



# TaxNewsFlash

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## U.S. Tax Court: Participation interest may constitute partnership interest regardless of subjective intent to be a partner

The U.S. Tax Court yesterday held that if a participation interest gives the holder a contractual right to a share of proceeds from the sale of specified securities owned by a partnership, that interest is a capital interest in the partnership, regardless of the holder's subjective intent to participate in the partnership's business.

The Tax Court also held that the taxpayer did not meet its burden of proof that there was no reasonable expectation that it would ultimately receive interest on an outstanding loan that it later deducted as uncollectible, and thus that it could stop accruing such interest.

The case is: *YA Global Investments, LP v. Commissioner*, T.C. Memo 2024-78 (August 8, 2024). Read the Tax Court's [opinion](#)

### Summary

The taxpayer, a partnership, provided funding to portfolio companies in exchange for stock, convertible debentures, promissory notes, and warrants. Because the taxpayer had no employees, it hired a Delaware limited liability company to manage its assets and serve as its tax matters partner. In a previous decision, the Tax Court held that the taxpayer was engaged in the conduct of a U.S. trade or business based on the activities of its asset manager and was also a "dealer in securities" subject to the mark-to-market accounting rules of section 475. Read [TaxNewsFlash](#)

Yesterday's opinion by the Tax Court addresses certain remaining issues of the taxpayer for a subsequent tax year, 2009. Relevant to those issues are the following facts. First, the taxpayer's general partner established certain foreign special purpose vehicles (SPVs) in 2009 to facilitate the redemption of indirect interests in the partnership. Each foreign SPV held a participation interest entitling it to receive cash distributions as the partnership sold specified securities. Second, under its established accounting policies, the partnership stopped accruing interest on debentures and promissory notes in 2009 when, in the opinion of its general partner, reasonable doubt existed as to the collectibility of the interest.

The Tax Court held that if the participation interests held by the foreign SPVs were contract rights to shares of the proceeds from the sale of specified securities owned by the partnership, those interests were capital

interests in the partnership under Treas. Reg. § 1.704-1(e)(1)(v), regardless of the foreign SPVs' subjective intent to participate in the partnership's business. Because the record did not establish whether the participation interests held by the foreign SPVs gave them undivided ownership interests in specified securities or instead were contractual rights to receive proceeds upon the partnership's sale of those securities, the taxpayer did not meet its burden of establishing that the foreign SPVs were not partners in the partnership during 2009. Therefore, the partnership's withholding tax liability under section 1446 for 2009 must take into account the items of partnership income, gain, loss, and deduction allocable to the foreign SPVs.

The Tax Court further held that the taxpayer failed to establish that when it accrued interest in 2009 that it later wrote off as uncollectible in the same year, there was no reasonable expectation that the interest would ultimately be paid. The taxpayer's accrual of the interest indicated that, at the time of accrual, its general partner had not determined that reasonable doubt existed as to the collectability of the interest, and the taxpayer did not identify any evidence unavailable to its general partner during 2009 that would establish that the taxpayer should have had no reasonable expectation of ultimately receiving the interest.

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