KILPATRICK TOWNSEND

4 KEY TAKEAWAYS

Mid-Year Tax Update

On June 22nd, Kilpatrick Townsend Tax attorneys Lynn Fowler, Heather Preston, Rob Daily, and Jeff Reed participated in a mid-year tax update webinar hosted by the firm. The webinar discussed recent tax issues in the federal and state arenas that occurred during the first half of 2021.

Here are 4 key takeaways from the webinar:

1

Two-Step Property Acquisition Yields Surprising Result. We recently advised a client on an interesting transaction that produced a surprising result. The client desired to acquire a 90% interest in an entity ("NewCo") that would acquire and operate a hotel. The other 10% will be owned by the operator of the hotel, who also is a partner in the entity that currently owns the hotel.

The twist is that the client's capital came from a purchase at a discount of the existing mortgage secured by the hotel. The client would then acquire the interest in NewCo in exchange for forgiveness of the purchased mortgage debt. While the client's basis in the note reflected the acquisition discount, the client's initial capital account reflected the full face value of the mortgage. Through careful planning, we were able to get all parties comfortable that neither the acquisition of the note nor the acquisition of the partnership interest in exchange for forgiveness caused the existing owner to realize cancellation of indebtedness income.

2

Tax Reform is all the Rage. The news this summer will be dominated by talk of tax reform to pay for any passed infrastructure and other administrative priorities. The Administration has proposed a wishlist containing number of tax increases, including:

- Raising the corporate income tax rate
- Imposing a global minimum tax on multinational corporations
- Raising the top individual income tax rates for high-income individuals
- Eliminating the preferential rates on long-term capital gains for high-income individuals
- Eliminating like-kind exchanges, a popular tax deferral opportunity for real estate investors

The Kilpatrick Townsend Tax Team is monitoring closely legislative talks regarding these proposals. Later this summer we will be introducing a new blog, the Kilpatrick Townsend Tax Legislation Tracker, to keep you informed about legislative developments for tax reform and any other significant tax legislation.

3

Changes to Carried Interest. Private equity and investment fund managers will want to watch potential tax reform. These managers often receive a large amount of compensation through carried interest, which under current law is not taxed upon grant and may be taxed at preferential capital gains rates on exit. The Tax Cuts and Jobs Act added a three-year holding period for carried interest in Section 1061, but did not fundamentally change the way carried interest is taxed. This past January, the Department of Treasury released taxpayer-favorable regulations that simplified many rules under Section 1061. Most importantly, the regulations clarify the "capital exception" that exempts investment fund managers from the three-year holding period for a partnership interest that relates to capital that they invest as long as the capital interest is separately identified from the manager's carried interest.

That said, the significance of these regulations will ultimately depend on tax reform. President Biden's wish list includes carried interest reform that seeks to end the ability for investment fund managers to be taxed at preferential capital gains rates. There are also numerous bills in the Senate that seek to change the character and timing of carried interest. But because these proposals have been floating around Congress for over a decade, it is difficult to know whether this time is different. We will track these carried interest proposals in our Kilpatrick Townsend Tax Legislation Tracker.

4

States are Increasingly Offering Elective Pass-Through Entity Tax Regimes. A popular trend in early 2021 has been the enactment of state pass-through entity tax regimes to get around the $10,000 federal state and local tax deduction limitation. By way of background, it used to be that state and local taxes (e.g., state income taxes and property taxes) could be deducted on individuals' personal income tax returns without limitation. Then the Tax Cuts and Jobs Act limited the deductible amount to $10,000. To get around the $10,000 limitation, state pass-through entity taxes allow partner taxes to be paid at the pass-through level, which can then be deducted without limitation. Treasury Department guidance issued in late 2020 confirms that this structure works state taxes can be deducted without limitation for federal income tax purposes at the partnership level). In response to the Treasury Department guidance, states have been rushing to enact pass-through entity tax regimes. So should every partnership elect into these regimes? Look before you leap – there can be differences between states in how the partnership tax is computed, which can impact the benefit of making the election. Additionally, there is a question about whether nonresident partners will be able to claim a resident credit for partnership taxes paid on their home state returns.

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