Disguised Sale Rule Reversal: Using Leveraged Partnerships to Defer Gain on Debt-Financed Distributions

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SECTION 707(A)(2)(b)

The regulations under Section 707(a)(2)(B) set forth rules as to when a contribution to the partnership followed by (or preceded by) a partnership distribution will be deemed a sale requiring the selling partner to recognize gain or loss on the disguised sale.

Facts and Circumstances Test

Contributions of property (excluding money) to a partnership and distribution of money or other consideration (including the assumption of debt or taking property subject to a liability) by the partnership to the partner will constitute a sale if, based on all of the facts and circumstances:

Facts and Circumstances Test (Cont'd.)

(1) the partner's receipt of money or other consideration would not occur but for the transfer of property, and

(2) if the transfers are not simultaneous, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

List of Factors

1. The timing and amount of a subsequent transfer are determinable with reasonable certainty at the time of an earlier transfer;
2. The transferor has a legally enforceable right to the subsequent transfer;
3. The partner's right to receive the transfer or money or other consideration is secured in any manner;

List of Factors (Cont'd.)

4. Any person has made or is legally obligated to make contributions to the partnership in order to permit the partnership to make the transfer of money or other consideration;
5. Any person has loaned or agreed to loan the partnership the money or other consideration required to enable the partnership to make the transfer;

List of Factors (Cont'd.)

6. The partnership has incurred or is obligated to incur debt to acquire the money or other consideration necessary to permit it to make the transfer, taking into account the likelihood that the partnership will be able to incur that debt;
7. Any person holds money or other liquid assets beyond the reasonable needs of the business that are expected to be available to make the transfer;

List of Factors (Cont'd.)

8. The transfer of money or other consideration by the partnership to the partner is disproportionately large in relationship to the partner's general and continuing interest in partnership profits; and
9. The partner either has no obligation to return or repay the money or other consideration to the partnership or has such an obligation but the obligation is likely to become due at such a distant point in the future that the present value of that obligation is small in relation to the amount of money or other consideration transferred by the partnership to the partner.

List of Factors (Cont'd.)

Example #1

A transfers Property X to Partnership AB in exchange for an interest in a partnership. At the time of the transfer, Property X has a fair market value of $4,000,000 and an adjusted tax basis of $1,200,000. Immediately after the transfer, the partnership transfers $3,000,000 in cash to A. A is considered to have sold a portion of Property X with a value of $3,000,000 to the partnership in exchange for the cash and $900,000 of the basis would be allocated to the sale resulting in $2,100,000 of gain.

Two-Year Presumption

Unless the facts and circumstances clearly establish otherwise, if a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner within a two-year period, then the transfers are presumed to be a sale of the property to the partnership.

Two-Year Presumption (Cont'd.)

If the transfer of property by the partner to the partnership and the transfer of money or other consideration to the partner by the partnership takes place more than two years apart, then the transfers are presumed to not constitute a sale unless the facts and circumstances clearly establish otherwise.

Two-Year Presumption (Cont'd.)

Example #2

Operation of Presumption of Transfers More Than Two Years Apart

G transfers undeveloped, unencumbered land to the GH partnership in exchange for an interest in the partnership. The land has an adjusted tax basis of $500,000 and a fair market value of $1,000,000. H contributes $1,000,000 in cash.

Under the partnership agreement, the partnership is obligated to construct a building on the land. The projected construction cost is $5,000,000.

Two-Year Presumption (Cont’d.)

Example #2 (Cont’d.)

The partnership secures commitments for construction and permanent financing. The amount of the permanent loan is to equal the lesser of $5,000,000 or 80 percent of the appraised value of the property.

The partnership is obligated to apply the proceeds of the permanent loan to retire the construction loan and to hold any excess proceeds for transfer to G 25 months after G's transfer of the land to the partnership.

Two-Year Presumption (Cont'd.)

Example #2 (Cont'd.)

The appraised value of the improved property is expected to exceed $5,000,000 only if the partnership is able to lease the property on a spec basis. The partnership completes construction of the building and the permanent loan is funded in the amount of $5,000,000. The partnership transfers the $1,000,000 excess permanent loan proceeds to G 25 months after G's transfer of the land to the partnership.

Two-Year Presumption (Cont'd.)

Example #2 (Cont'd.)

Since the $1,000,000 transferred to G is more than two years later, the transfer is presumed not to be a sale unless the facts and circumstances clearly establish otherwise.

Two-Year Presumption (Cont'd.)

Example #2 (Cont'd.)

Since there was a significant risk that the appraised value of the property would be insufficient to support a permanent loan in excess of $4,000,000 because of the risk that the partnership would not be able to achieve a sufficient occupancy level, the facts indicate that at the time G transferred the land to the partnership the subsequent transfer of $1,000,000 to G depended on the entrepreneurial risks of partnership operations. Accordingly, G's transfer of the land to the partnership is not treated as part of a sale.

Exceptions to Sale Treatment

- Certain
  - "guaranteed payments,"
  - "preferred returns,"
  - "operating cash flow distributions," and
  - "reimbursements of preformation expenditures"
- are not treated as part of a sale.

Guaranteed Payments

Reasonable guaranteed payments for capital made to a partner are not treated as part of a sale of property. A guaranteed payment for capital is any payment to a partner by a partnership that is determined without regard to the partnership income and that is for the use of that partner's capital.

Payments are not treated as being made for the use of a partner's capital if the payments are designed to liquidate all or part of the partner's interest in property contributed to the partnership rather than to a provide the partner with a return on an investment in the partnership.

Reasonable Preferred Returns

Reasonable preferred returns presumptively do not constitute part of a sale of property to a partnership. A preferred return is a preferential distribution of partnership cash flow to a partner with respect to capital contributed to the partnership by the partner that will be matched by an allocation of income or gain. (Reg. Section 1.707-4(a)(2).)

<u>Reasonable Preferred Returns</u> (Cont'd.)

<u>What is a Reasonable Preferred Return and/or Guaranteed Payment</u>?

Preferred returns or guaranteed payments for capital are reasonable only if:

(1) pursuant to a written provision of a partnership agreement; and

(2) only to the extent that the payment is made for the use of capital after the date on which that provision is added.

Reasonable Preferred Returns (Cont'd.)

A preferred return or guaranteed payment for capital is presumed reasonable only if it does not exceed the amount determined by multiplying either the partner's unreturned capital at the beginning of the year or, at the partner's option, the partner's weighted average capital balance for the year by the safe harbor interest rate for that year.

Reasonable Preferred Returns (Cont'd.)

The safe harbor interest rate for a partnership's taxable year equals 150 percent of the highest applicable Federal rate.

A partner's unreturned capital equals the excess of the aggregate amount of money and the fair market value of other consideration (net of liabilities) contributed by the partner to the partnership over the aggregate amount of money and the fair market value of other consideration (net of liabilities) distributed by the partnership to the partner.

Operating Cash Flow Distributions

Certain operating cash flow distributions are presumed to not constitute part of a sale of property to a partnership unless the facts and circumstances clearly establish that the transfer is part of a sale. Operating cash flow distributions are one or more transfers of money by a partnership to a partner during a tax year of the partnership to the extent that the transfers:

Operating Cash Flow Distributions (Cont'd.)

(1) are not guaranteed payments; (2) are not reasonable preferred returns; (3) are not characterized as distributions to the partner acting in a capacity other than as a partner; and (4) do not exceed the product of the net cash flow of the partnership from operations for the year multiplied by the lesser of: (i) the partner's percentage interest in overall partnership profits for that year; or (ii) the partner's percentage interest in overall partnership profits for the life of the partnership.

Reimbursements of Preformation Expenditures

A transfer of money or other consideration by a partnership to a partner is not treated as part of the sale of property by the partner to the partnership under the facts and circumstances test to the extent that the transfer to the partner by the partnership is made to reimburse the partner for, and does not exceed the amount of, certain "preformation expenditures."

Reimbursements of Preformation Expenditures (Cont'd.)

Subject to the 20% limitation, preformation expenditures are those capital expenditures that (1) are incurred during the two-year period preceding the transfer by the partner to the partnership and (2) are incurred by the partner with respect to partnership organization and syndication costs or property contributed to the partnership.

Reimbursements of Preformation Expenditures (Cont'd.)

20% Limit

Preformation expenditures must not exceed 20 percent of the property's fair market value at the time of the contribution. The 20 percent limit does not apply if the contributed property's fair market value does not exceed 120 percent of the partner's adjusted basis in the contributed property at the time of contribution.

Reimbursements of Preformation Expenditures (Cont'd.)

Example #3

X transfers to a partnership an unencumbered property with a $1,200,000 value and a $1,000,000 basis. X made a $750,000 capital expenditure with respect to the property in the previous two years. The partnership simultaneously transfers $500,000 of cash to X.

Reimbursements of Preformation Expenditures (Cont'd.)

Example #3 (Cont'd.)

Since the $1,200,000 value of the contributed property does not exceed 120% of X's $1,000,000 basis in the property (which is exactly equal to $1,200,000), the 120% Safe Harbor is satisfied and the 20% Limitation is inapplicable. Therefore, the entire $500,000 distribution to X is excluded from being treated as part of a disguised sale as a reimbursement of capital expenditures. If the value is $1,201,000, then the 20% limit would apply and the non-taxable distribution would be limited to $240,000.

Gross Fair Market Value or Net Fair Market Value?

Where the contributed property is subject to debt, the provision does not specify whether "fair market value" (as used in the 20% Limitation and 120% Safe Harbor) means *gross* value or *net* value.

This issue is highlighted when there is encumbered property.

Gross Fair Market Value or Net Fair Market Value? (Cont'd.)

Example #4

Consider a transaction where a partner contributes to a partnership property with a gross value of $100,000,000 subject to $75,000,000 of nonrecourse debt that constitutes a qualified liability, with a basis of $75,000,000 and then the partnership transfers $20,000,000 of cash to the partner. Assume the partner made $20,000,000 of capital expenditures with respect to the property in the previous two years. *(Ignore relief of debt for this example.)*

Gross Fair Market Value or Net Fair Market Value? (Cont'd.)

Example #4 (Cont'd.)

If the 20% Limitation limits reimbursements to 20% of the $100,000,000 gross value of the contributed property (i.e., $20,000,000), the entire $20,000,000 distribution to the partner would qualify as a reimbursement of capital expenditures and would be a tax-free distribution.

Since the $75,000,000 qualified liability is excluded under the disguised sale rule, one might have thought that the 20% Limitation would limit the amount qualifying as a reimbursement of capital expenditures to 20% of the net value of $25,000,000 or $5,000,000..

Gross Fair Market Value or Net Fair Market Value? (Cont'd.)

Example #4 (Cont'd.)

The 2015 proposed Regulations deal with this issue in part to the extent that "Preformation Expenditures" are funded by borrowing. These preformation expenditures cannot be repaid tax-free if the liability is shifted to another partner.

What is "Such Property"?

Regulation section 1.707-4(d) provides for exclusion of reimbursement of capital expenditures that "are incurred by the partner with respect to… property contributed to the partnership by the partner, but only to the extent the reimbursed capital expenditures do not exceed 20 percent of the fair market value of SUCH PROPERTY at the time of the contribution.

To what property does "such property" refer?

What is "Such Property"? (Cont'd.)

Example #5

X contributes one property with a value of $2,000,000 (Property A) and another property with a value of $8,000,000 (Property B). Neither property is subject to any debt. In the previous two years, X incurred $2,000,000 of capital expenditures with respect to Property A and no capital expenditures with respect to Property B. X receives a $2,000,000 distribution from the partnership (Ignoring the 120% rule).

What is "Such Property"? (Cont'd.)

Example #5 (Cont'd.)

If "such property" refers to all property, then the amount of the 20% Limitation would be set at $2,000,000. But if it refers only to the property to which the capital contribution was made, then the amount of the 20% Limitation would be set at $400,000.

What is "Such Property"? (Cont'd.)

Example #5 (Cont'd.)

The 2015 proposed Regulations provide that these limitations are on a property-by-property basis.

Liabilities Assumed in Transfer

A transfer of property by a partner to a partnership may be treated as a disguised sale if the contributing partner incurs debt in anticipation of the transfer and the partnership assumes the debt or takes the contributed property subject to the debt.

Qualified Liabilities

If a transfer of property by a partner to a partnership is not otherwise treated as a sale, the partnership's assumption of or taking subject to a "qualified liability" in connection with the transfer also is not treated as part of a sale.

Definition of Qualified Liability

- A qualified liability is a liability that:
  1. was incurred by the partner more than two years prior to the earlier date that the partner agreed in writing to transfer the property or the date that the partner transferred the property to the partnership, and that has encumbered the transferred property throughout the two-year period; or
  2. was not incurred in anticipation of the transfer of the property to the partnership; or

Definition of Qualified Liability (Cont'd.)

3. is allocable to capital expenditures with respect to the property; or
4. Under the 2016 Regulations, was incurred in the ordinary course of the trade or business in which property transferred to the partnership as used or held but only if all of the assets related to that trade or business are transferred other than assets that are not material to the continuation of the trade or business.

Nonqualified Liabilities

If a partnership assumes or takes property subject to a liability of the partner **OTHER THAN A QUALIFIED LIABILITY**, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability immediately after the partnership assumes or takes subject to the liability.

Disclosure of Transfers Made Within Two Years

Disclosure to the Internal Revenue Service in accordance with Section 1.707-8 is required if -

1. Where a partner elects to treat a contribution of property as something other than a sale, notwithstanding the sale presumption application to contributions within two years of a distribution to the partner of money or other consideration (other than distributions that are presumed to be guaranteed payments for capital, are reasonable preferred returns, or are operating cash flow distributions;

Disclosure of Transfers Made Within Two Years (Cont'd.)

2. Where a liability incurred within two years of a contribution of property by a partner is treated as not incurred in anticipation of the contribution notwithstanding the contrary presumption;
3. Where a distribution of property to a partner within two years of a contribution of money or other consideration to a partnership is not treated as part of a sale notwithstanding the presumption to the contrary; and

Disclosure of Transfers Made Within Two Years (Cont'd.)

4. Where a partnership liability incurred within two years of a distribution of property to a partner is treated as not incurred in anticipation of the distribution notwithstanding the contrary presumption.

Disclosure of Transfers Made Within Two Years (Cont'd.)

Disclosure is to be made either on a completed Form 8275 or by attaching a statement to the transferor's return for the year of the transfer. The statement must include the following:

1. A caption identifying it as a §707 disclosure;
2. An identification of the items to which the disclosure relates;
3. The amount of each item; and
4. The facts affecting the potential tax treatment of the items under §707.

Ordering Rule for Debt Financed Distributions

Debt Financed Distribution Exception:

- Distribution of money to a partner generally is not treated as consideration to the extent:
  - the distribution is traceable to a partnership liability
  - amount of the distribution does not exceed the partner’s allocable share of the liability incurred to fund the distribution

- Add an ordering rule that applies the debt-financed distribution exception before other exceptions to the disguised sale rules

- Debt-financed distributions can deliver cash tax-free to a contributing partner, if the partner’s share of partnership liabilities is sufficient to cover the distribution.

Leveraged Partnership

1. Property Owner transfers property to a partnership
2. Partnership borrows against the property
3. Property Owner guarantees partnership liability
4. Partnership distributes loan proceeds to the Property Owner

Transaction Objectives and Hurdles

- Property Owner converts property to cash tax-free
- Property Owner bears the risk of loss for the liability
- Property Owner seeks to reduce the risk of loss with guarantee that has limited recourse
  - Bottom-dollar guarantee
  - Shell member

Allocation of Recourse Liabilities

- Liability is recourse to the extent the partner bears the "economic risk of loss"
- Nonrecourse liabilities are allocated among partners
- Generally, a reduction in the partnership liabilities allocated to a partner is treated as a deemed cash distribution, which is taxable to the extent it exceeds the partner's adjusted tax basis in their interest
  - A partner that contributes property to a partnership that is encumbered by liabilities in excess of the contributor's tax basis in the property may recognize taxable gain as a result

Bottom Dollar Guarantee

- Partner-guarantor is not obligated to make a payment to a lender unless it first fails to collect from the partnership a specified minimum amount, usually a fraction of the liability amount
- Used to avoid this result, the partner may seek to have other partnership liabilities allocated to him
- That allocation can be accomplished under current law by using it to cause otherwise nonrecourse liabilities of the partnership to be recourse liabilities with respect to the contributing partner

Bottom Dollar Guarantee Example

Partner A agrees to guarantee up to $25 of a $100 partnership liability (secured by $150 of assets). The guarantee would apply if the lender failed to collect at least $25 from the partnership in the case of a default. Under current regulations, a partner is generally allocated the full amount of the liability, even if the economic risk being borne is quite remote.

Temporary 707 Regulations—Treat all Partnership Liabilities as Nonrecourse

- Treat all partnership liabilities as nonrecourse liabilities for purposes of Treas. Reg. § 1.707-5
- Allocate partnership liabilities using the ratios in Treas. Reg. § 1.752-3(a)(3) for allocating excess nonrecourse liabilities
  - A partner’s allocated share under this rule cannot exceed the partner’s share of partnership liability under section 752
  - Use lesser of two percentages
  - Rule caps partner’s share of partnership liabilities for purposes of the disguised sale rules

Temporary 752 Regulations—Elimination of Bottom Dollar Guarantee

- The proposed regulations treat debt as “recourse” for liability allocation purposes only when the partner has real and meaningful economic risk with respect to the debt
- Guarantees will not be recognized for purposes of recourse liability allocations unless (1) a six-factor test is satisfied and (2) the guaranteeing partner satisfies a minimum net value requirement

Elimination of Bottom Dollar Guarantee (Cont'd.)

- One of the six factors requires that a partner is liable for the full amount of his payment obligation if, and to the extent that, any amount of the guaranteed liability is not otherwise satisfied
- Typical bottom-dollar guarantees would fail this requirement, because a bottom-dollar guarantee typically applies only to a portion of the guaranteed liability

Effect of Disregarded Entity

- Treas. Reg. § 1.752-2(k) take economic risk of loss into account only to the extent of DRE’s net value

Code §707 Proposed Regulations—Partnership Interest for Services

- On July 22, 2015, the IRS issued proposed regulations ("2015 Proposed Regulations") addressing the rules for allocating partnership liabilities among partners that will impact the application of disguised sale rules

Effectiveness of 2015 Proposed Regulations

- The proposed regulations are effective for arrangements entered into or modified after the date final regulations are published in the Federal Register
- However, the regulations also state that the current position of Treasury and the IRS is that the proposed regulations generally reflect current law under the legislative history of §707(a)(2)(A)

Goal of 2015 Proposed Regulations

- Per the Preamble, goal was to determine whether partnership interests granted in connection with a “management fee waiver” should be taxable compensation for the performance of services, rather than as nontaxable “profits interests” in the partnership
- Remove interests received in exchange for waived fees from an existing safe harbor, under which the receipt of certain interests are treated as “profits interests” that are not currently taxable

Goal of 2015 Proposed Regulations (Cont'd.)

- To the extent that an arrangement permits a service provider to waive all or a portion of its fee for any period after the date the arrangement is created, the arrangement would be treated as modified on the date or dates that the fee is waived

Disguised Sale Rules on Payment for Services

- Code §707(a)(2) grants the IRS broad regulatory authority to identify transactions involving disguised payments for services
- The IRS will determine whether the payment is subject to significant entrepreneurial risk as to both the amount and fact of payment
- An arrangement for an allocation and distribution to a service provider which involves limited risk as to amount and payment is treated as a service fee

Disguised Sale for Payment for Services

Determination whether a disguised sale for services exists:

1. a service provider performs services (directly or through its delegate) to or for the benefit of a partnership, either as a partner or in anticipation of becoming a partner;
2. there is a related direct or indirect allocation and distribution to the service provider; and
3. The performance of the services and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a person acting other than in that person's capacity as a partner

Disguised Sale for Payment for Services (Cont'd.)

- When appropriate, the partnership would have to capitalize these amounts and treat the arrangement as a payment to a non-partner in determining the remaining partners' shares of taxable income or loss
- If after applying these rules, no partnership exists as a result of the service provider failing to become a partner under the arrangement, the service provider would be treated as having provided services directly to the other purported partner

Whether a Payment for Services?

- Whether an arrangement is characterized as a payment for services is determined at the time the arrangement is entered into or modified and without regard to whether the terms of the arrangement require the allocation and distribution to occur in the same tax year

Payment for Services Factors

- Whether an arrangement should be treated as a payment for services, the 2015 proposed regulations list six non-exclusive factors:
  1. Significant entrepreneurial risk;
  2. Transitory partner status;
  3. Timing of service and allocation/distribution;
  4. Primary purpose of US tax benefits;
  5. Relatively small general and continuing interest; and
  6. Related persons

Payment for Services Factors (Cont'd.)

1. Significant entrepreneurial risk:
   - Given the most weight of all factors
   - Compare a service provider's entrepreneurial risk relative to the overall entrepreneurial risk
2. Transitory Partner Status:
   - Service provider holds (or is expected to hold) a partnership interest for a short period of time
3. Timing of Service and allocation/distribution:
   - Made within a time frame that is comparable to the time frame that a non-partner service provider would receive payment

Payment for Services Factors

4. Primary Purpose:
   - Service provider becomes a partner primarily to obtain US tax benefits that are N/A if the services had been rendered in a non-partner capacity
5. Relatively small general/continuing interest:
   - Value of interest in partnership profits is small in relation to the allocation and distribution in question
6. Related Persons:
   - Different arrangements for related persons
   - Levels of entrepreneurial risk that vary significantly

Payment for Services Analysis

- For the IRS, the most important factor is a lack of "significant entrepreneurial risk" for the purported partner
- An arrangement that lacks significant entrepreneurial risk constitutes a payment for services, while an arrangement that has significant entrepreneurial risk generally will not constitute a payment for services unless other factors establish otherwise

Lack of Entrepreneurial Risk

Presumption an arrangement lacks significant entrepreneurial risk if any of these factors are present:

(i) capped allocations of income;
(ii) allocations for a fixed number of years under which the income that will go to the partner is reasonably certain;
(iii) service provider waives right to receive payment for the future performance of services in a manner that is non-binding or fails to timely notify the partnership;
(iv) continuing arrangements in which purported allocations and distributions are fixed in amount or reasonably determinable under all facts and circumstances; or
(v) allocations of gross income items

Entrepreneurial Risk Example

Accountant A performs services for partnership. Instead of receiving $50K fee, A contributes cash for 25% interest. A receives special allocation of $40K for first two years from gross income; partnership generates $200K annually.

- The special allocation is a capped amount and is from gross income
- Allocation lacks significant entrepreneurial risk and is treated as a disguised sale

Management Fee Waivers

- In a management fee waiver arrangement, a private equity or fund manager exchanges all or a portion of their unearned management fees for a "priority" profit interest in the fund
- Essentially, this is an exchange of unearned management fees subject to ordinary tax rates for a distributive share of the partnership's capital gain (based on the character flow-through) from disposition of fund assets

Management Fee Waivers (Cont’d.)

- Management fee waivers also provides investment managers with the ability to defer income recognition until the investment manager receives an allocation of gain or income from the fund, which may occur years after the management fee would otherwise have been paid

Management Fee Example

GP provides mgmt. services to investment fund partnership but has delegated work to controlled X. Partnership will pay X amount equal to 1% capital contributed and GP receives 20% of future net income. GP also gets an additional interest in net profits, but it is not reasonably determinable at grant. GP must commit to a clawback provision that apples to both interests.

- GP has significant entrepreneurial risk because the allocation to the GP is of net profits
- Allocation is subject to a clawback obligation over the life of the fund

Impact on Payment for Services Analysis

- Prop. Reg. §1.707-2 provides a mechanism for determining whether or not an arrangement is treated as a disguised payment for services
- An arrangement that is treated as a disguised payment for services under these proposed regulations will be treated as a payment for services for all purposes of the Code:
  - The partnership must treat the payments as payments to a non-partner in determining the remaining partners' shares of taxable income or loss, and

Impact on Payment for Services Analysis (Cont'd.)

  - The partnership must capitalize the payments or otherwise treat them in a manner consistent with the recharacterization
- 2015 proposed regulations apply to a service provider who purports to be a partner even if applying the regulations causes the service provider to be treated as a person who is not a partner

Preamble to 2015 Proposed Regulations

- The Preamble states that the IRS does not believe the profit interest safe harbor applies to common management fee waiver arrangements (where the service provider and the allocation recipient are separate legal entities)
- The IRS will issue a revenue procedure providing an additional exception to the safe harbor
- This new exception will effectively place at issue the valuation of management fee waiver interests even when the service provider and recipient are the same legal entity