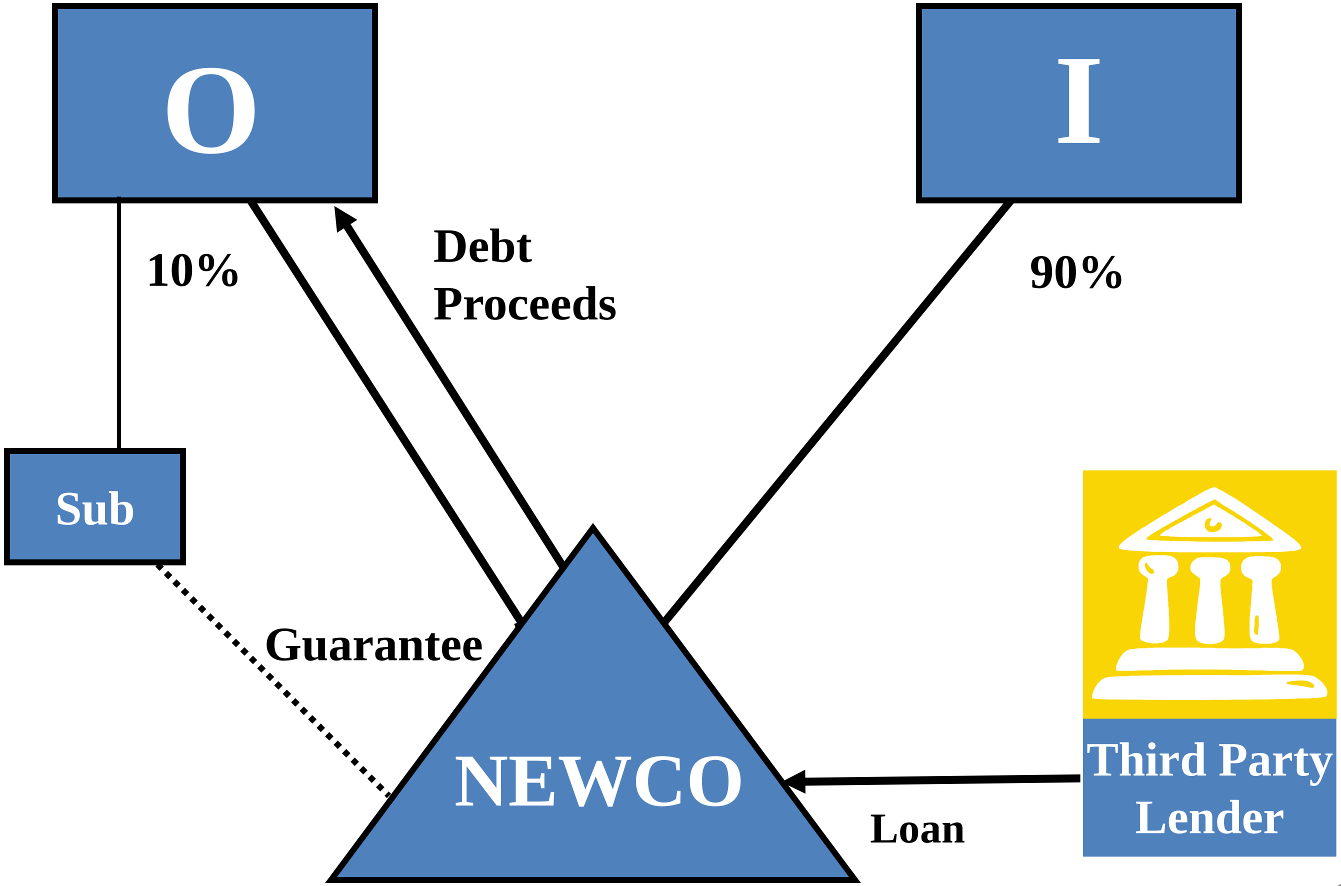
Leveraged Acquisition Partnership: Second Step

<u>Second Step</u>

- Newco borrows money on a nonrecourse basis.
- A subsidiary of O ("Sub") guarantees the debt, but is only obligated to pay after the lender has exhausted remedies against Newco.
  - It is unclear what level of assets Sub needs to maintain, but after *Canal Corp v. Comm'r*, 135 T.C. 199 (2010), it is arguable that Sub should be committed to maintaining assets equal to 100% of the debt (including principal and interest).
- The proceeds of the debt are distributed to O.

Leveraged Acquisition Partnership Diagram: Second Step

Second Step



What Could Go Wrong?

- All these transactions must overcome an initial hurdle:
  - Should the contribution of assets to the partnership be recharacterized as a "*disguised sale*" of the assets?
- "Disguised sales" are governed by complex regulations. Treas. Reg. § 1.707-1 to -9.
- If that initial hurdle is passed, Owner's precontribution gain can be deferred -- but for how long?
- Several kinds of events trigger the deferred gain

When is Gain Triggered?

- Events that trigger precontribution gain:
  - Sale of the Old Property at ***any time*** (if Owner is still a member of Newco). *See* Code § 704(c)(1)(A).
  - Paydown of debt or other decrease in partner's share of liabilities (in the case of a leveraged partnership). *See* Code § 752(b).
  - Distribution of the Old Property to Investor within ***seven years*** of the contribution. *See* Code § 704(c)(1)(B).
  - Redemption of Owner within ***seven years*** of the contribution. *See* Code § 737.

When is Gain Triggered?

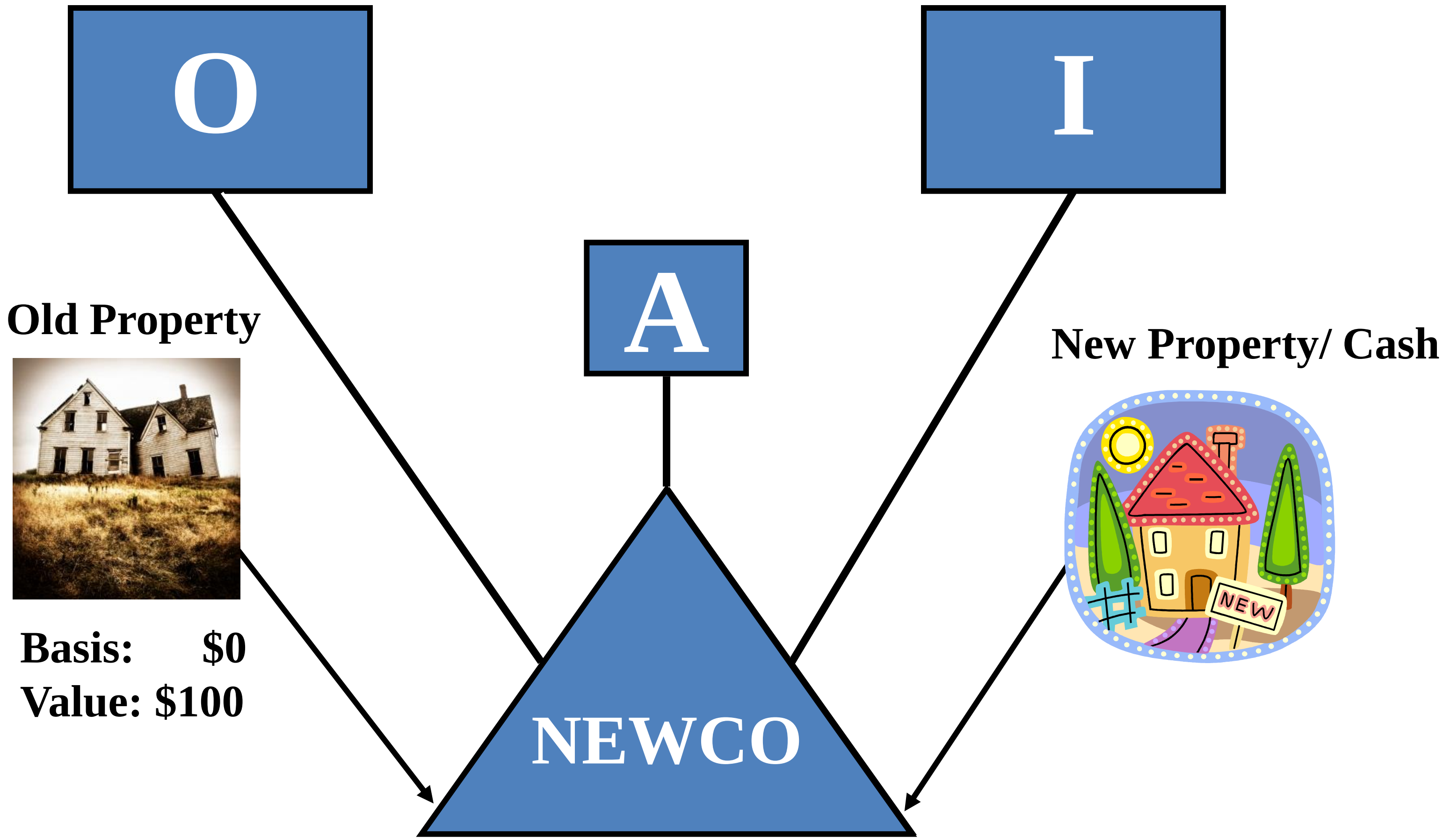
- Any one of these events triggers the gain when the event occurs, so gain can be deferred at least for some period (unlike the "disguised sale" rules").
- The "anti-mixing bowl rules" -- the last two events -- trigger gain if they occur within 7 years of contribution.
  - Ideally the parties can manage to stay wedded for 7 years.
  - If they split up after 7 seven years, there may be indefinite tax deferral.

First Anti-Mixing Bowl Rule

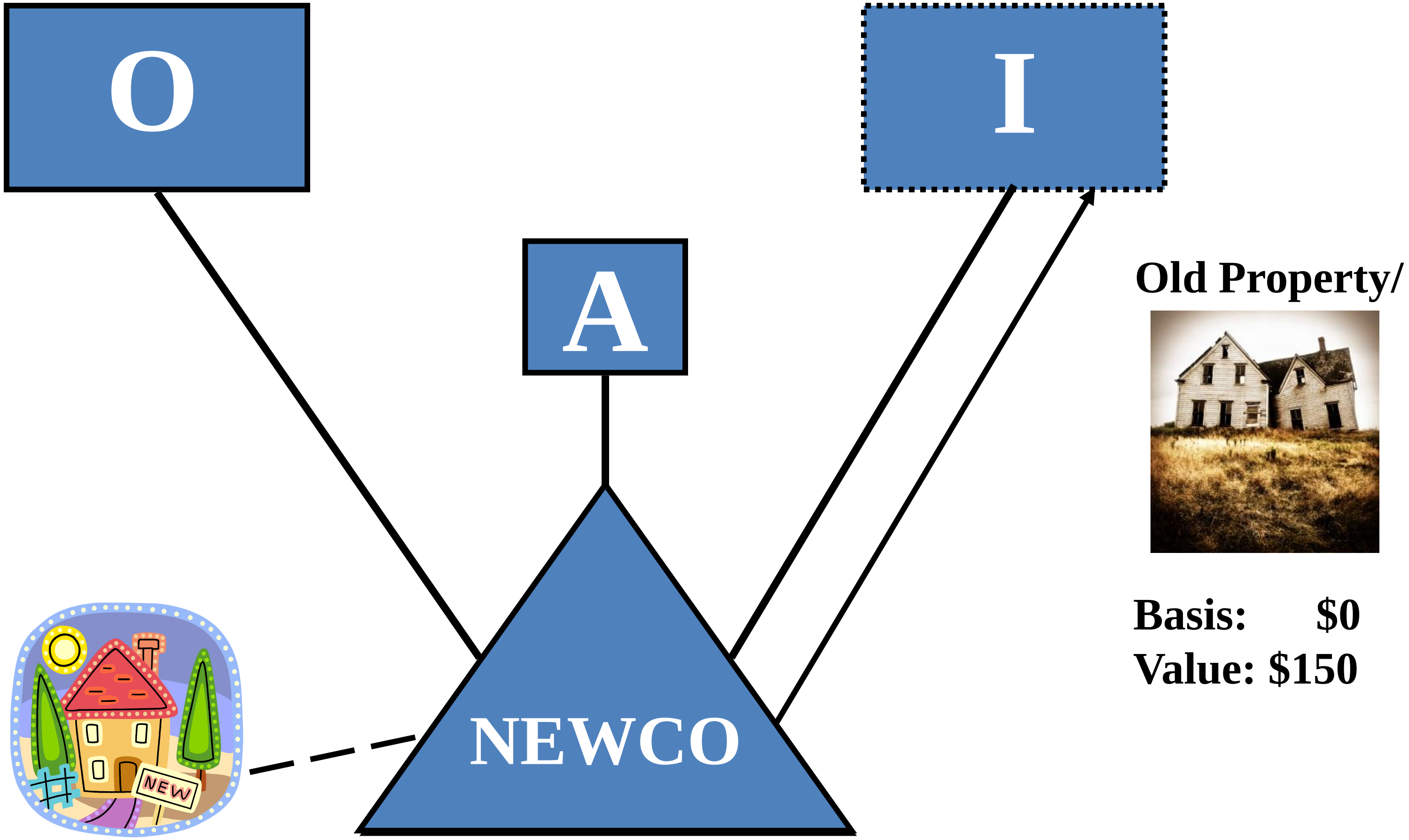
- Suppose Old Property is contributed by Owner.
- ***Old Property later distributed to Investor***.
  - Contribution is generally tax-free.
  - Distribution is generally tax-free.
  - Has Owner transferred Old Property to Investor and paid no tax?
    - Maybe yes, if the parties can wait 7 years (and there was not a "disguised sale").
    - If the Old Property is distributed to the non-contributing partner (i.e., Investor) within 7 years, Owner recognizes precontribution gain. Code § 704(c)(1)(B).
    - *But after 7 years, the rule is inapplicable.*

Mixing Bowl Partnership: Contribution

Note: "A" is added to the example so there will be at least two partners at all times.



Mixing Bowl Partnership: Old Property Distribution



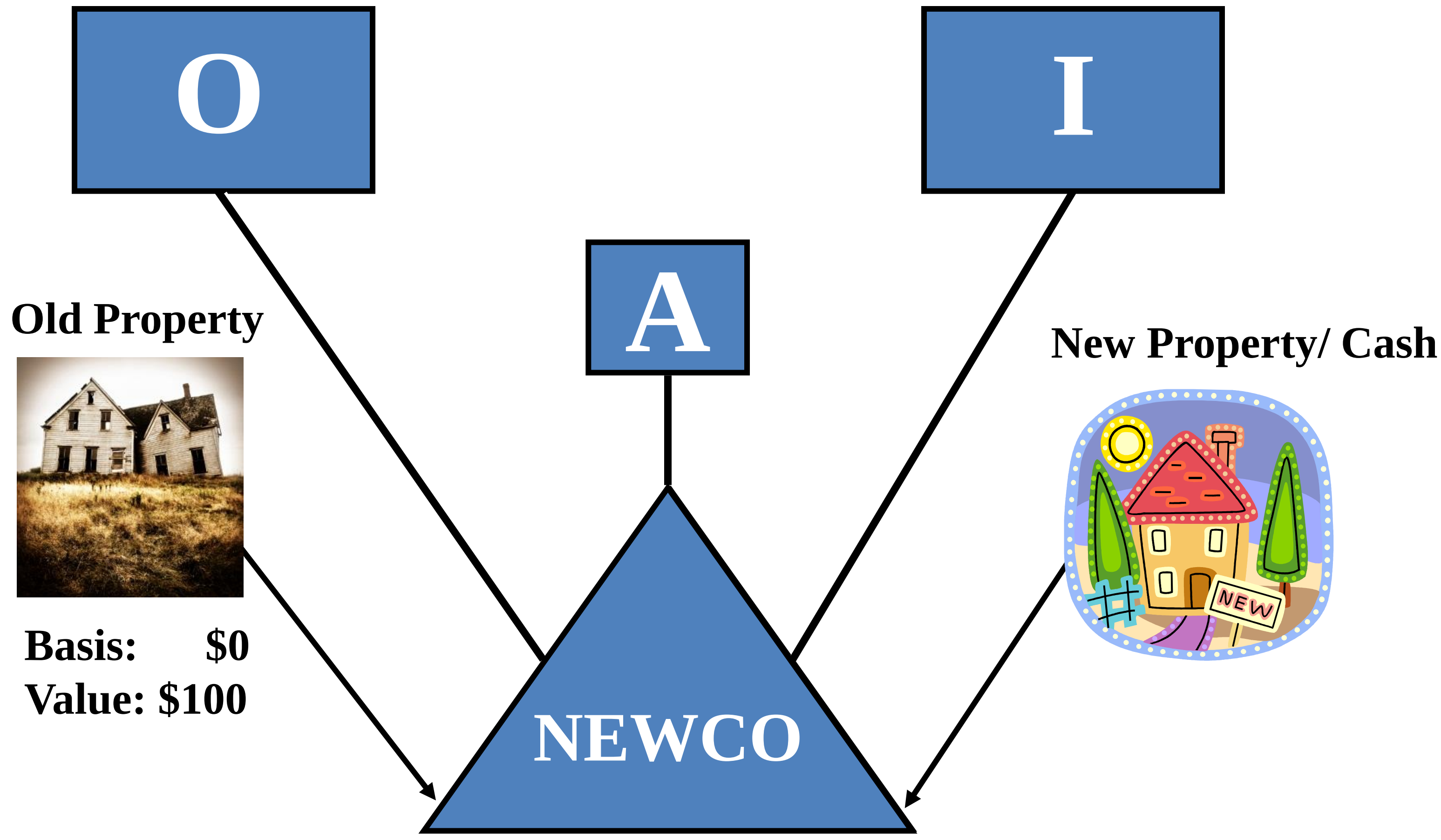
First Anti-Mixing Bowl Rule

- Assume Old Property is distributed to Investor in complete liquidation of Investor's interest.
- If distributed in *Year 6*, Owner recognizes the $100 "precontribution" gain.
  - Owner's original deferral of gain ends.
  - Owner's basis in the Partnership increases by $100.
- If distributed in *Year 8*, Owner does not recognize gain.
  - Owner's gain continues to be deferred.
  - Owner's basis in the Partnership stays the same.
- In both cases:
  - Investor does not recognize gain.
  - No one recognizes the additional $50 of appreciation in Old Property.

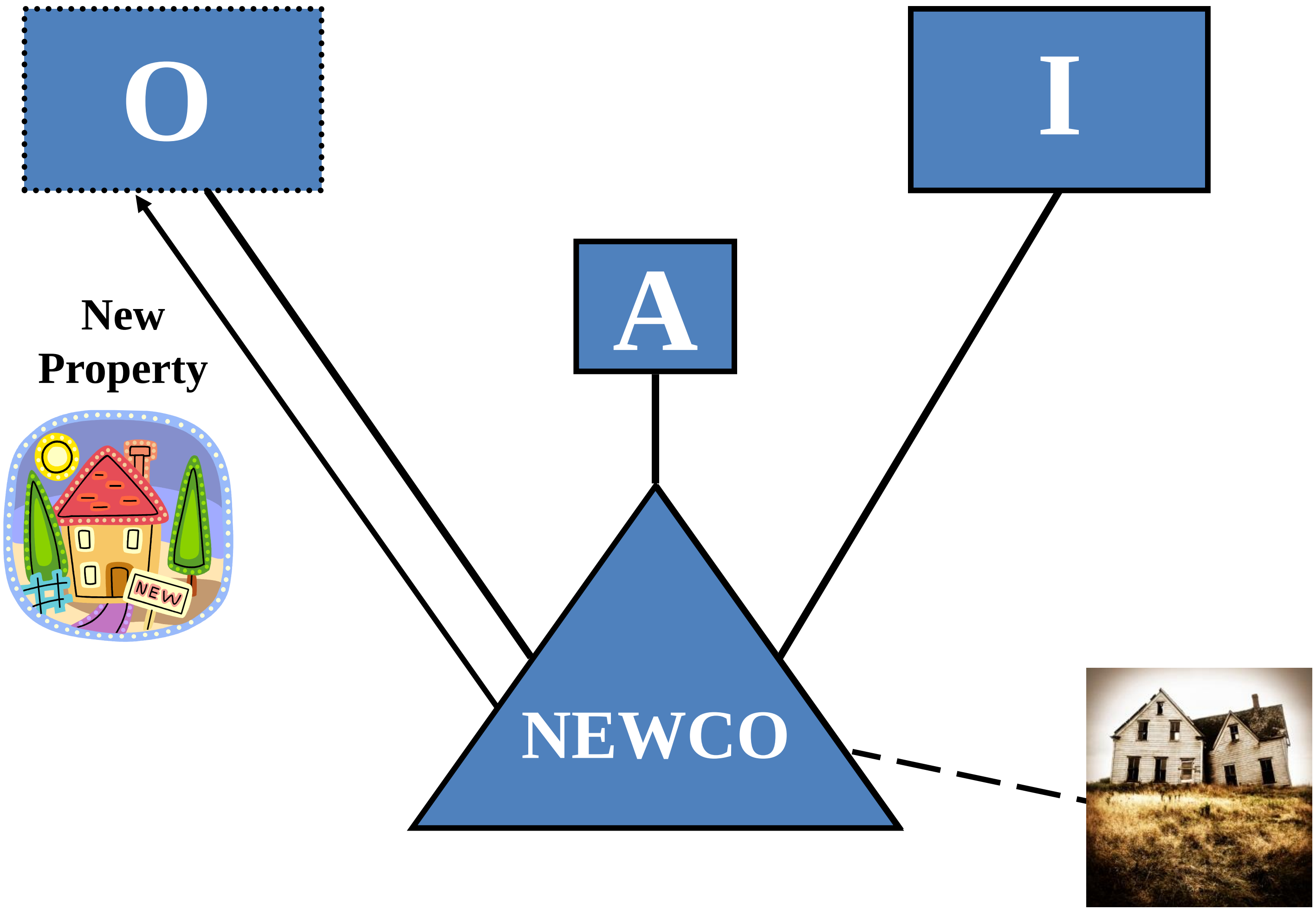
Back-Up
Anti-Mixing Bowl Rule

- Old Property is contributed by Owner.
- ***New Property later distributed to Owner*.**
  - Contribution is generally tax-free.
  - Distribution is generally tax-free.
  - Has Owner transferred Old Property to Investor and paid no tax?
    - Maybe yes, if parties can wait 7 years (and there was not a "disguised sale").
    - If the New Property is distributed to the contributing partner (i.e., Owner) within 7 years, Owner recognizes precontribution gain. Code § 737.
    - *But after 7 years, the rule is inapplicable.*

Mixing Bowl Partnership: Contribution



Mixing Bowl Partnership: New Property Distribution



Back-Up Anti-Mixing Bowl Rule

- Assume New Property is distributed to Owner in complete liquidation of Owner's interest.
- If distributed in *Year 6*, Owner recognizes the $100 "precontribution" gain.
  - Owner's original deferral of gain ends.
  - Owner's basis in the New Property increases by $100.
- If distributed in *Year 8*, Owner does not recognize gain.
  - Owner's gain continues to be deferred.
  - Owner's basis in the New Property is the same as Owner' basis in the Partnership.
- In both cases:
  - Investor does not recognize gain.
  - No one recognizes the additional $50 of appreciation in Old Property.

Final Separation

- If the parties are able to remain together in Newco for more than seven years, it may be possible for Owner and Investor to go their separate ways without Owner recognizing its precontribution gain.
- If Owner or Investor is going to be redeemed, the value of the redeemed interest, and the value of the property used for the redemption, ideally should be determined *at the time of the redemption*.
- Although the parties may try to "lock in" the value at the time of the original contribution -- so that both parties know with some certainty what Owner or Investor will get when it leaves -- doing so adds to the tax risks.

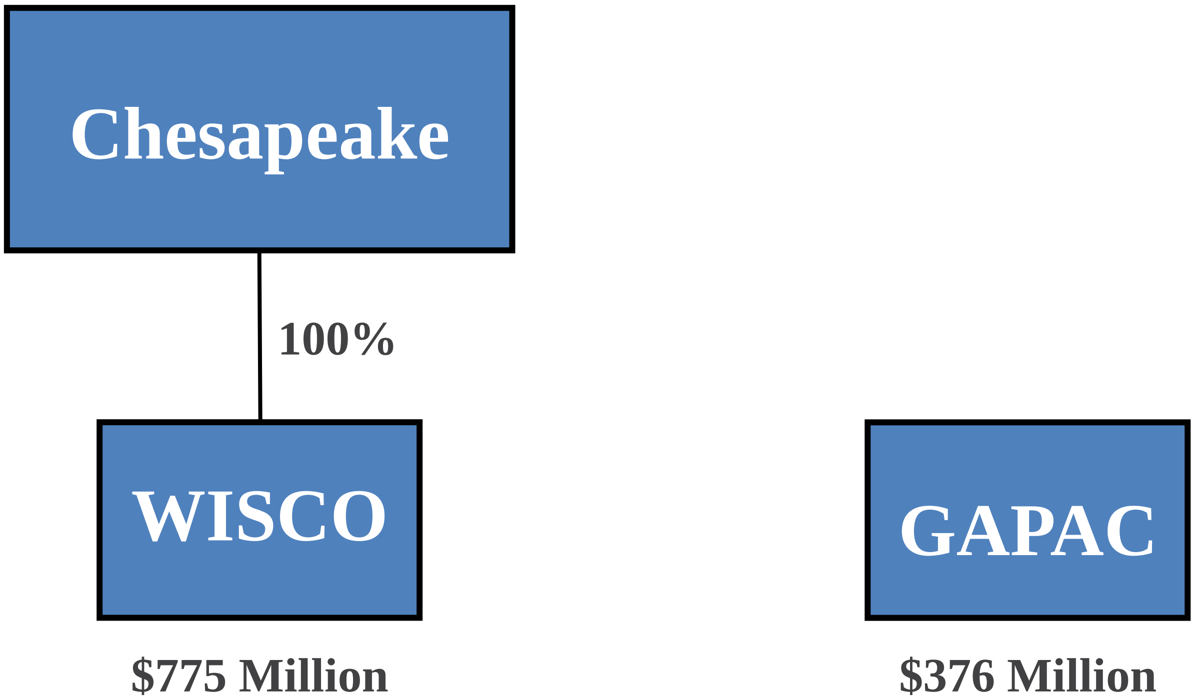
Canal Corp v. Comm'r, 135 T.C. 199 (2010): Court Denies Tax-Free Leveraged Distribution

Canal Corp v. Commissioner 135 TC No. 9 (2010)

- In leveraged partnerships such as the one at issue in *Canal Corp*, the fundamental question is the extent to which property is treated as:
  - *"Contributed"* to a partnership under Code § 721, with the partnership making a non-taxable debt-financed distribution under Code § 731 to the "contributor," rather than*:*
  - *"Sold"* to a partnership under Code § 707(a)(2)(B), with the partnership making a taxable payment of the purchase price to the "seller."

Initial Structure

- Chesapeake (later known as Canal) owned Wisconsin Tissue Mills, Inc. (WISCO).
- WISCO owned a tissue business valued at $775 million.
- Georgia Pacific (GAPAC) owned a tissue business valued at $376 million.

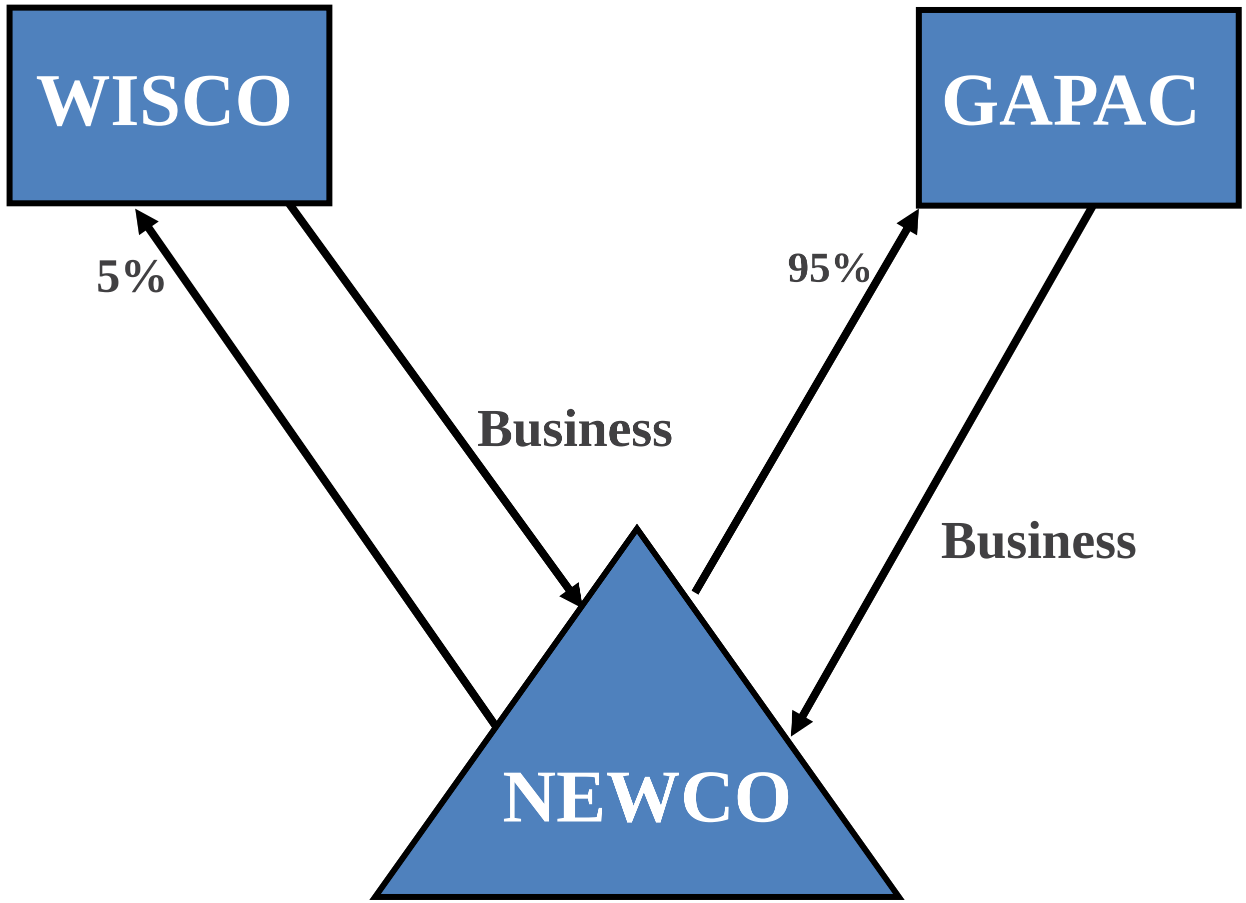


Sale vs. Leveraged Partnership

- GAPAC was interested in purchasing WISCO stock or assets.
  - However, Chesapeake did not want to incur the consequences of a taxable sale.
- Chesapeake's advisors suggested a leveraged partnership.

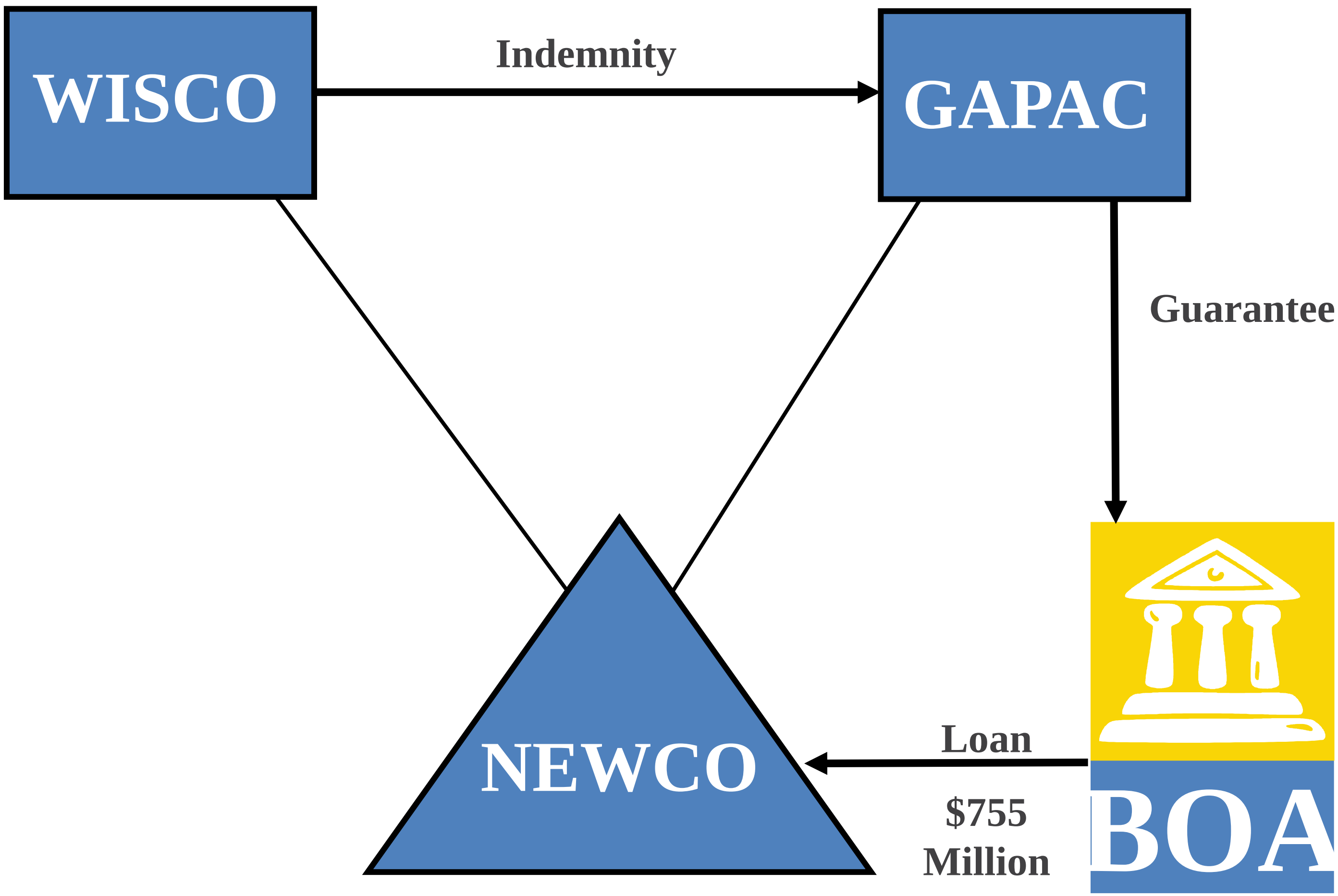
Assets Contributed

- WISCO contributed its tissue business to Georgia-Pacific Tissue LLC (Newco) and received a 5% interest.
- GAPAC contributed its tissue business to Newco and received a 95% interest.



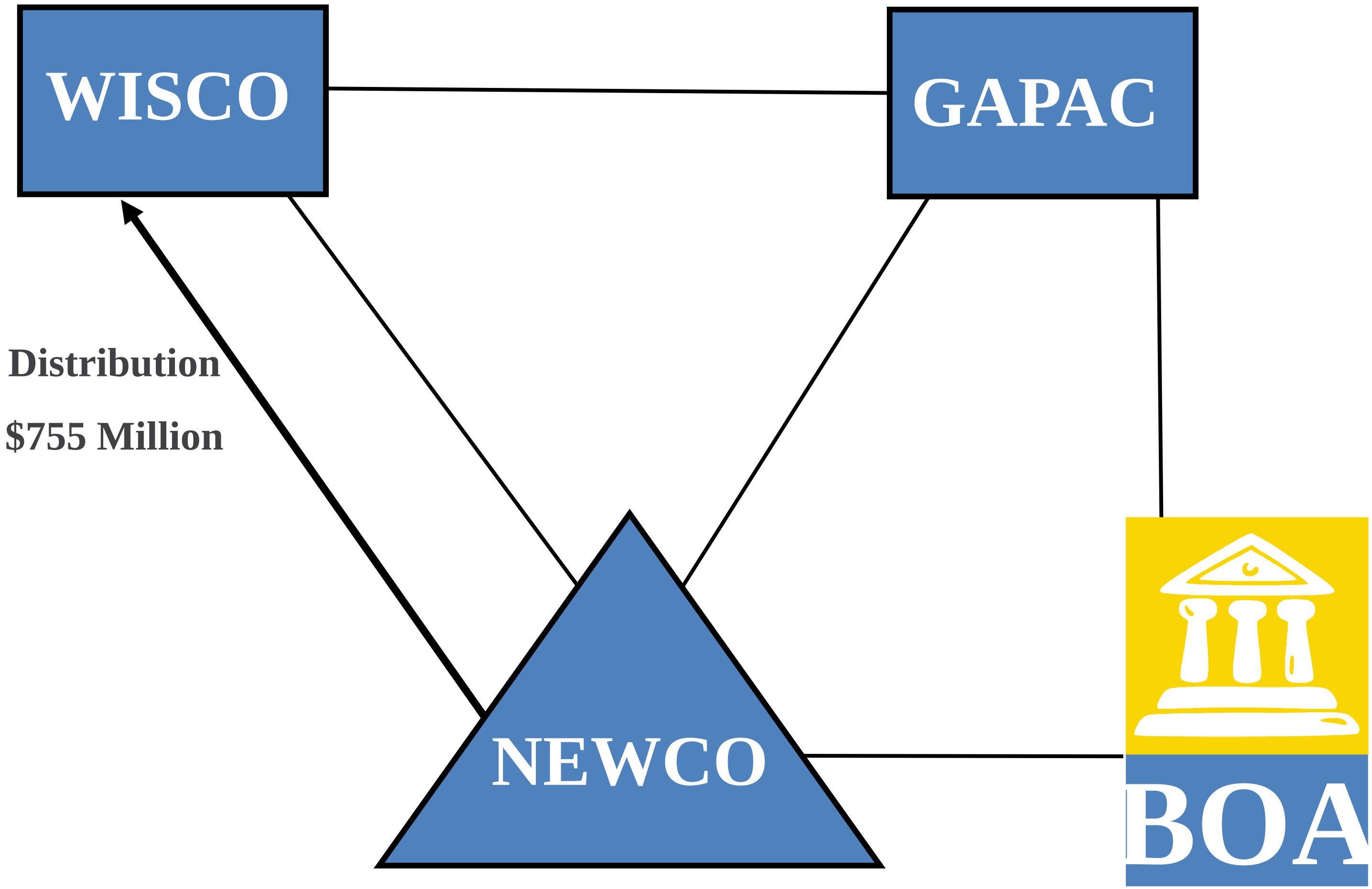
Loan Made

- On the same day, Bank of America (BOA) loaned $755 million to Newco.
- GAPAC guaranteed all obligations under debt.
- WISCO agreed to indemnify GAPAC for principal payments on the guarantee.



Loan Proceeds Distributed

- Also on the same day, Newco distributed the entire loan proceeds to WISCO.
- WISCO paid the proceeds out to affiliates. However, it took back a $151 million note from Chesapeake. WISCO's other assets were worth $6 million



Debt-Financed Transfer Rules

- If the distribution of the loan proceeds to WISCO qualified as a debt-financed transfer of consideration under Treas. Reg. § 1.707-5(b), then the transfer of its tissue business to Newco would be treated as a tax-free capital contribution and not as a "disguised sale."
  - The rules for such debt-financed transfers are an exception to the "disguised sale" rules.
  - The theory is that borrowing money through a partnership should not be treated less favorably than borrowing money directly.
- To the extent that WISCO's indemnity obligation is respected, WISCO bears the ultimate risk of loss on the debt, and the debt should be allocated to WISCO.
- To the extent that the debt is "allocated" to WISCO, the distribution of the loan proceeds should qualify as a debt-financed transfer under the regulations.
- However, if WISCO's indemnity obligation is disregarded in full (but GAPAC's guarantee is respected in full), the debt would be "allocated" entirely to GAPAC, and the distribution of the loan proceeds would not qualify as a debt-financed transfer.

Anti-Abuse Regulations

- The regulations generally presume that partners and related persons who have obligations to make payments will fulfill their obligations, regardless of actual net worth. Treas. Reg. § 1.752-2(b)(6).

  > "For purposes of determining the extent to which a partner or related person has a payment obligation and the economic risk of loss, it is assumed that all partners and related persons who have obligations to make payments actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation."

Anti-Abuse Regulations

- However, the IRS argued, and the Tax Court agreed, that WISCO's obligation to indemnify GAPAC should be disregarded under the "anti-abuse" rules in Treas. Reg. §1.752-2(j).

> "*(1) In general.* An obligation of a partner or related person to make a payment may be disregarded or treated as an obligation of another person for purposes of this section if facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation or create the appearance of the partner or related person bearing the economic risk of loss when, in fact, the substance of the arrangement is otherwise. . . .
>
> . . .
>
> "*(3) Plan to circumvent or avoid the obligation.* An obligation of a partner to make a payment is not recognized if the facts and circumstances evidence a plan to circumvent or avoid the obligation."

Anti-Abuse Regulations

- Some language in the decision suggests that the anti-abuse rule applies whenever there is only a "remote" chance that the indemnitor will have to make a payment. For example,

  > "We have carefully considered the facts and circumstances and find that the indemnity agreement should be disregarded because it created no more than a remote possibility that WISCO would actually be liable for payment."

- Such a view would be inconsistent with the regulations, which allocate liabilities on "recourse" debt to the party that bears the ultimate risk of loss, even if that risk is nominal.
  - The test for ultimate risk of loss in the regulations appears to be purely mechanical, with no reference to the likelihood of loss.
  - It is commonly the case that a guarantor or indemnitor's loss is highly unlikely.
- Even purely nonrecourse debt is allocated to the partners, but in *Canal* GAPAC's guarantee presumably rendered the debt "recourse" in the relevant sense.

No Requirement To Maintain Net Worth

- The tax advisor determined that WISCO had to maintain a minimum net worth of $151 million (20% of its maximum exposure on the indemnity), not counting its interest in Newco.
- The court hinted that 20% was insufficient, but refused to set any “bright-line percentage test.”
- An even bigger problem for the court apparently was that WISCO had no obligation to maintain even that level, or any level at all, of net worth.

No Requirement To Maintain Net Worth

- According to the court, Chesapeake, the parent of WISCO:

  " … had full and absolute control of WISCO. Nothing restricted Chesapeake from canceling the note at its discretion at any time to reduce the asset level of WISCO to zero."

- The court dismissed Chesapeake's argument that fraudulent conveyance principles kept Chesapeake from stripping assets out of WISCO and rendering WISCO insolvent.

Other Factors

- Loan was not directly guaranteed by the partner taking the distribution.
  - WISCO did not directly guarantee the loan, but only agreed to indemnify GAPAC.
  - GAPAC had to proceed first against Newco before pursuing an indemnity claim against WISCO.
- Guarantee/indemnity was backed by assets representing only a fraction of the guarantor's theoretical exposure.
  - Even at best, WISCO's indemnity was backed by net assets equal to only 20% of the total exposure.
  - The indemnity was given only by WISCO, to avoid exposing all the assets of the Chesapeake group.
- Indemnity covered only loan principal.
  - WISCO's indemnity only covered principal and not interest (or, presumably, fees, expenses or penalties).

Other Factors

- No business need for guarantee/indemnity
  – GAPAC did not require the indemnity, but WISCO gave it anyway, because its tax advisor insisted.
- Increase in equity for paying out on the guarantee/indemnity.
  – WISCO's equity interest in Newco would have increased if WISCO had made indemnity payments.
- Sale treatment for non-tax purposes
  – Chesapeake reported $377 million of book gain, but of course no tax gain.
  – Chesapeake did not treat its indemnity obligation as a liability for accounting purposes.
  – Chesapeake executives represented to the rating agencies that the only risk on the transaction was the tax risk.

Penalties Upheld

- The court upheld substantial understatement penalties of $36.6.
- The court's reasoning calls into question some opinion practices that are prevalent, if not universal.
- Chesapeake received a "should"-level tax opinion from PWC. However, the opinion gave no protection against penalties, because, in the court's view:
  - It was "unreasonable for a taxpayer to rely on a tax adviser actively involved in planning the transaction and tainted by an inherent conflict of interest."
  - An inherent conflict existed because PWC charged an "exorbitant" fixed fee ($800,000) not based on time spent.
    - The court seemed to imply that a flat fee is inherently suspect, and that Chesapeake should have known that.
    - The court inferred that the fee was contingent on the issuance of the opinion (rather than, as the engagement letter said, on the closing of the financing), presumably on the ground that the financing would not have closed without the opinion.

Penalties Upheld

- The opinion relied on reasoning by analogy and on the writer's interpretation of the regulations.
  - The court seemed to be saying that an opinion must be supported by direct authority.
- The opinion was, in the court's view, "littered with typographical errors, disorganized and incomplete" and "riddled with questionable conclusions and unreasonable assumptions."
  - The court said that only a draft of the opinion was submitted as evidence.
  - Commentators claim that in fact the final opinion was in evidence, and that the document the court criticized was a draft memo supporting the opinion.
- The court probably did not mean to apply the economic substance doctrine, although it said that the indemnity lacked economic substance.

Tax-Free Exchange

Cash for some partners;

real estate

for others

Example

- The ABC partnership owns Whiteacre.
  - Basis is $3 million.
  - Whiteacre is under contract for $21 million cash.
  - Buyer has agreed to cooperate with a tax-free exchange through a Qualified Intermediary.
- Each partner has an equal 1/3 interest
  - Each partner's basis is $1 million.
  - Each partner's capital account is $1 million.
- A wants her $7 million share of the sale in cash, even if she recognizes $6 million of income.
- B and C want to roll over their $14 million share of the sale tax-free into Blackacre.
- What can they do?

What's the Problem?

The parties will suggest simply exchanging:

- Whiteacre (worth $21 million),

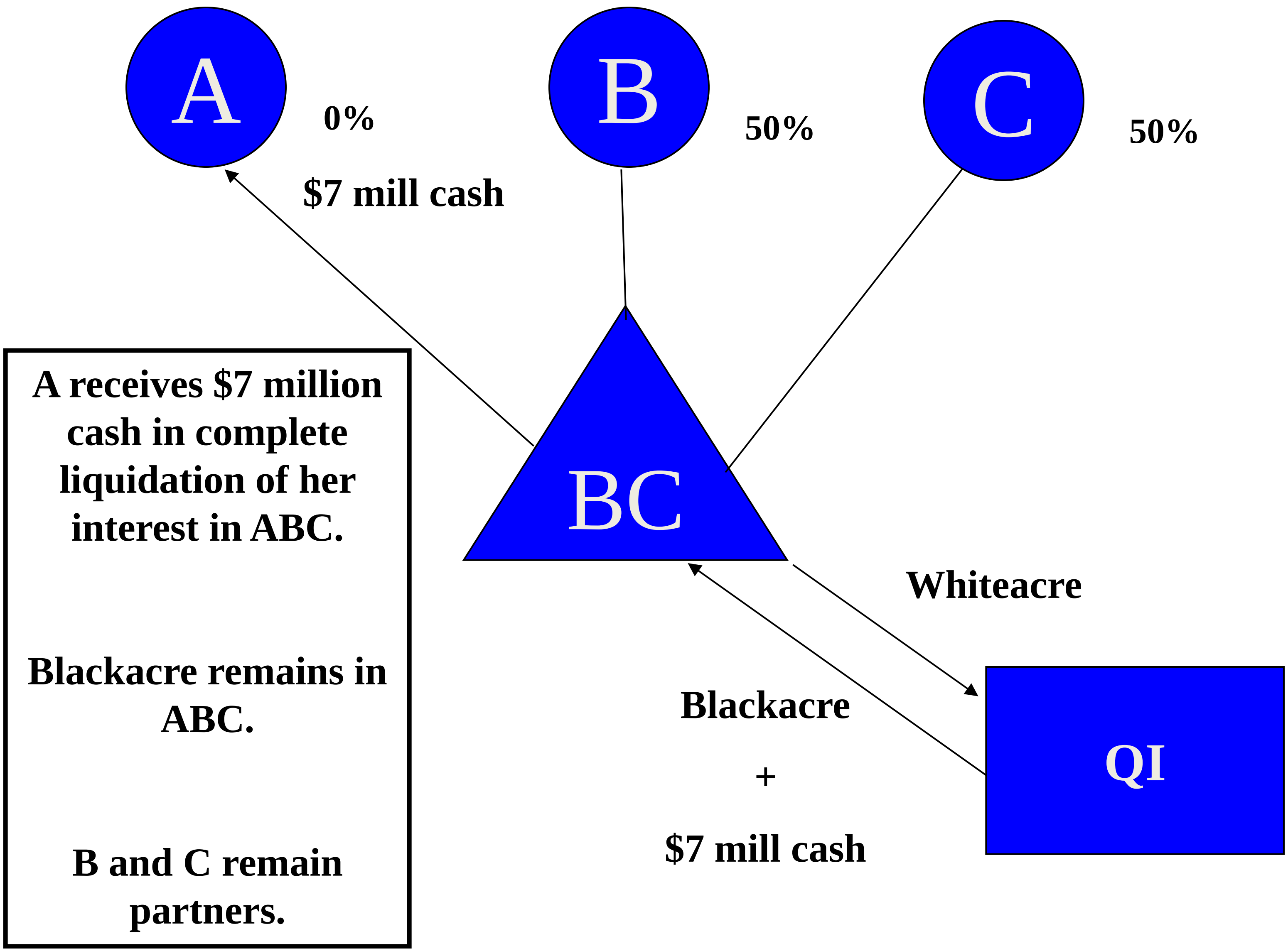
  for

- A combination of:
  - Blackacre (worth $14 million), and
  - Cash ($7 million).

The exchange of Whiteacre for Blackacre is intended to be a tax-free exchange under Code § 1031.

Of course the $7 million is taxable "boot" in the exchange but so what? A wants cash, and expects to pay tax on her gain.

Exchange With Boot



The Problem

- ABC is an equal partnership.
- There is $7 million of "boot" in the exchange.
- All of the boot gain, not A’s $6 million share of gain, is recognized.
  - A’s $1 million "share" of Whiteacre’s basis does not offset the boot.
- Even worse, the $7 million of boot normally would be ***allocated evenly among all three partners***, including B and C.
- B and C together have $4.67 million of taxable income (2/3 of $7 million).
  - B and C get no cash.
  - B and C thought they had a tax-free exchange.

Overview of Possible Solutions

- Special Allocation.
  - Partnership specially allocates boot to A.
- Distribution of Fractional Interest.
  - Partnership distributes a 1/3 undivided fractional interest to A.
  - A sells her 1/3 interest.
  - Partnership exchanges its 2/3 interest for Blackacre.
- Installment Sale.
  - Partnership exchanges Whiteacre for Blackacre plus boot, but the boot this time in the form of an installment note.
  - Partnership distributes the installment note to A.
- Cross-Purchase or Redemption.
  - Partners buy out A for cash prior to exchange of Whiteacre, *or*
  - Partnership buys out A for a note prior to exchange of Whiteacre.

Special Allocation: A Simple Solution?

- B and C will suggest specially allocating the boot gain to A.
- After thinking about it, A may say okay:
  - Special allocation of $7 million gain to A increases her basis from $1 million to $8 million.
  - On distribution of $7 million in complete liquidation of her interest, she has no additional income and recognizes a $1 million loss.
  - The $7 million gain allocation, less the $1 million loss on liquidation of her interest, nets to $6 million of income.
  - A started with $1 million basis and received $7 million in cash.
  - Paying tax on $6 million strikes her as fair.
- ***So can B and C avoid taxable gain?***

A Simple Solution?

- Maybe this approach is a solution but maybe not.
- There are at least three possible positions on the validity of the special allocation:
  - The special allocation lacks "substantial economic effect" and is invalid.
  - The special allocation is fully valid.
  - The special allocation is valid only to the extent of allocating $6 million to A.

Substantial Economic Effect

- Treas. Reg. § 1.704-1(b)(2)(iii)(a):
  - In general an allocation is "substantial" if there is a reasonable possibility that the allocation will *affect substantially the dollar amounts to be received* by the partners from the partnership, independent of tax consequences.
- ***Does the special allocation of $7 million of taxable income to A affect the dollar amounts to be received by A or any of the other partners?***
- ***Some advisors say no:*** A, B, and C are entitled to the same dollar values ($7 million each) with or without the special allocation.

Substantial Economic Effect

- ***Some advisors say yes:***
  - The special allocation reflects the fact that the partners receive different things:
    - A is getting $7 million in cash.
    - No one knows what B and C will ultimately receive; B and C, unlike A, will participate in the future profits or losses from the Replacement Property.
  - It may be easier to defend:
    - $6 million allocation to A (bringing her capital account up to $7 million with no tax loss), *than*
    - $7 million allocation to A (bringing her capital account to $8 million and generating a $1 million loss).

Substantial Economic Effect

- More specifically, Treas. Reg. § 1.704-1(b)(2)(iii)(a) says an allocation is not substantial if:
  - *Benefit to Some Partners.*
    - The after-tax economic consequences of at least one partner may, in present value terms, be enhanced compared to such consequences if the allocation were not contained in the partnership agreement.

AND

  - *No Detriment to Other Partners.*
    - There is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to such consequences if the allocation were not contained in the partnership agreement.

Substantial Economic Effect

- **Is there a benefit to B and C?**
  - ***Yes.*** B and C benefit because taxable income is allocated away from them to A.
- **Is there any detriment to A?**
  - ***Some advisors say no:*** The gain allocation increases A's basis. For a partner like A whose interest is being completely liquidated, gain allocation under Code § 704(b) may simply reduce gain recognition (or increase loss recognition) under Code § 731(a) on the liquidation.
  - ***Some advisors say yes:*** Is it a detriment to A that she will not participate in future gains or losses from the Replacement Property?

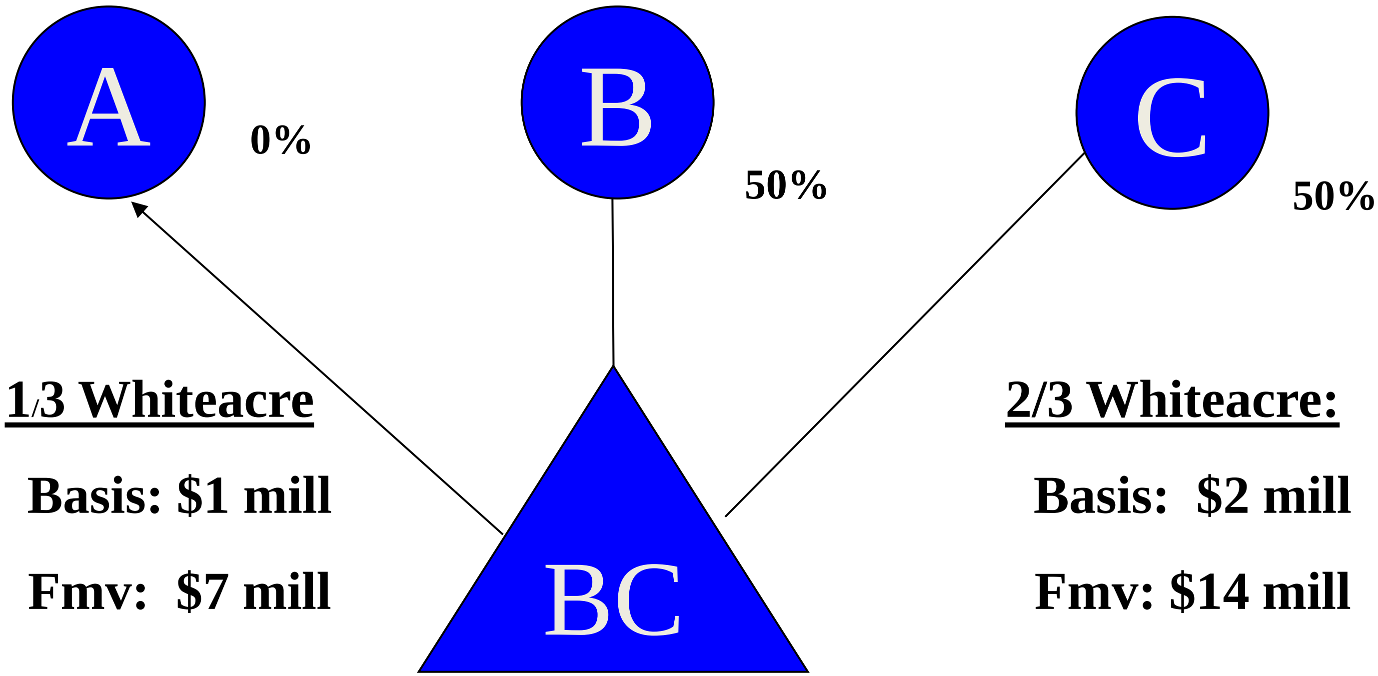
Distribution of Fractional Interest

A receives 1/3 undivided fractional interest in Whiteacre in complete

liquidation of her interest in ABC.

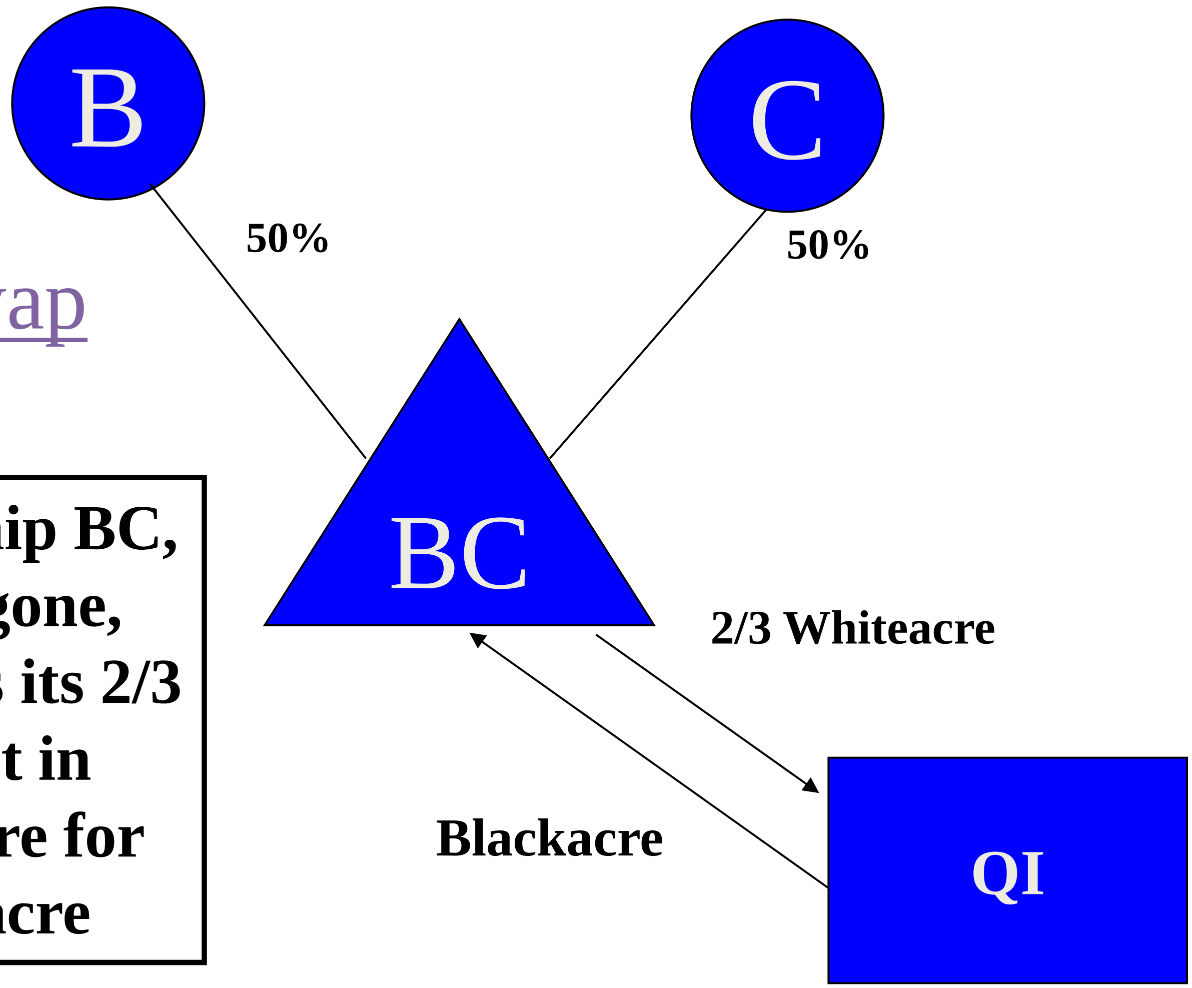
A and BC now own fractional interests in Whiteacre together as "tenants in common."

1. Distribution



Distribution of Fractional Interest

2. Swap



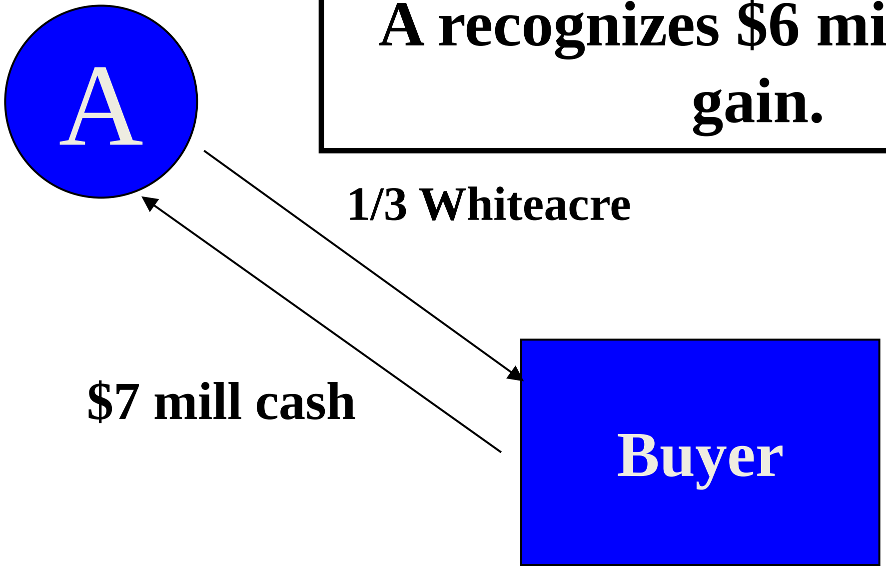
Partnership BC, with A gone, exchanges its 2/3 interest in Whiteacre for Blackacre

Distribution of Fractional Interes

3. <u>Sale</u>

A sells her 1/3 interest in Whiteacre for cash, outside the QI arrangement.

A recognizes $6 mill taxable gain.



Is Fractional Interest Distribution a Solution?

- Maybe this approach is a solution, but maybe not.
- **Were the Parties Tenants in Common for Tax Purposes?**
  - Even after the "fractional interest" is distributed, is the relationship between A (on the one hand) and BC (on the other) for tax purposes a tenancy in common (as the parties want) or merely a continued partnership among A, B, and C?
  - Rev. Proc. 2002-22, 2002-1 C.B. 733, which indirectly sparked explosive growth in the "TIC" industry, is of limited help at best here.
    - Consider net-leasing the property prior to the distribution; net leased property held by tenants in common arguably is less likely to be recharacterized as partnership-owned than the property otherwise might be.
  - If A, B, and C remain partners, then ABC partnership presumably exchanged Whiteacre for a combination of Blackacre and cash, and the distribution to A accomplished nothing.

Is Fractional Distribution a Solution?

- **Did A Really Sell Her Separate Interest?**
  - If ABC negotiated to sell Whiteacre, will the IRS argue that in substance ABC partnership exchanged Whiteacre for a combination of Blackacre and boot, and distributed the boot to A?
    - *See Comm'r v. Court Holding Co.*, 324 U.S. 331 (1945).
  - Once again, if the IRS's argument succeeds, the distribution to A accomplished nothing.

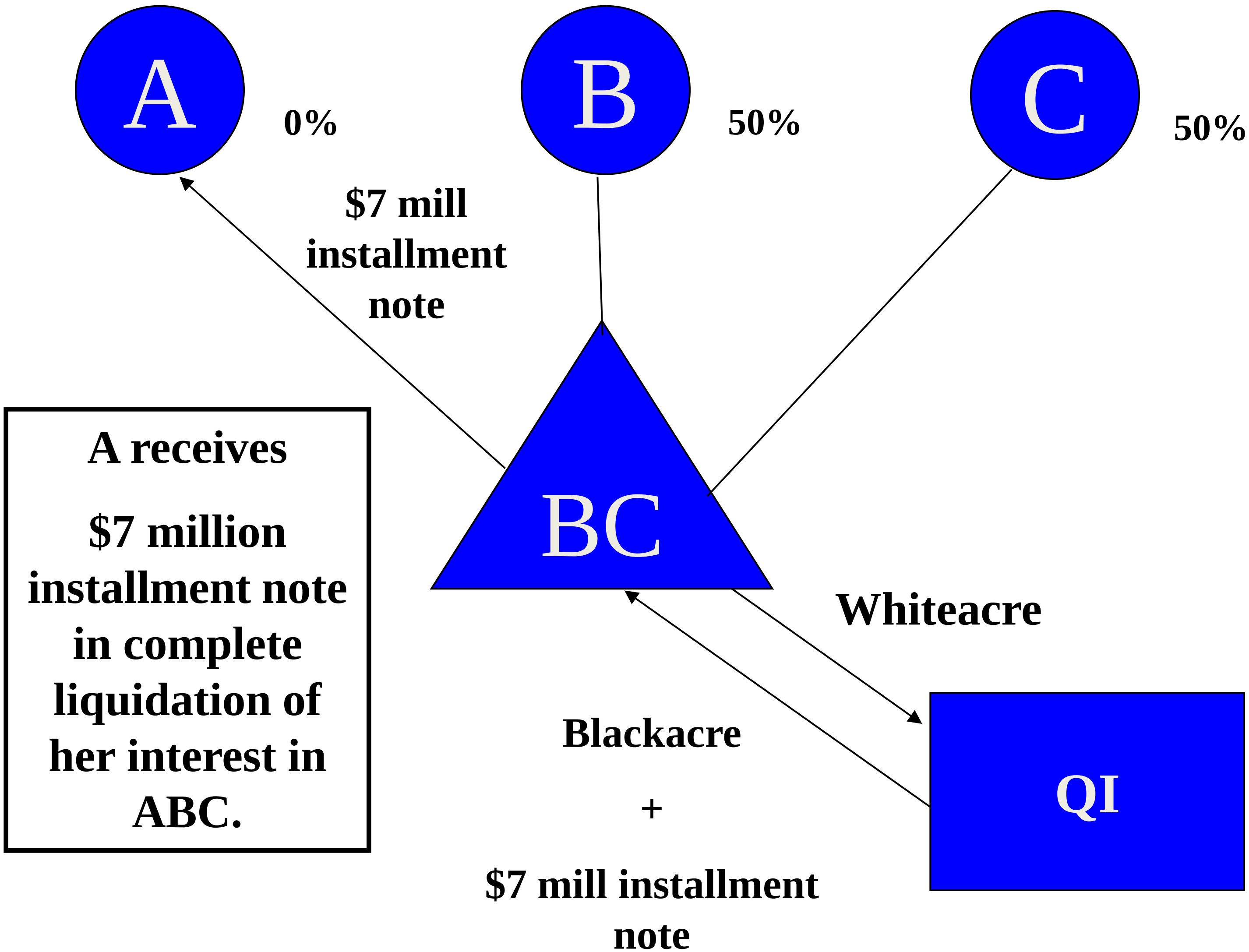
Installment Sale

- B and C are frustrated:
  - They face risks if the partnership receives cash in the sale of Whiteacre and distributes the cash to A.
  - They face risks if the partnership lets A sell her share of Whiteacre outside the partnership, and the cash goes directly to A.
  - They do not want to incur additional debt to buy A out.
- The underlying problem is that the boot is currently taxable.
- They ask their tax advisor:
  - **Isn't there any kind of boot that is tax-deferred?**
- Your answer, to their surprise:
  - **Yes, an installment note.**

Installment Sale

- Sale of property in exchange for a note or other promise by the purchaser to pay in the future is treated as *fully taxable* in the year of sale, *unless* the sale qualifies to be reported on the "installment method."
- An installment sale is "a disposition of property where *at least one* payment is to be received after the close of the taxable year in which the disposition occurs." Code § 453(b)(1).
- Some other requirements must be met.
- The installment sale alternative is essentially the same as the initial proposal, ***except that:***
  - Instead of receiving cash boot of $7 million, the partnership receives a $7 million installment note.
  - Instead of distributing $7 million of cash to A, the partnership distributes a $7 million installment note to her.

Installment Sale



Is Installment Sale a Solution?

- Maybe.
- Assuming the "boot" gain qualifies for installment reporting, there seems to be no tax at partnership level either on:
  - Receipt of the installment note, or
  - Distribution of the installment note to A.
- A takes a basis in the installment note equal to her "outside" basis in ABC, *i.e.*, $1 million. Code 732(b).

Is Installment Sale a Solution?

- Will A be willing to accept, and Buyer be willing to provide, an installment note?
- Installment note is riskier than cash.
- Risk can be reduced by:
  - Having most (not all) of the note payable shortly after closing (at least some portion of the note must be payable after the end of the current tax year).
  - Backing up the note with a letter of credit.
- How much risk will A accept, given that the use of an installment note was proposed by B and C as a way out of **their** tax problem?
- If the installment note bears a favorable interest rate, A is more likely to accept it, but will Buyer be willing to pay it?
- Consider whether the installment note can come from the QI**.**
- Note that if Whiteacre is subject to debt, Blackacre must be subject to at least as much debt (not just 2/3 of the amount).

Cross-Purchase or Redemption

- What if the installment sale is not practical?
  - Before the exchange, B and C could buy A out for cash.
  - But where do B and C get the cash? In this situation the buyer is not supplying it.