Historic Boardwalk Hall, LLC v. Commissioner, 136 T. C. 1 (U. S. Tax Ct. 2011)

The U. S. Tax Court ruled that Historic Boardwalk Hall, LLC, was not a sham partnership and upheld the validity of a transaction allowing Pitney Bowes to invest in the rehabilitation of Atlantic City's East Hall, a historic structure. The court found that the partnership had economic substance and that the rehabilitation tax credits were a legitimate incentive for the investment. This decision reinforces the use of tax credits to spur private investment in public historic rehabilitations, impacting how such partnerships are structured and scrutinized for tax purposes.

Parties

Historic Boardwalk Hall, LLC (Petitioner) and the Commissioner of Internal Revenue (Respondent). Historic Boardwalk Hall, LLC, was formed by New Jersey Sports and Exposition Authority (NJSEA) and Pitney Bowes (PB) to rehabilitate the East Hall in Atlantic City, New Jersey. NJSEA was the managing member, while PB was the investor member with a 99. 9% interest. The Commissioner challenged the partnership's tax treatment at the partnership level.

Facts

Historic Boardwalk Hall, LLC, was formed on June 26, 2000, with NJSEA as the sole member. On September 14, 2000, PB was admitted as a member, contributing approximately $18. 2 million in capital over several years. The East Hall, a historic structure in Atlantic City, underwent a significant rehabilitation project costing around $100 million, part of which was funded by PB's investment. The rehabilitation allowed PB to claim historic rehabilitation tax credits under section 47 of the Internal Revenue Code. NJSEA managed the project and received a $14 million development fee from the partnership. The East Hall was successfully rehabilitated and operated as an event space, though it incurred operating losses. The Commissioner issued a notice of final partnership administrative adjustment (FPAA) challenging the tax treatment of the partnership, alleging it was a sham and that PB was not a genuine partner.

Procedural History

The Commissioner issued an FPAA on February 22, 2007, challenging the tax years 2000, 2001, and 2002. The FPAA asserted that the partnership items should be reallocated from PB to NJSEA and imposed accuracy-related penalties under section 6662. Historic Boardwalk Hall, LLC, filed a petition in response on May 21, 2007. A trial was held from April 13-16, 2009, in New York, New York. The Tax Court's jurisdiction was limited to partnership items and penalties as per section 6226(f).

Issue(s)

Whether Historic Boardwalk Hall, LLC, is a sham partnership lacking economic substance?

Whether Pitney Bowes became a partner in Historic Boardwalk Hall, LLC?

Whether NJSEA transferred the benefits and burdens of ownership of the East Hall to Historic Boardwalk Hall, LLC?

Whether the section 6662 accuracy-related penalties apply?

Rule(s) of Law

The economic substance doctrine requires that a transaction have both objective economic substance and subjective business motivation. See *IRS v. CM Holdings, Inc.* , 301 F. 3d 96, 102 (3d Cir. 2002). The Tax Court must consider whether the partnership is bona fide and whether the tax benefits are consistent with the intent of subchapter K of the Internal Revenue Code. See *Sec. 1. 701-2, Income Tax Regs.* The determination of partnership items, including whether a partnership is a sham and whether a partner's interest is genuine, is made at the partnership level under the Tax Equity and Fiscal Responsibility Act (TEFRA). See *Sec. 6226(f).*

Holding

The Tax Court held that Historic Boardwalk Hall, LLC, was not a sham partnership and did not lack economic substance. The court found that PB became a partner in the partnership, and NJSEA transferred the benefits and burdens of ownership of the East Hall to Historic Boardwalk Hall, LLC. The section 6662 accuracy-related penalties were not applicable.

Reasoning

The Tax Court analyzed the economic substance of the transaction by considering both the objective economic substance and the subjective business motivation. The court found that the partnership had objective economic substance because it affected the net economic positions of both NJSEA and PB. The rehabilitation of the East Hall was successful, and PB's investment facilitated the project, which would have been more costly to the state without PB's participation. The court rejected the Commissioner's argument to ignore the rehabilitation tax credits in evaluating economic substance, noting that Congress intended such credits to spur private investment in historic rehabilitations. The court also found that PB had a meaningful stake in the partnership, as it faced risks related to the rehabilitation's completion and potential environmental hazards. The court determined that the partnership's structure and operations were consistent with the intent of subchapter K, as exemplified by *Sec. 1. 701-2(d), Example (6), Income Tax Regs.* , which allows for partnerships to facilitate the transfer of tax benefits. The court concluded that the partnership was valid, and the tax benefits were appropriately allocated to PB.

Disposition

The Tax Court entered an appropriate decision upholding the partnership's tax treatment and denying the Commissioner's adjustments and penalties.

Significance/Impact

This case reaffirms the legitimacy of using partnerships to facilitate private investment in public historic rehabilitations, supported by tax incentives like the section 47 rehabilitation credit. It clarifies that such transactions can have economic substance even if primarily motivated by tax benefits, as long as they achieve the legislative intent of encouraging investment in otherwise unprofitable projects. The decision impacts how partnerships are structured for similar projects and how the economic substance doctrine is applied in the context of tax credits. It also underscores the importance of considering the legislative purpose behind tax incentives when evaluating the economic substance of transactions.

