

April 28, 2017

On Remand from the Court of Common Pleas

In Re: Platinum OwnerCo, LLC

Docket Nos: 36BPMERZZ8031; 36NPMERZZ9094 36BPREFZZ9731

Statement of Record:

1. The Tax Review Board (TRB) hereby incorporates by reference its original Opinion in this case, dated December 1, 2015.
2. This matter was remanded to the Tax Review Board by Common Pleas Court Order of the Hon. Linda Carpenter, dated April 5, 2016, as amended April 6, 2016. The Order directed the TRB to specifically reference "the facts on the record as to whether the transaction under review was a sham transaction."
3. The TRB held an administrative hearing on August 2, 2016 pursuant to the Order by the Court. At the conclusion of the hearing, a briefing schedule was set for the parties and the matter was taken under advisement.
4. On December 15, 2016, The TRB announced its decision to as follows:
Denied on the merits after review on remand from the Court of Common Pleas. Petitioner did not adequately address the issue of whether the creation of the partnership was a sham transaction to meet its burden of proof.
5. Petitioner requested a rehearing on January 12, 2017 specifically for reconsideration of a waiver of interest and penalties. This rehearing request was denied by the TRB.
6. Petitioner filed an appeal to the Court of Common Pleas.

Findings of Fact:

1. The TRB hereby incorporates all facts recited in its prior Opinion of December 1, 2015 in the matter of PlatinumOwnerCo, LLC.
For clarity and simplification, below is a reproduced outline of transactions from this prior Opinion:
 - a. Petitioner owned 100% of a subsidiary company known as South 17th Street Ownerco Mezzanine, LLC. (Mezzanine).
 - b. South 17th Street Ownerco Mezzanine, LLC owned 100% of the company known as South 17th Street Ownerco, LLC
 - c. South 17th Street Ownerco, LLC owned the Sofitel Hotel in Philadelphia.
 - d. Petitioner formed and owned a subsidiary company known as South 17th Street InterMezzCo, LLC. (InterMezzCo). This new entity elected to be taxed as a corporation.
 - e. Petitioner contributed a portion of its interest, .01%, in Mezzanine, LLC to the new corporation, InterMezzCo.
This transfer of ownership interest caused Mezzanine to become a partnership between Petitioner & South 17th Street InterMezzCo, LLC.

Petitioner and InterMezzCo, LLC entered into an agreement for each to sell all of their partnership interest in South 17th Street Ownerco Mezzanine, LLC to an unrelated third party.

Pursuant to this Agreement of Sale, a new purchaser acquired the entire interests of Petitioner and InterMezzCo which was comprised of 100% of Mezzanine and its assets including South 17th Street Ownerco, LLC., the company that owned the Philadelphia hotel. This sale occurred in 2010.

2. Petitioner transferred the .01% interest in Mezzanine to InterMezzCo on November 11, 2010.
3. Petitioner and InterMezzCo sold their interests in Mezzanine on December 1, 2010.
4. At the remand hearing on August 6, 2016, Petitioner presented the testimony of Craig Caffarelli, a partner in GEM Realty Capital, an investment advisor to Petitioner with respect to the transactions at issue in this appeal.
5. Mr. Caffarelli testified that the creation of the IntermezzCo partnership and particularly the splitting of the partnership interest was specifically designed to reduce or minimize taxes for the sale of the partnerships owning the hotel that resulted in the gain the City is seeking to tax in this instance. TRB N.T. 8-2-16, page 27. Tax avoidance was the sole purpose for the structure of the transactions.
6. Mr. Caffarelli also testified that all parties understood that there were risks to the proposed partnership structure for this sale. He did not recall specifically what those risks might be for the company. The determination was made that, on balance, the risks were worth taking to move ahead, but still with the understanding that risk existed.

Conclusions of Law:

This matter was remanded to the TRB for reconsideration by the Court of Common Pleas (CCP) based on a finding by the Court that the TRB had misapplied the law, specifically Internal Revenue Code 704(e). The TRB was directed to provide a further explanation as to its prior ruling or to change its decision based on the Court's analysis.

It was the determination of the Court that a corporation must show a legitimate business interest other than tax avoidance to reap the benefit of its tax avoidance strategy. It was the determination of the TRB that this case was remanded to revisit the question of whether Petitioner's creation of the partnership known as South 17th St. IntermezzoCo, LLC (IntermezzCo) was a sham transaction. And while the TRB has the authority to determine the transaction was not a sham, the petitioner must present evidence beyond what was in the record before the Court. See CCP Notes of Testimony, 4-5-2016, Page 42.

The remand hearing was an opportunity for Petitioner to present evidence on this issue, along with any others it believed pertinent. Petitioner was on notice as a result of the Order that the business motives for the creation of IntermezzCo would be an issue for consideration by the Board.

Petitioner did not provide evidence to explain the purpose for creating the new partnership other than for tax avoidance. Petitioner's focused on the set up and structure of the partnerships and partners and its compliance with the Internal Revenue Code.

In addition, Petitioner counseled the TRB to uphold its original decision and not be swayed by the Opinion and Order of the Court of Common Pleas. Petitioner maintained its position that any motive or business interest for creating the partnership was irrelevant for purposes of determining its validity.

In its prior Opinion in this matter, the TRB focused on Internal Revenue Code §704(e) as part of its analysis of whether Petitioner was required to establish a business motive for the creation of a partnership.

At the original TRB hearing, when presented with Petitioner's argument and evidence that motive for the partnership creation was irrelevant, the City did not provide sufficient rebuttal evidence to establish for the TRB that Petitioner had not met its burden of proof at that time. "The City's own audit report characterized the assessment under challenge as imposition of the BIRT and NPT on "the capital gain from sale of partnership interest", without further explanation. See City Audit Report, pages C1 & D1. The auditor testified (Notes of Testimony, October 2, 2014, pg. 22) that Petitioner was in a partnership that had an interest in a Philadelphia hotel. There was no evidence presented to establish that Petitioner owned the hotel itself or that a direct sale of the Philadelphia hotel occurred." TRB Opinion, Platinum OwnerCO, LLC., 12-1-15

On remand and after a review of the CCP findings, the TRB looked to Petitioner to address the issues as stated by the Court, and primarily to provide evidence to rebut the accusation that the partnership created at or about the same time as the sale in question had a legitimate business purpose and was not solely for the purpose of avoiding the BIRT on the gain from the sale.

There were several factors surrounding the transactions that called into question whether a true business purpose existed for the creation of IntermezzCo:

1. The partnership with Petitioner and InterMezzCo was created with a miniscule ownership interest in Mezzanine transferred by Petitioner to InterMezzCo. This created the partnership that allowed Petitioner to claim it was no longer subject to the BIRT.
2. All partners involved in all of the transactions were owned by Petitioner.
3. This new partnership owning Mezzanine was sold almost simultaneously with the creation of IntermezzCo.
4. The primary or only benefit that the TRB was presented for the creation of the partnership, IntermezzCo, was that it allowed Petitioner to avoid the BIRT on capital gain from the sale of Mezzanine. Petitioner offered no other explanation.

Petitioner set up a series of partnerships and put them through a series of transactions to minimize and then avoid the Philadelphia BIRT on the multi-million dollar gain from the sale of one of these partnerships. All of which it was certainly entitled to do in its attempts to minimize

its tax burdens. However, a review by the TRB following the guidance laid down by the CCP established this series of transactions designed to get around the BIRT fails.

The decision of the TRB was to deny the petitions as Petitioner did not meet its burden of proof on remand to establish with substantial evidence that there was a business purpose separate and apart from tax avoidance, for the creation of the partnership known as IntermezzCo.

As to interest and penalties accrued against delinquent taxes, The Philadelphia Code §19-1705(2) provides:

Upon the filing of any petition for the waiver of interest and penalties accruing upon any unpaid money or claim collectible by the Department of Revenue, for or on behalf of the City or the School District of Philadelphia, the Tax Review Board may abate in whole or in part interest or penalties, or both, where in the opinion of the Board the petitioner acted in good faith, without negligence and no intent to defraud.

Petitioner is a sophisticated taxpayer, well represented by counsel and professional advisers for all transactions and tax matters.

~~Petitioner purposefully created a complicated series of partnerships and transactions with no other stated purpose than avoiding the Philadelphia BIRT. The heart of its argument was that the motive for its transactions was irrelevant as long as they were undertaken legally.~~

Petitioner and its partners understood that undertaking this structure came with a risk, apparently not articulated. The risk that it could be challenged by a taxing authority is what happened in this instance. They weighed the pros and cons and in the end made the decision to go ahead with this series of structures and transactions, admittedly, for the sole purpose of attempting to minimize their tax liability. They believed the risks, whatever they were thought to be, were small enough to justify taking the risk. When faced with the consequences of their choice, they requested relief from the interest and penalties that resulted from the delay in payment to the city. This is relief the Tax Review Board did not find warranted in this circumstance.

Concurred:

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Kaitlin McKenzie-Fiumara, Esq.
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