No. 12-901

IN THE

Supreme Court of the United States

HISTORIC BOARDWALK HALL, LLC,
NEW JERSEY SPORTS AND EXPOSITION
AUTHORITY, TAX MATTERS PARTNER,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF

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REPLY BRIEF

This petition for writ of certiorari involves pivotal issues of federal tax law that have far-reaching consequences for thousands of historic rehabilitation tax credit projects throughout the country that either have been completed, are currently in progress, or are planned for the future. The government's brief in opposition attempts to portray this case as merely a routine factual dispute between petitioner and the Third Circuit. Nothing could be more drastically wrong. As the petition makes clear, the court of appeals' opinion creates dangerous and legally unsupportable new tax law that directly conflicts with precedent of this Court and with courts of appeals.

Respondent's brief purposely structures its argument as a factual one and deliberately ignores the critical legal issues raised in the petition. Specifically, the government does not address the validity of the Third Circuit's ruling that a partner, in this case Pitney Bowes Historic Renovation, LLC ("PBHR"), who has absolutely no right to the return of its $19.3 million capital contribution from the partnership, *i.e.*, Historic Boardwalk Hall, LLC ("HBH"), somehow has no risk with respect to its capital, and therefore is not a partner for federal income tax purposes. Similarly, respondent fails to confront the court of appeals' baseless holding that the allocation of historic rehabilitation tax credits ("HRTCs") by operation of law from HBH to PBHR should be considered a "repayment" or "sale" of property from HBH to PBHR. Lastly, the government does not address the Third Circuit's legally confounding substance over form analysis which inexplicably uses PBHR's entitlement to the HRTCs as the very grounds for denying them.

These are overarching legal questions of extraordinary national significance. Respondent's strategy, however, is to try to convince this Court that Congressionally sanctioned and encouraged HRTCs are simply another element to be considered in a "totality of the facts and circumstances" analysis of whether a partnership exists under *Commissioner v. Culbertson*, 337 U.S. 733 (1949). In doing so, respondent glides over the fact that the Third Circuit created new law -- and extremely bad law -- in an opinion that has harmful consequences to thousands of HRTC projects involving partnership investments totaling billions of dollars.[1] The utter danger of the court of appeals' opinion underscores the reason that this Court should grant review.

I. The Third Circuit Incorrectly Applied Established Precedent And Created New Law For Federal Tax Attributes

1. The issue decided by the Third Circuit was whether PBHR was a *bona fide* partner in HBH. The other partner in HBH is the New Jersey Sports and Exposition Authority ("NJSEA"), an instrumentality of the State of New Jersey. The court of appeals found that PBHR was not a partner in HBH because PBHR allegedly did not have a meaningful stake in the success or failure of HBH.

The Third Circuit purportedly based its ruling on this Court's holding in *Commissioner v. Culbertson*, 337

1. *See Third Annual Report on the Economic Input of the Federal Historic Tax Credit*, at 8 (Rutgers University, July 2012), http://www.nps.gov/tps/tax-incentives/taxdocs/economic-impact-2012-pdf (last visited April 29, 2013).

U.S. 733 (1949). Under *Culbertson*, a partnership exists if based on the totality of the facts and circumstances, it is determined that "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Id.* at 741. As stated above, respondent's strategy is to posit this case as a fact-bound disagreement over the application of a *Culbertson* facts and circumstances analysis. Respondent's position is completely without merit. As the petition demonstrates, the Third Circuit has disregarded established law, and created new law, which conflicts with *Culbertson* and the decisions of courts of appeals.[2]

2. Congress enacted 26 U.S.C. § 47, *i.e.*, the statute which provides for the 20 percent HRTC at issue herein, to purposely direct and motivate the investment by public companies in the rehabilitation of our nation's buildings of historic significance. PBHR, as a partner in HBH, acted in furtherance of this Congressional mandate when it invested $19.3 million of capital in HBH. PBHR's capital was used, together with other funds, to successfully renovate the Historic Boardwalk Hall (also known as the "East Hall") in Atlantic City, New Jersey.

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2. This is not to say that petitioner agrees with the Third Circuit's factual findings because it certainly does not. Moreover, there is a serious question as to why the Third Circuit made any factual determinations regarding the existence of a *bona fide* partnership when the trier of fact, *i.e.*, the Tax Court, had already ruled in petitioner's favor finding that PBHR and NJSEA had intended to form a partnership. Nonetheless, petitioner's arguments herein are purely legal ones, and are not based on the Third Circuit's distorted, one-sided, and flawed factual findings.

The Third Circuit wrongfully held that PBHR was not a partner in HBH because its capital allegedly was not at risk in the partnership. The foundation of the court's legally defective decision is its holding that PBHR was "certain to recoup [its capital] contributions" from HBH because PBHR was entitled to the allocation of the HRTCs from the partnership. Pet. App. 63a. In point of fact, however, PBHR had absolutely no right to the return of its capital from HBH, either under the partnership agreement or through any other means. It was an egregious misapplication of federal tax law for the Third Circuit to rule that the allocation of federal tax attributes under the Internal Revenue Code (the "Code") constitutes a "recoupment" of a partner's capital contribution from the partnership. Further, the Third Circuit then treated the analysis as complete, thus turning the subjective *Culbertson* test – what did the parties intend – into a new objective test – did one of the parties receive an amount, from whatever unrelated source, that compensated that party for its initial investment. The Third Circuit thus tossed out over 65 years of Supreme Court jurisprudence.

Respondent's brief in opposition perpetuates the legally indefensible analysis of the court of appeals. Respondent, however, stretches the court's reasoning to an even more absurd level by arguing that HRTCs, a tax credit created by Congress, are nothing more than another "fact and circumstance" to be considered under *Culbertson*. Federal tax benefits expressly established by Congress and allocated from a partnership to a partner *by operation of law* are not merely another item to be tallied on a partnership-formation checklist. No court in the country has ever made such an altogether sweeping and blatantly unfounded ruling with respect to federal tax attributes.

Both the Third Circuit and respondent look to the case of *TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006), which is known as the *Castle Harbour* case, to buttress their faulty risk analysis under *Culbertson*. The *Culbertson* analysis, as applied by the Second Circuit in *Castle Harbour*, examines the relationship between the partner and the partnership to determine whether the partner's capital is at risk in the partnership in order to ascertain the intent of the parties. The Third Circuit's and respondent's application of *Castle Harbour* is squarely in conflict with *Culbertson*, and the *Castle Harbour* case itself, for two major reasons.

First, the capital contribution of $19.3 million that PBHR made to HBH was manifestly consistent with the clear Congressional purpose of encouraging private investment in the rehabilitation of historic buildings by providing tax credits to make such investments economically profitable. In *Castle Harbour*, on the other hand, the parties were attempting to use the partnership tax rules for a tax avoidance purpose which frustrated the tax laws, namely, to assign taxable income away from a United States taxpayer to tax indifferent Dutch banks.

Second, in *Castle Harbour*, the Second Circuit found that under the partnership agreement the Dutch banks were guaranteed to receive cash distributions *from the partnership* equal to their original capital contributions, plus an annual return of approximately 9 percent. *Id.* at 226-27. On this basis, the court ruled that the Dutch banks' capital was not at risk, and the banks' interest was that of a creditor rather than a partner. PBHR, unlike the Dutch banks in *Castle Harbour*, has *no* right under the HBH partnership agreement to receive, or compel HBH or NJSEA to repay, all or any part of its capital

contribution. Thus, PBHR's capital was, and is, at risk in the partnership.

The Second Circuit in *Castle Harbour* found that the Dutch banks had no meaningful participation in the partnership because their position was like that of a creditor. The banks' intent was to be repaid by the partnership, regardless of the success or failure of the partnership. This intent was directly contrary to an intent to join together in a partnership, and thus the Dutch banks were not partners under the *Culbertson* analysis. By contrast, the facts that respondent marshals do not show that PBHR intended to be repaid by HBH or by NJSEA, but rather that PBHR intended to receive HRTCs. This intent is entirely consistent with the intent to form a partnership. The Third Circuit and respondent have jettisoned this Court's subjective test under *Culbertson* (do the facts and circumstances show that the parties intended to form a partnership?) for an entirely objective test based on a misreading of *Castle Harbour* (do the facts and circumstances show that one party will recover, from whatever source, an amount to compensate for its initial investment?).

3. The Third Circuit and respondent's brief in opposition compound the dizzying assembly of errors in their *Culbertson* "analysis" by grasping for aid in the wholly inapposite case of *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, 639 F.3d 129 (4th Cir. 2011). The *Virginia Historic* case did not even address *Culbertson*, and hence it is an unworthy reference point for any purpose in this case. In fact, in *Virginia Historic*, the Fourth Circuit assumed that the purported partners were valid partners in certain partnership investment funds for purposes of its opinion. *Id.* at 137.

In *Virginia Historic*, the issue was whether simultaneous transfers of cash by partners to the partnerships in exchange for *state law* historic rehabilitation tax credits were income generating "disguised" sales for federal income tax purposes under 26 U.S.C. § 707. This question turned on whether the *state* tax credits were "property" for purposes of applying the disguised sale rules. *Id.* at 140-42. The Fourth Circuit found under the particular limiting facts of the *Virginia Historic* case that the state tax credits were property and that the credits could be transferred. The court ultimately concluded that the transfer of the state tax credits in exchange for cash generated income to the partnerships under 26 U.S.C. § 707. *Id.* at 142.

The Third Circuit, claiming to rely on *Virginia Historic*, wrongfully held that the federal HRTCs arising from the renovation of the East Hall are property that was transferred to PBHR by HBH, or sold to PBHR by HBH. *See, e.g.,* Pet. App. 62a, n. 54, 63a, 68a. The court reaches this unsupportable conclusion without ever even examining whether HRTCs are "property" for purposes of the *Culbertson* analysis, or whether the allocation of HRTCs pursuant to 26 U.S.C. §§ 702 and 704 is a "transfer" or "sale" of HRTCs.

Respondent's brief denies that the Third Circuit found that the HRTCs were property transferred by HBH to PBHR (Br. Op. 13-14) but the court's opinion plainly states otherwise. *See, e.g.,* Pet. App. 62a, n. 54, 63a, 68a. Indeed, respondent itself calls the HRTCs "consideration" paid to PBHR by HBH. Br. Op. 14. There is no legal authority for the extraordinary new law created by the court in its opinion. No precedent exists in federal income tax law that lends any credence to a holding that the allocation

of a federal tax attribute to a partner under the Code constitutes a transfer of the attribute to the partner by the partnership, or that a federal tax benefit is property that can be bought and sold. The court's fallacious ruling is undoubtedly wrong in this case, and, unless corrected, it clearly will wreak havoc for innumerable other HRTC investment partnerships.

The Third Circuit's holding that HRTCs are property that can be transferred, bought, and sold lacks any authority whatsoever in the tax law. The court's ruling, moreover, is directly at odds with this Court's holding in *Randall v. Loftsgaarden*, 478 U.S. 647 (1986). There, the Court found that federal tax benefits, including specifically tax credits, have "no value in themselves." *Id.* at 657. In other words, the Court recognized that the receipt of a tax benefit provided under the Code does not transfer money or other property to the recipient. *Id.* at 656-57. The holding of the Court in *Randall* applies with equal force in the present case and demonstrates yet another reason why the decision of the court below is irreparably in conflict with this Court's precedent.

4. The discussion in respondent's brief regarding the "substance over form" doctrine is illogical, circular, and does violence to the tax law. (Br. Op. 15-16). Respondent claims, as did the Third Circuit, that PBHR's entitlement to the HRTCs themselves should be included in the substance over form analysis of whether PBHR is a *bona fide* partner in HBH. In making this argument, respondent impermissibly treats the HRTCs as simply another "fact" under the *Culbertson* totality of the facts and circumstances analysis.

The position set forth by respondent and the Third Circuit has no basis in law. Congress enacted 26 U.S.C. § 47 with the clearly-stated purpose of motivating public corporations to invest in the renovation of historic buildings in order to receive the allocation of HRTCs under the Code law. In this case, PBHR invested $19.3 million in capital in a partnership with NJSEA to renovate the East Hall, an irreplaceable part of our country's history. This is precisely what Congress intended in enacting the HRTC statute.

Respondent and the Third Circuit claim that the allocation of the HRTCs to PBHR was a "repayment" of its capital contribution by the partnership which eliminated PBHR's downside risk. For this reason, it is alleged, PBHR was not in substance a partner in HBH. The fallacy of this reasoning is patently obvious: Congressionally established and sanctioned HRTCs cannot be used as the central element of the analysis which denies a taxpayer those tax attributes. In other words, when the substance over form doctrine is applied, the analysis *must* be conducted without considering the actual tax benefits in question, because the entitlement to those tax benefits is the very issue to be decided. *See, e.g., Grodt & McKay Realty, Inc. v. Commissioner*, 77 T.C. 1221, 1242-43 (1981); *Harmston v. Commissioner*, 61 T.C. 216, 228 (1973), *aff'd*, 528 F.2d 55 (9th Cir. 1976).

It was wrong for the Third Circuit to take into account the HRTCs in considering whether the business arrangement among PBHR, NJSEA, and HBH was a valid partnership for federal income tax purposes. Indeed, the aim of the substance over form analysis is to determine who is entitled to the HRTCs, and this analysis must be

performed without considering the tax credits. In this case, it is clear that the Third Circuit assumed that PBHR was entitled to the tax credits in order to find that PBHR was *not* entitled to the credits. Such muddled reasoning surely demands this Court's review.

II. This Case Clearly Warrants The Court's Review

Congress enacted the historic rehabilitation tax credit decades ago with the express purpose of stimulating the investment by public corporations in the renovation and preservation of our nation's historic buildings. The statute has been an unqualified success. It has resulted in the completion of thousands of partnership historic rehabilitation projects involving billions of dollars which have created countless jobs.

Congress reiterated its unconditional commitment to the HRTC when it enacted the landmark Tax Reform Act of 1986 (the "1986 Act"). The Congressional report for the 1986 Act stated:

> The Congress concluded that the incentives granted to rehabilitations 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 investor's profit projections. 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.

Pub. L. No. 99-514; 99th Congress, H.R. 3838 (Part 2 of 19 Parts); JCS-10-87- *General Explanation of the Tax Reform Act of 1986*, p. 149 (1987).

The clear intention of Congress was echoed recently on March 21, 2013 when former Secretary of the Interior Kenneth Salazar announced steps to *expand* the use of the HRTC. Former Secretary Salazar stated:

> To date, the historic tax incentive program has been a great success, and these recommendations will help make the program an even more powerful force to revitalize our urban areas, create new jobs and build civic pride among citizens as they celebrate their heritage. Working with local governments, developers and other stakeholders, we will ensure that this program continues to be as effective as possible in helping preserve our nation's history and fuel our economy.

News Release (March 21, 2013), http://www.doi.gov/news/pressrelease (last visited May 2, 2013).

This is a case of exceptional national importance, particularly because thousands of partnership projects with HRTCs have been structured in a manner indistinguishable from the one herein. The Congressional purpose in enacting 26 U.S.C. § 47 is clear and there can be no doubt that the Third Circuit's opinion imperils that mandate. The petition demonstrates that the court's reasoning and conclusions are legally indefensible, and that the opinion conflicts with the precedent of this Court and with courts of appeals. All of these factors establish an urgent need for this Court to grant review.

CONCLUSION

For all the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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