

# Partnership Taxation



# Partnership Taxation

---

FIFTH EDITION

**Richard Lipton**

PARTNER, BAKER & MCKENZIE LLP

**Paul Carman**

PARTNER, CHAPMAN AND CUTLER LLP

**Walter D. Schwidetzky**

PROFESSOR OF LAW  
UNIVERSITY OF BALTIMORE SCHOOL OF LAW

**Ross Cohen**

PARTNER, DENTONS BINGHAM GREENEBAUM LLP



CAROLINA ACADEMIC PRESS  
Durham, North Carolina

Copyright © 2021  
Carolina Academic Press, LLC  
All Rights Reserved

LCCN: 2021934089  
ISBN: 978-1-5310-2239-6  
eISBN: 978-1-5310-2240-2

Carolina Academic Press  
700 Kent Street  
Durham, North Carolina 27701  
(919) 489-7486  
[www.cap-press.com](http://www.cap-press.com)

Printed in the United States of America

To Wally Blum, Cynthia Holcomb Hall, and Sharon King, who taught me how to be a tax lawyer. And to my wonderful wife and family, who have come to understand and cope with my love of tax law and golf (not necessarily in that order).

— Richard M. Lipton

To my loving wife and daughters, who wisely discourage me from talking about tax at home.

— Paul Carman

To Chuck Fassler, whose mentoring and guidance have been invaluable to the development of my career as a tax attorney. And to my wonderful wife, Shannon, and our two sweet girls, Elin and Mallory, for their love and support and for putting up with my long working hours, particularly while at home during a pandemic year.

— Ross Cohen

Dedicated to the memory of Walter H. and Augusta J. Schwidetzky.

I wish to acknowledge my indebtedness to Professors Stephen Lind, Stephen Schwarz, Daniel Lathrope, and Joshua Rosenberg, authors of *Fundamentals of Partnership Taxation*. I taught from their text for many years and it influenced my own approach to this effort.

— Walter D. Schwidetzky



# Contents

---

Table of Cases	xxiii
Introduction • The Spirit of Partnerships and Partnership Taxation	xxxiii
<b>Chapter 1 • Defining Partnerships and Partners for Tax Purposes</b>	<b>3</b>
§ 1.01 Introduction	3
§ 1.02 The Existence of a Business Entity	3
§ 1.03 Classifying Partnerships for Tax Purposes	5
A. The Nature of Partnerships	5
B. The Classification of Domestic Business Entities	6
C. The Classification of Non-U.S. Business Entities	8
D. Reclassifying Partnerships as Corporations	9
1. An Election Under Treas. Reg. § 301.7701-3	9
2. Publicly Traded Partnerships	9
3. Taxable Mortgage Pools	11
§ 1.04 Distinguishing Partnerships from Other Contractual Arrangements	12
A. Distinguishing Partnerships from Loans	12
B. Distinguishing Partnerships from Service Agreements	14
C. Distinguishing Partnerships from Leases	15
D. Distinguishing Partnerships from Other Co-Ownerships	16
E. Distinguishing Partnerships from Trusts	17
1. Grantor Trusts	17
2. Business Trusts	18
3. Investment Trusts	19
F. Comparison Charts	20
§ 1.05 Determining Who Is a Partner	22
§ 1.06 Electing Out of Subchapter K	23
§ 1.07 Aggregate and Entity Theories of Partnership Taxation	25
§ 1.08 Series LLCs	26
A. Introduction	26
B. Tax Classification and the Proposed Regulations	30
1. Overview	30
2. Definitions	30
3. Starting Gate	31

4. Single Entity/Multiple Entities	34
5. Who Are the Owners?	35
6. Liabilities and Tax Collection	37
7. Information Statements	37
8. Questions and Issues	38
9. Practical Considerations	39
C. Conclusion	40
§ 1.09 Side Pockets and Alternative Investment Vehicles	41
§ 1.10 Comparison of Partnerships with S Corporations	42
§ 1.11 Reading, Questions, and Problems	43
A. Reading	43
B. Questions and Problems	43
<b>Chapter 2 • Formation of the Partnership</b>	<b>47</b>
§ 2.01 Introduction	47
§ 2.02 Transfer of Property to Partnership	47
A. General Rules	47
B. What Constitutes Property	48
1. Cash	48
2. Contract Rights	48
a. Promissory Notes	48
i. Contributor's Promissory Note	48
ii. Third-Party Note	49
iii. Installment Note	49
iv. Partnership's Indebtedness to the Partner	50
b. Right to Acquire Property	52
3. Services	53
4. Assignment of Income	53
5. Right to Use Property	53
6. Recapture Property	54
7. Inventory and Accounts Receivables	54
8. Recapitalizations	54
C. When Is Property Contributed	55
D. Effect on Depreciable Assets	56
E. Stock of Corporate Partners	57
F. Disregarded Entity Becoming Partnership	58
G. Underwritten Partnership Interests	59
§ 2.03 Transfers to Investment Companies	59
A. Taxability of Transfer	59
B. Table	61
§ 2.04 Effect of Receipt of Boot	62
§ 2.05 Basis of Partnership Interest to Partner	62



§ 2.06	Effect of Liabilities	62
§ 2.07	Holding Period of Partnership Interest	64
§ 2.08	Partnership's Basis for Contributed Property	65
§ 2.09	Partnership's Holding Period for Property Received	66
§ 2.10	Character of Gain or Loss from Sale of Contributed Property	66
	A. Contributions of Ordinary Income Assets	66
	1. Unrealized Receivables	66
	2. Inventory Items	67
	B. Contributions of Capital Loss Property	67
	C. Tax-Free Transfers	67
§ 2.11	Organization and Selling Expenses	68
	A. Selling Expenses	68
	B. Organization Expenses	68
	C. Start-Up Expenses	69
§ 2.12	Reading, Questions, and Problems	70
	A. Reading	70
	B. Questions and Problems	71
<b>Chapter 3 •</b>	<b>Outside Basis and Allocation of Liabilities</b>	<b>75</b>
§ 3.01	Introduction	75
§ 3.02	Relevance of Outside Basis	75
	A. Gain or Loss	75
	B. Limitation on Loss	75
	C. Effect of Distributions	76
	1. Cash Distributions	76
	2. Property Distributions	76
§ 3.03	General Rules for Computing Basis	77
	A. Starting Point	77
	1. Capital Contributions	77
	2. Purchase of a Partnership Interest	77
	3. Gifts	77
	4. Inherited Partnership Interest	78
	B. Adjustments to Basis of Partnership Interest — Generally	78
	C. Special Adjustments	78
	1. Tax-Exempt Income	78
	2. Natural Resources Property	79
	3. Nondeductible Expenditures	79
	4. Distributions	80
	D. No Negative Basis	80
	E. Time for Computing Basis	81
	F. Ordering Rules	81
§ 3.04	Effect of Partnership Liabilities	81

A. General Rules	81
B. Definition of Recourse and Nonrecourse Liabilities	83
1. Definition of Liability	84
2. Definition of Recourse Liability	84
3. Anti-Abuse Rule	91
4. Assumption of Liability	94
5. Definition of Nonrecourse Liability	95
6. Bifurcated Liability	95
C. Allocation of Recourse Liabilities	96
D. Allocation of Nonrecourse Liabilities	97
1. Exculpatory Liabilities	100
E. Contributions and Distributions of Encumbered Property	102
F. Tiered Partnerships	104
G. Sales of Partnership Interests	104
H. Treas. Reg. § 1.752-7: Another Anti-Abuse Rule	105
1. Assumption by Partnership	106
a. Transfer of Partnership Interest	107
b. Assumption of § 1.752-7 Liability	107
§ 3.05 Tax Basis Capital	108
A. Background	108
§ 3.06 Reading, Questions, and Problems	112
A. Reading	112
B. Questions and Problems	112
<b>Chapter 4 • Operation of the Partnership: Calculation of Partnership Taxable Income</b>	<b>115</b>
§ 4.01 Introduction	115
§ 4.02 Pass-Through Nature of Partnership	115
§ 4.03 Computing Income, Gain, Loss, Deductions, and Credits of Partnership	117
A. Generally	117
B. Taxable Income of the Partnership	118
C. Separately Computed Items	118
1. Gains and Losses from Sales	118
2. Charitable Contributions	119
3. Dividend Income	119
4. Foreign Taxes Paid	120
5. Other Items	120
D. Bottom Line Profit or Loss	121
§ 4.04 Elections	122
§ 4.05 Accounting Method	123
A. C Corporation Is Partner	123

1. Farming Business	123
2. Qualified Personal Service Corporation	123
3. Small Corporations	124
B. Tax Shelters	126
1. Registered Offering	126
2. Syndicate	126
3. Tax Shelter Defined	127
C. Accrual Method Taxpayers That Issue Financial Statements	127
D. Farming Partnerships	129
1. Partnerships Having Corporations as Partners	129
2. Farming Syndicate	129
§ 4.06 Characterization	129
A. Dealer Status	130
B. Holding Period	130
C. Hobby Loss Rules	130
D. Like-Kind Exchanges and Involuntary Conversions	131
E. Discharge of Indebtedness Income	131
§ 4.07 Loss Limitation Rules	132
A. Basis Limitation	133
B. At Risk Rules	134
1. Limitations on Losses to Amount at Risk	134
2. Calculations of Amount at Risk	134
3. Nonrecourse Financing	136
4. Carryover of Disallowed Losses	136
5. Applicability to Partnerships	137
6. Disposition of Activity or Partnership Interest	137
C. Passive Loss Limitation	138
1. Loss Disallowance Rule	138
2. Passive Activity	138
3. Material Participation	140
4. What Is an Activity and Why Is It Important?	142
5. Disposition of Partnership Interest	143
6. Real Estate Professionals	144
D. Net Operating Losses and Excess Business Losses	145
1. TCJA	145
a. Net Operating Losses	145
b. Excess Business Losses	145
2. CARES Act	146
§ 4.08 Taxable Year of Partnership	147
A. Required Taxable Years	147
B. Business Purpose	149
C. § 444 Election	150

§ 4.09 Partnership Level Liability on Audits	151
§ 4.10 Reading, Questions, and Problems	154
A. Reading	154
B. Questions and Problems	155
<b>Chapter 5 • Operation of a Partnership: Allocation of     Partnership Income and Losses</b>	<b>157</b>
§ 5.01 Introduction	157
§ 5.02 Capital Accounts	158
§ 5.03 Substantial Economic Effect Rules	160
A. Introduction	160
B. Economic Effect Rules	160
1. “Regular” Rules	160
2. Alternative Economic Effect Rules	164
3. Economic Effect Equivalence	168
C. Substantiality	169
1. General Rules	169
2. Shifting and Transitory Allocations	171
3. Depreciation/Recapture Gain Chargebacks	172
4. Tax Credits	173
5. “q” Adjustments	174
D. Sample Language	174
§ 5.04 Partner’s Interest in the Partnership and Common Allocation Structures	177
A. Introduction to PIP	177
B. Partner’s Interest in the Partnership, In General	178
C. Book-Value Liquidation as PIP	180
D. Other Liquidation Models	182
E. Based on Capital Contributions	183
F. Avoiding Negative Capital Accounts as PIP	183
G. Overall Percentage	185
H. Interest in Net Profits	186
I. Percentage of Assets and Percentage of Liabilities	187
J. Income	187
K. Capital Account Impact	188
L. Common Allocation Structures	189
1. Introduction	189
2. Percentage Interests	189
a. Hypothetical Language	189
b. Discussion	190
3. Targeted Capital Account Approach	191
a. Hypothetical Language	191
b. Discussion	193

4. Waterfall Approach	196
a. Hypothetical Language	196
b. Discussion	197
5. Cash Flow Approach	198
a. Hypothetical Language	198
b. Discussion	198
M. Foreign Tax Credits	199
§ 5.05 Book-Tax Disparities — I.R.C. § 704(c) Allocations	200
A. Introduction	200
B. I.R.C. § 704(c) Methods of Allocation	203
1. The Traditional Method	203
a. Abusive Use of Traditional Method	205
2. Traditional Method with Curative Allocations	206
3. Remedial Method	207
4. Depreciation	208
5. Other Considerations	209
C. I.R.C. § 704(c)(1)(C)	210
§ 5.06 Reverse I.R.C. § 704(c) Allocations	211
§ 5.07 Allocations of Nonrecourse Deductions	214
A. Introduction	214
B. The Regulatory Safe Harbor	217
C. Subsequent Nonrecourse Borrowing	223
D. Partner Nonrecourse Deductions	224
E. Sample Language	228
§ 5.08 Gifted Partnership Interests	229
A. Introduction	229
B. Pre-I.R.C. § 704(e) Case Law	230
C. I.R.C. § 704(e)/I.R.C. § 761(b)	230
§ 5.09 Changes in Partnership Interests During the Tax Year	231
A. General Rules	231
B. Closing of Partnership Taxable Year	232
C. Requirement to Account for Varying Interests	232
D. Methods of Allocation Where Partnership's Tax Year Does Not Close Early	233
E. Additional Details	234
§ 5.10 Reading, Questions, and Problems	237
A. I.R.C. § 704(b)	237
1. Reading	237
2. Questions and Problems	238
B. I.R.C. § 704(c)	242
1. Reading	242
2. Questions and Problems	242
C. Nonrecourse Deductions	243

1. Reading	243
2. Questions and Problems	243
D. Family Allocations	244
1. Reading	244
2. Questions and Problems	244
E. Changes in Partnership Interests During the Tax Year	244
1. Reading	244
2. Questions and Problems	244
<b>Chapter 6 • Dispositions of Partnership Interests</b>	<b>247</b>
§ 6.01 Introduction	247
§ 6.02 Recognition of Gain or Loss	247
A. Amount Realized	247
B. Basis	248
C. Capital Accounts	249
§ 6.03 Character of Gain or Loss	250
A. General Rule	250
B. Unrealized Receivables and Inventory Items	250
1. Ordinary Income Recognition	250
2. Unrealized Receivables	251
3. Inventory Items	252
C. Unrecaptured I.R.C. § 1250 Gain and Collectibles Gain	252
§ 6.04 Holding Period	254
§ 6.05 Installment Sales	254
§ 6.06 Dispositions Other Than Sales or Exchanges	255
A. Gifts and Charitable Contributions	255
B. Death of a Partner	257
C. Exchanges of Partnership Interest	257
D. Abandonment and Worthlessness	258
E. Conversion to Corporation	260
F. Transfers to Other Partnerships	262
§ 6.07 Optional Adjustment to Basis of Partnership Property	263
A. I.R.C. § 743(b)	263
B. Making the I.R.C. § 754 Election	265
C. Effect of I.R.C. § 743(b)	266
D. Computation of Transferee's Proportionate Share of I.R.C. § 743(b) Adjustment	268
E. Allocation of Basis Adjustment Among Partnership Assets under I.R.C. § 755	269
1. Generally	269
2. Example	270
3. Related Matters	273

F. Additional Aspects of Adjustment	273
1. Transfer of Partnership Interest	273
2. Distribution of Partnership Property	274
3. Contribution of Property to Lower-Tier Partnership	274
4. Contribution of Property to Corporation	274
5. Computation of Income and Expenses	275
6. Special Basis Adjustment and Depreciable Property	275
7. Return Filing Requirements	276
§ 6.08 Termination of Partnerships	277
A. General Rule	277
B. The Old Twelve-Month Rule	278
1. What Transactions Are Taken into Account	279
2. Transactions Deemed to Occur	280
3. Effect of Partnership Termination	280
§ 6.09 Reading, Questions, and Problems	281
A. Reading	281
B. Questions and Problems	282
<b>Chapter 7 • Partnership Distributions</b>	<b>285</b>
§ 7.01 Introduction	285
§ 7.02 Nonliquidating Distributions of Money	285
§ 7.03 Nonliquidating Distributions of Property	286
A. General Rules	286
B. Outside Basis Less Than Inside Basis	288
C. Marketable Securities	289
D. Distributions When Stock Is Held of a Corporate Partner	291
§ 7.04 Capital Accounts	292
§ 7.05 I.R.C. § 732(d)	292
§ 7.06 The Sale of Distributed Property	293
§ 7.07 I.R.C. § 734(B) Adjustments	294
A. Introduction	294
B. The Devil Is in the Details	295
C. Mandatory “As If” I.R.C. § 754 Elections	298
§ 7.08 Shifts in Ordinary Income Property	300
A. Introduction	300
B. Unrealized Receivables and Substantially Appreciated Inventory	301
C. The Nuts and Bolts	302
D. Associated Issues	306
E. Proposed Regulations	308
§ 7.09 Liquidations of Partnerships and Partnership Interests	311
A. Introduction	311
B. Liquidations of the Partnership or of a Partnership Interest	311

C. I.R.C. § 736 Payments	314
1. Introduction	314
2. I.R.C. § 736(a) Payments	314
3. I.R.C. § 736(b) Payments	315
4. Allocating and Taxing I.R.C. § 736 Payments	316
§ 7.10 Reading, Questions, and Problems	319
A. Nonliquidating Distributions	319
1. Reading	319
2. Questions and Problems	319
B. I.R.C. § 734(b)	321
1. Reading	321
2. Questions and Problems	321
C. I.R.C. § 751(b)	321
1. Reading	321
D. Liquidations	322
1. Reading	322
2. Questions and Problems for I.R.C. § 751(b) and Liquidations	322
<b>Chapter 8 • Transactions Between Partner and Partnership;</b>	
<b>Issuance of a Partnership Interest for Services</b>	<b>325</b>
§ 8.01 Introduction	325
§ 8.02 The Different Roles of Partners in Transactions with a Partnership	325
§ 8.03 Distributions to a Partner as a Partner (Excluding Guaranteed Payments)	326
§ 8.04 Guaranteed Payments	326
§ 8.05 Payments to a Partner Other Than in Their Capacity as a Partner	329
§ 8.06 Disguised Sales	332
A. The Disguised Sale of Assets	332
1. General Rules	332
2. Exceptions	335
3. Liabilities	338
B. The Disguised Sale of Partnership Interests	344
C. The Disguised Payment for Services	347
§ 8.07 Limitations on Recognition of Losses and Recharacterization of Gains in Related Party Transactions	352
A. Limitations on Recognition of Losses	352
B. Recharacterization of Gains	354
§ 8.08A Issuance of a Partnership Interest in Exchange for Services	354
A. Potential Income to Partner and Gain to Partnership	354
B. Receipt of Profits Interests by Service Partners	356



§ 8.08B Issuance of a Partnership Interest Subject to a Substantial Risk of Forfeiture	358
§ 8.08C Compensatory Interest Proposed Regulations	360
A. Explanation of Provisions of the Compensatory Interest Proposed Regulations	361
§ 8.08D Holding Period for Partnership Interests Issued for Services	363
A. General Rule	363
B. Short-Term Capital Gain	364
C. Applicable Partnership Interest	365
D. Applicable Trade or Business	366
E. Specified Assets	366
F. Capital Interest Disposition Amount	367
§ 8.09 Comparison with S Corporations	368
§ 8.10 Reading, Questions, and Problems	368
A. Reading	368
B. Questions and Problems	369
<b>Chapter 9 • Business Combinations: Partnership Mergers and Divisions</b>	<b>373</b>
§ 9.01 Introduction	373
§ 9.02 Partnership Mergers	373
A. General Rules	373
B. Form of a Merger	375
C. Built-In Gain Resulting from the Merger	377
D. Buy-Out Rule	380
§ 9.03 Partnership Divisions	381
A. General Rules	381
B. Form of a Division	383
C. Built-In Gain in Divisions	383
§ 9.04 The Effect on the Partners and the Partnership	384
§ 9.05 Comparison with S Corporations	385
A. Mergers and Acquisitions	385
B. Corporate Divisions	386
§ 9.06 Reading, Questions, and Problems	387
A. Reading	387
B. Questions and Problems	387
<b>Chapter 10 • Partnership Options</b>	<b>391</b>
§ 10.01 Introduction	391
§ 10.02 Background for Noncompensatory Options	391
§ 10.03 Scope of Regulations on Noncompensatory Options	394
§ 10.04 Issuance, Lapse, and Straightforward Exercise of Noncompensatory Options	394

§ 10.05	Complications on the Exercise of Noncompensatory Options	398
A.	New Partner Enters While Option Outstanding	398
B.	Corrective Allocations	405
§ 10.06	Option Holder Treated as Partner	407
§ 10.07	Compensatory Options	413
A.	Issuance of a Compensatory Option	413
B.	Exercise of Compensatory Option	413
C.	Repurchase or Sale of Option	414
D.	Effect of Outstanding Option	414
E.	Recharacterization Rule	414
§ 10.08	Reading, Questions, and Problems	415
A.	Reading	415
B.	Questions and Problems	415
<b>Chapter 11 • I.R.C. § 197 Intangibles Amortization</b>		<b>417</b>
§ 11.01	Introduction	417
§ 11.02	Summary of I.R.C. § 197	417
§ 11.03	General Rules Applicable to Partnerships under I.R.C. § 197	418
A.	Contributions	418
B.	Distributions	419
C.	Terminations	420
D.	Basis Adjustments	421
E.	Allocations in Regard to Built-In Gain	421
§ 11.04	Anti-Churning Rules Applicable to Partnerships under I.R.C. § 197	422
A.	General Rules	422
B.	Contributions	425
C.	Distributions	426
D.	Adjustments to Basis of Partnership Property	428
E.	Partner's Use of Partnership Property	431
§ 11.05	Comparison with S Corporations	432
§ 11.06	Reading, Questions, and Problems	432
A.	Reading	432
B.	Questions and Problems	432
<b>Chapter 12 • Foreign Partnerships, Foreign Partners, and Partnerships with Tax-Exempt Entities</b>		<b>435</b>
§ 12.01	Introduction	435
§ 12.02	Foreign Partnerships	435
A.	Classification	435
B.	Foreign Tax Credit Rules in Regard to Foreign Partnerships	437
1.	Generally	437

2. Foreign Tax Credit Splitter Transactions	439
C. U.S. Participation Exemption	441
D. Controlled Foreign Corporations as Partners in Foreign Partnerships	442
E. U.S. Source of Income Rules in Regard to Foreign Partnerships	448
F. The Hybrid Entity Treaty Rules	449
G. Transfers to Partnerships with Related Foreign Partners	450
1. General Rules	450
2. Gain Deferral Method	451
3. Acceleration Events	452
§ 12.03 U.S. Partnerships with Foreign Partners	452
A. General Rules Relating to U.S. Taxation of Foreign Persons	452
B. Withholding Obligations in Regard to FDAP Income	455
C. Withholding in Regard to Income Effectively Connected with a U.S. Trade or Business	455
D. Branch Profits Tax	457
E. Disposition of Interests in U.S. Partnerships by Non-U.S. Persons	458
§ 12.04 Other International Issues	461
A. Base Erosion and Anti-Abuse Tax	461
B. Covered Asset Acquisitions	462
C. FATCA	465
D. Hybrid Transactions and Hybrid Entities	467
§ 12.05 Partnerships with Tax-Exempt Entities	470
A. Impact on the Organization's Exempt Status	470
B. Unrelated Business Taxable Income	471
C. Debt-Financed Income	474
§ 12.06 Limitations on Deductions Allocable to Property Used by Tax-Exempt Entities	475
A. General Rule on Limitation on Losses	475
B. Special Application to Partnerships	477
C. Exceptions	478
D. Application to Like-Kind Exchanges and Condemnations	479
§ 12.07 Comparison with S Corporations	480
§ 12.08 Reading, Questions, and Problems	480
A. Reading	480
B. Questions and Problems	480
<b>Chapter 13 • Anti-Abuse Provisions</b>	<b>483</b>
§ 13.01 Introduction	483
§ 13.02 Judicial Doctrines	483
A. Introduction	483
B. Substance Over Form	484

C. Business Purpose	487
D. Step Transaction Doctrine	489
E. Failure to Form a Valid Partnership for Tax Purposes	490
§ 13.03 Anti-Abuse Regulations	491
§ 13.04 Mixing Bowl Transactions	495
A. Introduction	495
B. I.R.C. § 707(a)(2)(B)	497
C. I.R.C. § 704(c)(1)(B)	497
D. I.R.C. § 737	500
E. I.R.C. § 707(a)(2)(A)	502
F. I.R.C. § 732(f)	503
§ 13.05 Reading, Questions, and Problems	504
A. Reading	504
B. Questions and Problems	504
<b>Chapter 14 • Family Partnerships</b>	<b>507</b>
§ 14.01 Income Tax Issues on the Partnership's Formation	507
A. Diversification	509
B. Investment Companies	511
§ 14.02 Who Are the Partners of Family Limited Partnerships?	512
§ 14.03 Income Tax Issues for Vacation/Rental Homes	516
§ 14.04 Income Tax Issues on Unwinding	518
A. Sale of the Assets	518
B. Distribution in Kind	519
§ 14.05 An Introduction to the Estate and Gift Tax Consequences	521
A. Background	521
B. Marketable Securities	523
C. Near-Death (and Not So Near-Death) Family Limited Partnerships	524
D. Judicial Responses	524
§ 14.06 Families and I.R.C. §§ 162 and 212	535
§ 14.07 Reading, Questions, and Problems	536
A. Reading	536
B. Questions and Problems	536
<b>Chapter 15 • Death of a Partner</b>	<b>539</b>
§ 15.01 Introduction	539
§ 15.02 Termination of a Partnership	539
§ 15.03 Income in Respect of a Decedent	541
§ 15.04 Closing of the Partnership Year	544
§ 15.05 Adjustment to Basis	548
§ 15.06 Reading, Questions, and Problems	549

A. Reading	549
B. Questions and Problems	549
<b>Chapter 16 • S Corporations</b>	<b>551</b>
§ 16.01 Qualification	551
§ 16.02 Formation	554
§ 16.03 Operation	555
§ 16.04 Distributions of Cash and Other Property	557
§ 16.05 Sale of Shares in an S Corporation	557
§ 16.06 Liquidation or Redemption	558
§ 16.07 QSubs	559
§ 16.08 Advantages of S Corporations	559
A. General Benefits That Come from Being a Corporation	559
B. Possible Social Security and Medicare Tax Planning	559
C. “Capital Gain Freeze”	562
§ 16.09 Disadvantages of S Corporations	563
§ 16.10 Reading, Questions, and Problems	564
A. Reading	564
B. Questions and Problems	564
<b>Chapter 17 • Legislative Updates and Non-Sub K Provisions</b>	<b>567</b>
§ 17.01 Introduction	567
§ 17.02 Tax Cuts and Jobs Act (“TCJA”)	567
A. Introduction	567
B. I.R.C. § 168(k)	567
C. Excess Business Losses	568
D. Net Operating Losses	568
E. I.R.C. § 199A and the Passthrough Deduction	569
1. Basic Rule for QBI Deduction	569
2. Combined QBI Amount in General	569
3. Combined QBI Amount for Taxpayers with Lower Taxable Income	570
4. Aggregating Combined QBI Amount for Businesses	570
5. QBI	570
6. Some Examples	572
F. I.R.C. § 163(j)	573
1. In General	573
2. As Applied to Partnerships and Partners	576
§ 17.03 Tax Basics of Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”)	580
§ 17.04 Qualified Opportunity Zone Funds	581
A. General Background	581
1. Overview	581

2. The Gain That May Be Deferred	582
3. The Investment Required	583
B. Technical Requirements	583
1. Requirements for Qualified Opportunity Zone Funds	583
2. Acceleration of Inclusion	584
C. Roles of Partnerships	585
1. Partnership as Taxpayer	585
2. Partner as Taxpayer	586
<b>Chapter 18 • Partnership Debt Workouts</b>	<b>589</b>
§ 18.01 Introduction	589
§ 18.02 Overview of (Mostly) the Fundamentals	589
A. Disputed Liabilities	590
B. Purchase Price Adjustment	591
C. Guarantors	592
D. PPP Loans	593
§ 18.03 The I.R.C. § 108 Exclusions	594
A. Bankruptcy	594
B. Insolvency	596
C. Reduction of Tax Attributes	598
D. Qualified Real Property Business Indebtedness	600
E. Basis Adjustments	603
F. Minimum Gain Chargebacks	606
§ 18.04 Foreclosure	609
§ 18.05 Partnership Allocation of CODI	611
§ 18.06 The Elephant in the Room: When Is Debt Recourse or Nonrecourse?	613
§ 18.07 Modification of Debt Instruments, §§ 108(e)(10), 1271–1274, and 1286	617
§ 18.08 Related Party Acquisitions	624
§ 18.09 Debt for Partnership Equity Exchanges	626
§ 18.10 Abandonment or Worthlessness of Partnership Interests	631
<b>Index</b>	<b>639</b>

# Table of Cases

---

- Abraham, Estate of, v. Commissioner, 408 F.3d 26 (1st Cir. 2005), 18, 532
- ACM Partnership v. Commissioner, T.C. Memo 1997-115, 490
- ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), 490
- Aizawa v. Commissioner, 99 T.C. 197 (1992), 609
- Alberto v. Diversified Group, Inc., 55 F.3d 201 (5th Cir. 1995), 35
- Aldon Homes, Inc. v. Commissioner, 33 T.C. 582 (1959), 31
- Andantech, L.L.C. v. Commissioner, 331 F.3d 972 (D.C. Cir. 2003), 4, 19
- Andantech, L.L.C. v. Commissioner, T.C. Memo 2002-97, 4, 19
- Appleby, Estate of v. Commissioner, 41 B.T.A. 18 (1940), 16
- Appleby, Estate of, Commissioner v., 123 F.2d 700 (2d Cir. 1941), 16
- ASA Investorings Partnership v. Commissioner, 201 F.3d 505 (D.C. Cir. 2000), xxxviii, 4, 5, 13, 484, 488, 490, 491, 504
- Astoria Marine Construction Co. v. Commissioner, T.C.M. (RIA) ¶ 45,083 (1945), 12
- Baker Commodities, Inc. v. Commissioner, 48 T.C. 374 (1967), 278
- Baker Commodities, Inc. v. Commissioner, 415 F.2d 519, 24 A.F.T.R.2d 69-5516 (9th Cir. 1969), 278
- Bankhead, Estate of Emilil, v. Commissioner, 60 T.C. 535 (1973), 590
- Barham v. United States, 301 F. Supp. 43 (M.D. Ga. 1969), 130
- Barham v. United States, 429 F.2d 40 (5th Cir. 1970), 130
- Basye, United States v., 410 U.S. 441 (1973), 25, 26, 129, 154
- Bateman v. United States, 490 F.2d 549 (9th Cir. 1973), 513
- Bentex Oil Corporation v. Commissioner, 20 T.C. 565 (1953), 15
- Bergford v. Commissioner, 12 F.3d 166 (9th Cir. 1993), 16
- Bertoli v. Commissioner, 103 T.C. 501 (1994), 31
- Better Business Bureau, Inc. v. United States, 326 U.S. 279 (1945), 470
- Bigelow v. Commissioner, T.C. Memo 2005-65, 529, 530
- Black, Estate of, v. Commissioner, 133 T.C. 340 (2009), 534
- Boca Investorings Partnership v. United States, 167 F. Supp. 2d 298 (D.C. 2001), 490
- Boca Investorings Partnership v. United States, 314 F.3d 625 (D.C. Cir. 2003), 490
- Bolker v. Commissioner, 81 TC 782 (1983), 131
- Bolker v. Commissioner, 760 F.2d 1039 (9th Cir. 1985), 131
- Bolling v. Patterson, 7 A.F.T.R.2d 1464 (D.C. Ala. 1961), 346

- Bongard, Estate of, v. Commissioner, 124 T.C. 95 (2005), 530-534
- Bosse v. Commissioner, T.C. Memo 1970-355, 590
- Brannen v. Commissioner, 722 F.2d 695 (11th Cir. 1984), 131
- Brooks v. Commissioner, T.C. Memo 1995-400, 186
- Brown Group Inc. v. Commissioner, 77 F.3d 217 (8th Cir. 1996), 26
- Bryant v. Commissioner, 399 F.2d 800 (5th Cir. 1968), 24, 25
- Bryant v. Commissioner, 46 T.C. 848 (1966), 24, 25
- Burke v. Commissioner, T.C. Memo 2005-297, 117
- Burke v. Commissioner, 485 F.3d 171 (1st Cir. 2007), 117
- Bussing v. Commissioner, 88 T.C. 449 (1987), 5
- Butler v. Adoption Media, LLC, 2005 U.S. Dist. LEXIS 46208 (N.D. Cal. 2005), 27
- Buttorff, United States v., 563 F. Supp. 450 (N.D. Tex. 1983), 18
- Buttorff, United States v., 761 F.2d 1056 (5th Cir. 1985), 18
- Cahill v. Commissioner, T.C.M. (RIA) ¶ 2013-220, 22
- Campbell v. Commissioner, 943 F.2d 815 (8th Cir. 1991), 357
- Campise v. Commissioner, T.C.M. (RIA) ¶ 80,130 (1980), 16
- Carl T. Miller Trust v. Commissioner, 76 T.C. 191 (1981), 590
- Carriage Square, Inc. v. Commissioner, 69 T.C. 119 (1977), 513
- Centennial Savings Bank FSB, United States v., 499 U.S. 573 (1991), 591
- Champlin v. Commissioner, T.C. Memo 1977-196, 345
- Charlotte's Office Boutique, Inc. v. Commissioner, 121 T.C. 89 (2003), 561
- Charlotte's Office Boutique, Inc. v. Commissioner, 425 F.3d 1203 (9th Cir. 2005), 561
- Chase v. Commissioner, 92 T.C. 874 (1989), 131
- Chemtech Royalty Associates, L.P. v. United States, 766 F.3d 453 (5th Cir. 2014), 14, 15
- Chemtech Royalty Associates, L.P. v. United States, 111 A.F.T.R.2d 953 (M.D. La. 2013), 15
- Church v. United States, 85 A.F.T.R.2d 804 (W.D. Tex. 2000), 523, 527
- Church v. United States, 268 F.3d 1063 (5th Cir. 2001), 403, 523, 527
- Citron v. Commissioner, 97 T.C. 200 (1991), 259, 281, 631
- Coleman v. Commissioner, 87 T.C. 178 (1986), 486
- Communications Satellite Corp. v. United States, 625 F.2d 997 (Ct. Cl. 1980), 56, 346, 347
- Comtek Expositions, Inc. v. Commissioner, 85 T.C.M. (CCH) 1280 (2003), 14
- Continental Illinois Corp. v. Commissioner, 998 F.2d 513 (7th Cir. 1993), 439
- Converse v. Earle, 43 A.F.T.R. 1308 (D.C. Or. 1951), 392
- Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991), 617
- Crane v. Commissioner, 331 U.S. 1 (1947), 82, 610
- Crenshaw v. United States, 450 F.2d 472 (5th Cir. 1971), 346
- Crescent Holdings, LLC v. Commissioner, 141 T.C. 477 (2013), 23, 359
- Culbertson v. Commissioner, T.C.M. (RIA) ¶ 47,168 (1947), 230
- Culbertson v. Commissioner, 230 Culbertson, Commissioner v., 337 U.S. 733 (1949), 3, 13, 22, 34, 43, 230, 231, 244, 491



- Cusick v. Commissioner, 76 T.C.M. (CCH) 241 (1998), 16
- Dagres v. Commissioner, 136 T.C. 263 (2011), 536
- Dallas Transfer & Terminal Warehouse Co. v. Commissioner, 70 F.2d 95 (5th Cir. 1934), 590
- Danielson, Commissioner v., 378 F.2d 771 (3d Cir. 1967), 486
- David v. Mast, 1999 Del. Ch. LEXIS 34 (Mar. 2, 1999), 35
- Davis, United States v., 370 U.S. 65 (1962), 392
- Davis v. Commissioner, 69 T.C. 814 (1978), 594
- Demirjian v. Commissioner, 457 F.2d 1 (3d Cir. 1972), 122
- Diamond v. Commissioner, 492 F.2d 286 (7th Cir. 1974), 356
- Diamond v. Commissioner, 56 T.C. 530 (1971), 356
- Distinctive Theatres of Columbus v. Looker, 165 F. Supp. 410 (S.D. Ohio 1958), 483
- Donroy, Ltd. v. United States, 301 F.2d 200 (9th Cir. 1962), 453
- Dosek v. Commissioner, T.C. Memo 1971-160, 590
- Drye Family 1995 Trust v. United States, 152 F.3d 892 (8th Cir. 1998), 35
- E.I. Du Pont de Nemours & Co. v. United States, 471 F.2d 1211 (Ct. Cl. 1973), 54
- Echols v. Commissioner, 93 T.C. 553 (1989), 259, 281, 633
- Echols v. Commissioner, 935 F.2d 703 (5th Cir. 1991), 259, 281, 633, 634, 635, 636, 637
- Echols v. Commissioner, 950 F.2d 209 (1991), 633
- Elm Street Realty Trust v. Commissioner, 76 T.C. 803 (1981), 18
- Erickson, Estate of, v. Commissioner, T.C. Memo 2007-107, 532
- Estate of (see name of party)
- Evans v. Commissioner, 54 T.C. 40 (1970), 279, 281, 322, 516
- Evans v. Commissioner, 447 F.2d 547 (7th Cir. 1971), 279, 322, 516
- Farley Realty Corp. v. Commissioner, 279 F.2d 701 (2d Cir. 1960), 12
- Federation Pharmacy Services, Inc. v. Commissioner, 625 F.2d 804 (8th Cir. 1980), 470
- Federation Pharmacy. Services, Inc. v. Commissioner, 72 T.C. 687 (1979), 470
- Fong v. Commissioner, 48 T.C.M. (CCH) 689 (1984), 123
- Fong v. Commissioner, 816 F.2d. 684 (9th Cir.), 123
- Forman v. Commissioner, 199 F.2d 881 (9th Cir. 1952), 35
- Foxman v. Commissioner, 352 F.2d 466 (3d Cir. 1965), 345
- Friedland v. Commissioner, T.C. Memo 2001-236, 592, 593
- Fuchs v. Commissioner, 80 T.C. 506 (1983), 312
- Gannon v. Commissioner, 16 T.C. 1134 (1951), 258
- Garnett v. Commissioner, 132 T.C. 368 (2009), 141
- Gemini Twin Fund III v. Commissioner, T.C. Memo. 1991-315, 48
- Gemini Twin Fund III v. Commissioner, 8 F.3d 26 (9th Cir. 1993), 48
- Gehl v. Commissioner, 75 A.F.T.R.2d 95-1605, 50 F.3d 12, 95-1 USTC ¶ 50,191 (8th Cir. 1995), 609
- General Shoe Corp., United States v., 282 F.2d 9 (6th Cir. 1960), 355
- General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935), 508

- Gitlitz v. Commissioner, 531 U.S. 206 (2001), 594
- Gleason Works v. Commissioner, 58 T.C. 464 (1972), 439
- Glenshaw Glass Co, Commissioner v., 348 U.S. 426 (1955), 589
- Golsen v. Commissioner, 54 T.C. 742 (1970), 633
- Gordon, Commissioner v., 391 U.S. 83 (1968), 489
- Gracia v. Commissioner, T.C. Memo 2004-147, 594, 595, 596
- Great Plains Gasification Associates v. Commissioner, T.C. Memo. 2006-276, 613, 614, 615, 616
- Grecian Magnesite Mining v. Commissioner, 149 T.C. 63 (2017), 459
- Grecian Magnesite Mining v. Commissioner, 926 F.3d 819 (D.C. Cir. 2019), 459
- Green, Commissioner v., 126 F.2d 70 (3d Cir. 1942), 636
- Gregory v. Helvering, 293 U.S. 465 (1935), 385, 483, 487, 504
- Griffin Paper Corp. v. Commissioner, T.C. Memo 1997-409, 408
- Groetzinger, Commissioner v., 480 U.S. 23 (1987), 19
- Gross v. Commissioner, 272 F.3d 333 (6th Cir. 2001), 403
- Grove v. Commissioner, 54 T.C. 799 (1970), 130
- Guardian Industries Corp. v. United States, 477 F.3d 1368 (Fed. Cir. 2007), 439
- Gulig v. Commissioner, 293 F.3d 279 (5th Cir. 2002), 403, 524
- GxG Management LLC v. Young Brothers & Co., Inc., 2007 U.S. Dist. LEXIS 12337 (D. Me. 2007), 27
- H.B. Zachry Co. v. Commissioner, 49 T.C. 73 (1967), 54
- Hale v. Commissioner, T.C. Memo 1965-274, 356
- Hanna v. Commissioner, T.C. Summary Opinion 2006-57, 144
- Harbor Cove Marina Partners Partnership v. Commissioner, 123 T.C. 64 (2004), 277, 312, 322
- Harco National Insurance Co. v. Green Farms, Inc., 1989 Del. Ch. LEXIS 114 (Sept. 19, 1989), 35
- Harlan E. Moore Charitable Trust v. United States, 812 F. Supp. 130 (C.D. Ill. 1993), 15
- Harlan E. Moore Charitable Trust v. United States, 9 F.3d 623 (7th Cir. 1993), 15
- Harmon v. Commissioner, T.C. Summary Opinion 2007-127, 144
- Hartman v. Commissioner, T.C.M. (RIA) ¶ 58,206 (1958), 14, 22
- Harper, Estate of, v. Commissioner, T.C. Memo 2002-121, 526, 528
- Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934), 483, 487, 504
- Helvering v. Horst, 311 U.S. 112 (1940), 53
- Helvering v. Smith, 90 F.2d 590 (2d Cir. 1937), 25
- Herbert v. Commissioner, 30 T.C. 26 (1958), 454
- Hewlett-Packard Co. & Consolidated Subsidiaries v. Commissioner, T.C. 2012-135, 468
- Hewlett-Packard Co. & Consolidated Subsidiaries v. Commissioner, 120 A.F.T.R.2d 2017-6542, 468
- Higgins v. Commissioner, 312 U.S. 212 (1941), 535
- Hope School, The, v. United States, 612 F.2d 298 (7th Cir. 1980), 473
- Hogan v. Commissioner, T.C. Memo 1990-295, 185
- Hubert Enterprises Inc. v. Commissioner, 125 T.C. 72 (2005), 135
- Hubert Enterprises, Inc. v. Commissioner, 230 F. App'x 526 (6th Cir. 2007), 135

- Hubert Enterprises, Inc. v. Commissioner, T.C. Memo 2008-46, 85, 135
- Hunt v. Commissioner, 57 T.C.M. (CCH) 919 (1989), 594
- Hurford, Estate of, v. Commissioner, T.C. Memo 2008-278, 532
- In re Higgins, 403 B.R. 537 (Bankr. E.D. Tenn. 2009), 590
- Interhotel Company Ltd. v. Commissioner, T.C. Memo 2001-151, 180, 182
- International Freighting Corporation, Inc. v. Commissioner, 135 F.2d 310 (2d Cir. 1943), 355
- Iowa State University of Science & Technology v. United States, 500 F.2d 508 (Ct. Cl. 1974), 472
- Jack Ammann Photogrammetric Engineers, Inc. v. Commissioner, 341 F.2d 466 (5th Cir. 1965), 50, 71
- Jelle v. Commissioner, 116 T.C. 63 (2001), 590
- Joly v. Commissioner, 211 F.3d 1269, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,315, 85 A.F.T.R.2d 1234 (6th Cir. 2000), 561
- Jorgensen, Estate of, v. Commissioner, T.C. Memo 2009-66, 532, 534
- Joseph Radtke, S.C. v. United States, 712 F. Supp. 143 (E.D. Wis. 1989), 560, 561
- Joseph Radtke, S.C. v. United States, 895 F.2d 1196 (7th Cir. 1990), 560, 561
- Jupiter Corp. v. United States, 2 Cl. Ct. 58 (1983), 346
- Kahn, Estate of, v. Commissioner, 499 F.2d 1186 (2d Cir. 1974), 6
- Kenroy, Inc. v. Commissioner, 47 T.C.M. (CCH) 1749 (1984), 356-357
- Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004), 526, 527, 528, 530
- Kintner v. United States, 107 F. Supp. 976 (D. Mt. 1952), 8
- Kirby Lumber Co., United States v., 284 U.S. 1 (1931), 488, 590, 626
- Klein v. Commissioner, 18 T.C. 804 (1952), 35
- Korby, Estate of, v. Commissioner, T.C. Memo 2005-102, 529, 530
- Korby, Estate of, v. Commissioner, T.C. Memo 2005-103, 529, 530
- Korby, Estate of, v. Commissioner, 471 F.3d 848 (8th Cir. 2006), 533
- Kornfeld v. Commissioner, 137 F.3d 1231 (10th Cir. 1998), 490
- Kreider v. Commissioner, 762 F.2d 580 (7th Cir. 1985), 486
- Kwait v. Commissioner, 1989 T.C.M. (P-H) ¶ 1989-382, 408
- Ledoux v. Commissioner, 77 T.C. 293 (1981), 251, 321
- Ledoux v. Commissioner, 695 F.2d 1320 (11th Cir. 1983), 251, 321
- Lee v. Commissioner, T.C. Memo 2006-193, 144
- Lender Management, LLC v. Commissioner, T.C. Memo 2017-246, 535, 536
- Lucas v. Earl, 281 U.S. 111 (1930), 53
- Luna v. Commissioner, 42 T.C. 1067 (1964), 3, 5, 6, 14, 22
- Lynch v. United States, 192 F.2d 718 (9th Cir. 1951), 488, 504
- Madison Gas & Electric Co. v. Commissioner, 72 T.C. 521 (1979), 17, 43
- Magneson v. Commissioner, 81 TC 767 (1983), 131
- Magneson v. Commissioner, 753 F.2d 1490 (9th Cir. 1985), 131
- Mammoth Lakes Project v. Commissioner, T.C. Memo 1991-4, 186
- Martin v. D. B. Martin Co., 88 A. 612 (Del. Ch. 1913), 35

- Mason v. Commissioner, T.C. Memo 1988-273, 346
- MAS One Limited Partnership v. United States, 271 F. Supp. 2d 1061 (S.D. Ohio 2003), 56, 71
- McCauslen v. Commissioner, 45 T.C. 588 (1966), 322
- McDonald's Restaurants of Illinois, Inc. v. Commissioner, 688 F.2d 520, 50 A.F.T.R.2d 82-5750 (7th Cir. 1982), 489
- McDougal v. Commissioner, 62 T.C. 720 (1974), 394
- MCM Investment Management, LLC v. Commissioner, T.C. Memo 2019-158, 633, 635, 636, 637, 638
- Medi-Tec of Egypt Corp. v. Bausch & Lomb Surgical, 2004 Del. Ch. LEXIS 21 (Mar. 4, 2004), 35
- Medlin v. Commissioner, T.C. Memo 2003-224, 593
- Meissner v. United States, 364 F.2d 409 (1966), 544
- Melvin v. Commissioner, T.C. Memo 2009-199, 591
- Merkel v. Commissioner, 192 F.3d 844 (9th Cir. 1999), 598
- Metro Auto Auction of Kansas City, Inc. v. Commissioner, T.C. Memo 1984-440, 316
- Mike J. Graham Trucking, Inc. v. Commissioner, 2004-1 U.S. Tax Cas. (CCH) 50,214, 93 Fed. Appx. 473, 93 A.F.T.R.2d 1626 (3d Cir. 2004), 560
- Mike J. Graham Trucking, Inc. v. Commissioner, T.C. Memo 2003-49, T.C.M. (RIA) ¶ 55,056, 85 T.C.M. (CCH) 908 (2003), 560
- Miller v. United States, 181 Ct. Cl. 331 (1967), 346
- Miller v. Commissioner, T.C. Memo 1984-336, 185
- Miller v. Commissioner, T.C. Memo 2006-125, 592
- Miller v. Commissioner, T.C. Memo 2011-219, 144
- Miller, Estate of, v. Commissioner, T.C. Memo 2009-119, 534
- Mingo v. Commissioner, T.C. Memo 2013-149, 254
- Mirowski, Estate of, v. Commissioner, T.C. Memo 2008-74, 534
- Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260 (D. Del. 1989), 35
- Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943), 31
- Monroe v. Commissioner, 7 T.C. 278 (1946), 230
- Morrissey v. Commissioner, 296 U.S. 344 (1935), 18
- Mowafi v. Commissioner, T.C. Memo 2001-111, 144
- N. Sobel, Inc. v. Commissioner, 740 B.T.A. 1263 (1939), 590
- National Oil Co. v. Commissioner, 52 T.C.M. (CCH) 1223 (1986), 356
- Nee v. Main Street Bank, 174 F.2d 425 (8th Cir. 1949), 18
- Neill v. Commissioner, 46 B.T.A. 197 (1942), 454
- NetJets Aviation, Inc. v. LHC Communications, LLC, 537 F.3d 168 (2d Cir. 2008), 35
- Nissho Iwai American Corp. v. Commissioner, 89 T.C. 765 (1987), 439
- North American Bond Trust, Commissioner v., 122 F.2d 545 (2d Cir. 1941), 19
- Norton v. Commissioner, T.C. Memo 2002-137, 485, 504
- Norwest Corp. v. Commissioner, 69 F.3d 1404 (8th Cir. 1995), 439
- Nu-Look Design, Inc. v. Commissioner, 356 F.3d 290 (3d Cir. 2004), 560, 564
- Nu-Look Design, Inc. v. Commissioner, T.C. Memo 2003-52, T.C.M. (RIA) ¶ 55,059, 85 T.C.M. (CCH) 927 (2003), 560, 564

- O'Brien v. Commissioner, 77 T.C. 113 (1981), 259, 281
- Oden v. Commissioner, T.C. Memo 1981-184, 48
- Oehlschlager v. Commissioner, T.C.M. (RIA) ¶ 88,210 (1998), 322
- O'Hare v. Commissioner, 641 F.2d 83 (2d Cir. 1981), 12, 13
- O'Hare v. Commissioner, T.C.M. (RIA) ¶ 80,034 (1980), 12
- Otey v. Commissioner, 634 F.2d 1046 (6th Cir. 1980), 56, 71
- Otey v. Commissioner, 70 T.C. 312 (1978), 56, 71, 333
- Palmer v. Commissioner, 302 U.S. 63 (1937), 391
- Payne v. Commissioner, T.C. Memo. 1998-227, 592, 593, 595
- Payne v. Commissioner, 224 F.3d 415, (5th Cir. 2000), 592, 593, 595
- Penn-Dixie Steel Corp. v. Commissioner, 69 T.C. 837 (1978), 408
- Peracchi v. Commissioner, 143 F.3d 487 (9th Cir. 1998), 49
- Peter Pan Seafoods, Inc. v. United States, 417 F.2d 670 (9th Cir. 1969), 488
- Pflugradt v. United States, 310 F.2d 412 (7th Cir. 1962), 516
- Phellis, United States v., 257 U.S. 156 (1921), 484, 504
- Pierre v. Commissioner, 133 T.C. 24 (2009), 534
- Pilgrim's Pride Corporation v. Commissioner, 141 T.C. 533 (2013), 631
- Pilgrim's Pride Corporation v. Commissioner, 779 F.3d 311 (5th Cir. 2015), 258, 631, 632
- Pinchot v. Commissioner, 113 F.2d 718 (2d Cir. 1940), 454
- Plumstead Theatre Society v. Commissioner, 675 F.2d 244 (9th Cir. 1982), 470, 471
- Plumstead Theatre Society v. Commissioner, 74 T.C. 1324 (1980), 470, 471
- PNRC Limited Partnership v. Commissioner, T.C. Memo 1993-335, 183
- Podell v. Commissioner, 55 T.C. 429 (1970), 130, 326
- Polakof v. Commissioner, 820 F.2d 321 (9th Cir. 1987), 131, 154
- Pratt v. Commissioner, 550 F.2d 1023 (5th Cir. 1977), 327, 328, 332, 368, 369, 370
- Pratt v. Commissioner, 64 T.C. 203 (1975), 327, 368
- Preslar v. Commissioner, 167 F.3d 1323 (10th Cir. 1999), 590, 591, 594
- Proesel v. Commissioner, 77 T.C. 992 (1981), 635
- Radtke v. United States, 712 F. Supp. 143 (E.D. Wis. 1989), 560, 561
- Ramos, United States v., 393 F.2d 618 (9th Cir.), 515
- Raphan v. United States, 758 F.2d 879 (Fed Cir. 1985), 613, 614, 615
- Redlands Surgical Services. v. Commissioner, 113 T.C. 47 (1999), 471
- Redlands Surgical Services. v. Commissioner, 242 F.3d 904 (9th Cir. 2001), 471
- Reichardt, Estate of, v. Commissioner, 114 T.C. 144 (2000), 526
- Reinberg v. Commissioner, 90 T.C. 116 (1988), 5
- Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. No. 7 (2011), 561
- Richardson v. Commissioner, 693 F.2d 1189 (5th Cir. 1982), 234, 244
- Richardson v. Commissioner, 76 T.C. 512 (1981), 234, 244
- Riegelman, Estate of, v. Commissioner, 253 F.2d 315 (2d Cir. 1958), 542

- Riether v. United States, 919 F. Supp. 2d 1140 (D. N.M. 2012), 116, 117
- Rood v. Commissioner, T.C. Memo 1996-248, 591
- Rosen, Estate of, v. Commissioner, T.C. Memo 2006-15, 532
- Roth v. Commissioner, 321 F.2d 607 (9th Cir. 1963), 251, 281, 321
- Rupple v. Kuhl, 177 F.2d 823 (7th Cir. 1949), 35
- Saba Partnership v. Commissioner, 273 F.3d 1135 (D.C. Cir. 2001), 490
- Safford v. United States, 216 F. Supp. 226 (E.D. Wis. 1963), 360
- Securities Co. v. United States, 85 F. Supp. 532 (S.D.N.Y. 1948), 590
- Shumaker v. Commissioner, T.C. Memo 1985-582, 187
- Sloan v. Commissioner, T.C. Memo 1981-641, 345, 346
- Smith, Estate of, v. Commissioner, 313 F.2d 724 (8th Cir. 1963), 14, 43
- Sommers v. Commissioner, 195 F.2d 680 (2d Cir. 1952), 35
- Southern Pacific Transportation Company v. Commissioner, 75 T.C. 497 (1980), 34
- Southgate Master Fund, L.L.C. v. United States, 659 F.3d 466 (5th Cir. 2011), 13, 14, 15
- Specialty Transport & Delivery Services, Inc. v. Commissioner, T.C. Memo 2003-51, T.C.M. (RIA) ¶ 55,058, 85 T.C.M. (CCH) 920 (2003), 560
- Specialty Transport & Delivery Services, Inc. v. Commissioner, 2004-1 U.S. Tax Cas. (CCH) 50,203, 91 Fed. Appx. 787, 93 A.F.T.R.2d 1364 (3d Cir. 2004), 560
- Spicer Accounting v. United States, 918 F.2d 90 (9th Cir. 1990), 561
- St. David's Health Care System v. United States, 349 F.3d 232 (5th Cir. 2003), 471
- St. John v. United States, 84-1, USTC ¶ 9158 (C.D. Ill 1983), 357
- Stafford, United States v., 727 F.2d 1043 (11th Cir. 1984), 52-53, 71
- Stilwell v. Commissioner, 46 T.C. 247 (1966), 259
- Stranahan, Estate of, v. Commissioner, 472 F.2d 867 (6th Cir. 1973), 250
- Strangi v. Commissioner, T.C. Memo 2003-145, 524, 528
- Strangi v. Commissioner, 417 F.3d 468 (5th Cir. 2005), 403, 524, 526, 528
- Strangi v. Commissioner, 429 F.3d 1154 (5th Cir. 2005), 526
- Strangi, Estate of, v. Commissioner, 115 T.C. 478 (2000), 403, 524, 525
- Stone, Estate of, v. Commissioner, T.C. Memo 2003-309, 526, 527
- Superior Proside, Inc. v. Commissioner, T.C. Memo 2003-50, T.C.M. (RIA) ¶ 2003-050, 85 T.C.M. (CCH) 914 (2003), 560
- Superior Proside, Inc. v. Commissioner, 2004-1 U.S. Tax Cas. (CCH) 50,146, 86 F. Appx 510, 93 A.F.T.R.2d (RIA) 647 (3d Cir. 2004), 560
- Tallal v. Commissioner, 778 F.2d 275 (5th Cir. 1985), 131
- Thompson v. United States, 87 Fed. Cl. 728 (2009), 141
- Thompson, Estate of, v. Commissioner, 382 F.3d 367 (3d Cir. 2004), 529, 530, 532, 533
- TIFD III-E Inc. v. United States, 342 F. Supp. 2d 94 (D. Conn. 2004), 5, 13, 187, 237
- TIFD III-E Inc. v. United States, 660 F. Supp. 2d 367 (D. Conn. 2009), 187, 237, 491
- TIFD III-E, Inc. v. United States, 459 F.3d 220 (2d Cir. 2006), 13, 187, 237, 491
- TIFD III-E, Inc. v. United States, 666 F.3d 836 (2d Cir. 2012), 187, 237, 491

- Tobias, Estate of, v. Commissioner,  
T.C. Memo 2001-37, 182
- Tower, Commissioner v., 327 U.S. 280  
(1946), 4, 5, 12, 19, 22, 34, 230, 231,  
244
- Transport Trading & Terminal Corp.,  
Commissioner v., 176 F.2d 570 (2d  
Cir. 1949), 488
- Tucker v. Commissioner, T.C. Memo  
2015-185, 636, 637
- Tufts, Commissioner v., 461 U.S. 300  
(1983), 82, 216, 227, 590, 609, 610
- Turner, Estate of, v. Commissioner,  
T.C. Memo 2011-209, 534
- Twenty Mile Joint Venture, PND, Ltd.  
v. Commissioner, 200 F.3d 1268  
(10th Cir. 1999), 56
- United States v. (see name of  
defendant)
- Vecchio v. Commissioner, 103 T.C. 170  
(1994), 184
- Veterinary Surgical Consultants, P.C.  
v. Commissioner, 2004-1 U.S. Tax  
Cas. (CCH) 50,209, 90 Fed. Appx.  
669, 93 A.F.T.R.2d 1273 (3d Cir.  
2004), 560
- Veterinary Surgical Consultants, P.C.  
v. Commissioner, T.C. Memo 2003-  
48, T.C.M. (RIA) ¶ 55,055, 85 T.C.M.  
(CCH) 901 (2003), 560
- VisionMonitor Software LLC v.  
Commissioner, T.C. Memo 2014-  
182, 48
- Wagner Supply Co. v. Bateman, 18  
S.W.2d 1052 (Tex. 1929), 15
- Water-Pure Systems, Inc. v.  
Commissioner, T.C. Memo 2003-53,  
T.C.M. (RIA) ¶ P55,060, 934 T.C.M.  
(CCH) 934 (2003), 560
- Water-Pure Systems, Inc. v.  
Commissioner, 2004-1 U.S. Tax  
Cas. (CCH) 50,214, 93 Fed. Appx.  
473, 93 A.F.T.R.2d 1626 (3d Cir.  
2004), 560
- Watson v. United States, 107 A.F.T.R.2d  
311 (S.D. Iowa 2010), 561, 564
- Weiss v. Commissioner, 956 F.2d 242  
(11th Cir. 1992), 259
- Western Management, Inc. v. United  
States, 45 Fed. Cl. 543 (2000), 560
- Whipple v. Commissioner, 373 U.S. 193  
(1963), 535
- Williams, Commissioner v., 256 F.2d  
152 (5th Cir. 1958), 12
- Winn-Dixie Stores, Inc. v.  
Commissioner, 254 F.3d 1313 (11th  
Cir. 2001), 485, 504
- Woodhall v. Commissioner, T.C.  
Memo 1969-279, 544
- Woodhall v. Commissioner, 454 F.2d  
226 (9th Cir. 1972), 544
- Woolsey, United States v., 326 F.2d 287  
(5th Cir. 1963), 251, 281
- Zarin v. Commissioner, 92 T.C. 1084  
(1989), 590
- Zarin v. Commissioner, 916 F.2d 110  
(3d Cir. 1990), 590





## Introduction

# The Spirit of Partnerships and Partnership Taxation

---

---

Most of this textbook focuses on the rules concerning partnership taxation—when a partnership exists, the tax treatment of contributions to a partnership, the basis of partnership assets and interests in a partnership, how income is allocated to the partners, the tax treatment of distributions, the consequences of partnership liabilities, partnership mergers, the retirement of a partner, and dissolution of the partnership. There also is significant attention paid to the numerous “anti-abuse” rules that have been adopted by Congress and the Internal Revenue Service (“IRS”) over the past several decades, including the disguised sale rules, the treatment of “mixing-bowl” transactions, the complex rules to prevent basis abuse, and the overriding “partnership anti-abuse regulations” adopted by the IRS. These rules are embodied in the Code,<sup>1</sup> the Regulations, rulings from the IRS and numerous precedents, all of which are explored and discussed below. Put simply, this textbook contains a thorough discussion of the rules of partnership taxation.

In addition, this textbook explores one of the fundamental questions which always arises in partnership taxation: is a partnership to be treated as a separate taxable entity or an aggregate of its partners? The tension between entity and aggregate treatment of a partnership is one of the recurring issues in determining the tax consequences of partnership transactions. Indeed, it can be argued that Congress created perpetual uncertainty when it decided in 1954 that for tax purposes, a partnership was not solely an aggregation of its partners or a separate legal entity, but at times one and at times the other. Many of the questions addressed in this textbook arise, at their heart, because of the bifurcated nature of a partnership as both a separate entity and an aggregate of its partners. Some of the more complex areas in partnership taxation (like the IRS audit rules governing partnership controversies) arise because of Congress’ unwillingness to draw the line between treating a partnership as a separate entity versus an aggregation of its partners.

However, this introduction focuses on a third aspect of partnership taxation—the spirit of partnerships and partnership taxation. The concept that individuals and corporations will, in the furtherance of legitimate business enterprise, want to

---

1. References to the “Code” and “I.R.C.” are references to the Internal Revenue Code of 1986, as amended.

enter into partnerships is one of the unspoken axioms of the tax law. The practical consequences of people coming together is the focus of the complex rules governing partnership taxation, but the underlying reason why people want to combine their efforts is not addressed frequently. People coming together to promote their individual and collective self-interests is what underlies every partnership.

In order to understand partnership taxation, you need to take into account the fact that partnerships are one of the fundamental building blocks of human economic interaction. Partnerships have long existed, and they will continue to exist, although the success of partnerships may depend upon the tax rules applicable to them. The rules concerning partnership taxation need to be judged by whether they further or inhibit this basic goal. In other words, as you read each of the chapters below, you should consider not only the technical partnership tax issues that are discussed, but also whether the rules are consistent with the undiscussed spirit of partnerships and partnership taxation. If the rules further these goals without fostering abuse, then the rules may be considered to be “spiritually” appropriate. On the other hand, if, out of a desire to prevent some perceived abuse, the rules make it harder for people to combine their resources and energy, or result in uncertain or disproportionately inappropriate tax consequences, then the wisdom of the rules need to be carefully considered.

**Why Are There Partnerships?** Anyone who wants to consider the origin of partnerships (and partnership taxation) needs to go no further than prehistoric times, as men banded together to hunt. The cave drawings found in Southern France all illustrate groups of men joining together to slay beasts, whether for food or protection. The proceeds of these efforts were shared by the hunters (partners), although a written agreement was not needed to determine how a slaughtered animal would be divided.

Indeed, it can be argued that the entire impetus of the change in civilization from a hunter/gatherer society to one in which people primarily lived in cities was a result of partnerships being formed. Although cities furthered economic growth and development by allowing individuals to exchange their efforts and goods, the impact of this interchange was greatly magnified as people joined together to increase the impact of their efforts. Partnerships provided the means for people to work together, and the law quickly developed to address the legal relationship of partners.

A survey of the laws of antiquity indicates that partnerships have been present for a long, long time. Dating back to the time of Sumer, there was a complex commercial system that included business partnerships. The transactions of these partnerships were recorded on clay tablets, some of which have been found in temple complexes.<sup>2</sup>

In his book on Mesopotamian contracts, Paul Halsell highlighted two contracts from the reign of Nebuchadnezzar II (c. 568–564 BC). In the first contract, Nabu-adki-iddin was an investor — a member of the great Egibi family. He contributed

---

2. Paul Guisepi & F. Roy Willis, *History-World.org/sumeria*, 2003.

four manas of capital to a partnership, while Bel-shunu, who was to carry on the business, contributed one half mana and seven shekels, whatever property he might have, and his time. Any expenses in excess of four shekels was considered to be extravagant and had to be paid by Bel-shunu from his own pocket. The contract was witnessed by three men and a scribe. In another partnership, entered into four years later, there were no initial contributions, but each of the partners drew 20 shekels of income one year later, and additional funds were used by the partnership to pay its obligations.<sup>3</sup>

This business model was carried over to ancient Greece and Rome. In Rome, in particular, “associations” were formed which functioned as partnerships. Partnerships were used, especially for transmarine transactions in which risk sharing was necessary in an age before insurance. Cato advised a capitalist not to fit out a single ship but, in concert with 49 other capitalists, to send out 50 ships and to take an interest in each to the extent of a fiftieth part.<sup>4</sup>

When Rome fell, and “darkness” spread upon the West, partnerships continued in the thriving intellectual climate of the Arab world. Indeed, partnerships were the primary form of business enterprise, because interest is forbidden in the Koran. Partnerships were regularly used to compensate the party who provided money to a venture, using a variable rather than a fixed rate of return. Indeed, there were different types of partnerships for the situation where one person contributed money and another contributed labor (Mudararah) and the situation in which both persons contributed capital (Musharakah).<sup>5</sup>

Even in the so-called Dark and Middle Ages, partnerships were the primary vehicle of commerce. For example, in 1235, a Jew (Saltell) and a Christian (Berenguer) formed a partnership to operate a mill. They originally agreed that Saltell would have one quarter of the income and bear one quarter of the losses. Seven years later, a dispute arose, with Saltell claiming he was owed money as a result of a premature disposition of the mill, and Berenguer claiming that there was a loss for which he was entitled to compensation. The matter was submitted to jointly accepted arbitrators, who found in favor of Saltell and awarded him monetary damages.<sup>6</sup>

The emergence of the West from the Dark Ages was accompanied by the growth of mercantile partnerships. Indeed, on his voyage of discovery, Christopher Columbus formed a partnership with the Spanish crown and Italian investors, in which

---

3. Paul Halsall, *Ancient History Sourcebook: A Collection of Contracts from Mesopotamia, c. 2300–428 BCE*, in *Internet Ancient History Sourcebook* (1999), <http://www.fordham.edu/halsall/ancient/mesopotamia-contracts.html>.

4. Theodor Mommsen, *The History of Rome*, Book III.

5. M.A. Mannan, *Economic Development and Social Peace in Islam* (1989); M.U. Chapra, *Towards a Just Monetary System* (1986).

6. *Medieval Sourcebook: A Business Partnership Between a Jew and a Christian in Barcelona, 1235–1242*, based on *Arxiu Capítular de Barcelona* 1-6-3475.

he shared the proceeds from his discoveries.<sup>7</sup> The explorations by Sir Francis Drake were supported by partnerships of investors.<sup>8</sup> And the great growth of trade in the Netherlands during the sixteenth century can be directly traced to partnerships in which investors held shares and entrusted their capital to the hands of active partners.<sup>9</sup>

The use of partnerships is also inextricably linked to the founding of this country. Although the original Virginia Company that founded the Jamestown settlement was a corporation chartered by the Crown, the Pilgrims who landed at Plymouth Rock conducted their enterprise as a partnership. There were “Adventurers,” who provided the capital and supplies needed for the settlement. The settlers themselves were often described as “partners in land” who would be entitled to a sharing of the proceeds with the Adventurers.<sup>10</sup>

Partnerships were so common that they could be found in everyday conversation and in famous literature. For example, in *A Christmas Carol*, when Ebenezer Scrooge and Jacob Marley left to form their own business, they formed a partnership, Scrooge and Marley. Shakespeare referred to partners in business enterprises in several of his plays.<sup>11</sup>

The story goes on and on. People joining together to collectively promote their interests — to form partnerships — are a fundamental part of the history of man. Partnerships are simply a part of fundamental human relationships — people enter into partnerships in order to conduct commercial enterprise, with the hope that this will improve their lives.

**Why Are There Separate Tax Rules for Partnerships?** If partnerships are such a fundamental building block for human relations, why is it necessary to have separate tax rules for partnerships? This seemingly simple question can be answered with an equally simple statement — our tax system focuses on income, and income eventually goes to the people who receive it. The income tax originally applied only to individuals, and the taxation of partnerships was always focused on the taxation of the people who formed those partnerships.

There is, needless to say, a long history of partnership taxation that pre-dates the current income tax. However, for much of antiquity, there was no income tax (as we currently understand such taxes), although partnerships would have been subject to wealth, property, and similar taxes. However, as far back as 519 B.C., King Darius of Persia established a tax system that was based on the anticipated yield of land. Although this was not a true “income” tax, the tax was imposed upon the source of production of income. Even earlier, in ancient Sumer and Babylon, professional

---

7. *Columbus' Campaign for Funding*, Wikipedia.org.

8. *The Beginning of the End: The Drake-Norris Expedition, 1589*, [www.loc.gov/rr/rarebook/catalog/drake](http://www.loc.gov/rr/rarebook/catalog/drake).

9. Jan de Vries, *The Dutch Atlantic Economies*, in Coclanis Books, at 10 (2005).

10. *The Present [1624] Estate of New Plymouth*, from the Mayflower Web Pages, Mayflo1620.

11. *See, e.g.*, *The Winter's Tale* act 4, sc. 2; *Coriolanus* act 5, sc. 6.

workers had to pay “taxes” to royal collectors in order to remain employed. Thus, both individuals and partnerships have long had tax burdens, although much of this taxation was not directly related to income.<sup>12</sup>

Of course, it also is possible to tax business entities, as the tax treatment of corporations shows. Arguments have been made that all business entities — corporations, partnerships, limited liability companies, business trusts — should be directly subject to taxation. The difficulty with this argument is that there is little difference between a sole proprietorship, which is difficult to tax as a separate business entity, and a two-person general partnership. The distinction becomes even harder to discern when families are involved. For example, if a woman sets up a business in her home and it is not taxable, but then brings her daughter into the business to help her and gives her daughter an ownership interest in the business, would the former not be a business entity subject to taxation but the latter would? Unless every business entity of any size, and without regard to the number of owners, is subject to entity-level taxation, there will always be some business entities that are effectively taxed to their owners directly and not to the entity itself.

Moreover, some state and local governments (and some foreign countries) currently tax partnerships as business entities, so it is clear that there is no fundamental cosmic reason why a partnership could not be subject to taxation. But in the United States, as a general rule, a partnership has been viewed not as a separate taxable entity but, instead, as a “pass-through” entity in which its owners (and not the partnership itself) are subject to taxation. This axiom — that income tax is paid by the partners of a partnership, and not the partnership itself — underlies many of the issues that will be discussed herein.

**Aggregate versus Entity Treatment.** The assumption that a partnership will be treated as a pass-through entity that is not directly subject to income taxation does not answer the question whether the calculation of income will be conducted at the partner or partnership level. In other words, even if the partners in the partnership (and not the partnership itself) are directly subject to taxation on income, the computation of income can be made either at the entity level (by treating the partnership as a separate entity for purposes of computing the income that is taxable to its owners) or at the partner level (by disregarding the partnership and treating it as an aggregation of its owners, each of whom determines his own income separately).

There is no clearly “correct” way to determine how a partnership should be treated, *i.e.*, both entity and aggregate treatments are appropriate at different times. Many of the chapters that follow will illustrate the tension between aggregate and entity treatment of partnerships in calculating the income that is taxable to the partners in a partnership. This is particularly evident in the various anti-abuse rules that have been adopted by Congress or promulgated by the IRS. Most of the anti-abuse

---

12. Michael Hudson, *Mesopotamia and Classical Antiquity—Taxation History*, Am. J. Econ. & Soc. (Dec. 2000).

rules address situations in which treating a partnership as a separate taxable entity results in more favorable tax consequences than would occur if the partnership were treated as an aggregation of its owners — the anti-abuse rules frequently treat the partnership as an aggregate in order to “correctly” determine the taxable income of its partners.

**Where Do Substance and Form Fit In?** If simplicity is ever to be achieved in the area of partnership taxation, then “substance” and “form” will remain significant determinants of the tax consequences of partnership transactions. It can be argued that much of the complexity in the more recent legislation and Regulations concerning partnership taxation are the result of Congress and the IRS not trusting that the courts will look at the substance (rather than the form) of partnership transactions. Many of the more recent rules appear to be designed to address situations in which the form of the transaction differed from its substance. It is possible that some of this complexity could be eliminated if Congress and the IRS would simply allow the courts to do their job in weighing the bona fides of partnership transactions.

For example, consider the decision in *ASA Investering Partnership v. Commissioner*.<sup>13</sup> The case involved the application of the installment sale rules under I.R.C. § 453 in the context of a partnership with foreign and domestic partners. The partnership was formed so as to cause an allocation of income (resulting from the installment sale) to the foreign partner. To address this transaction, the court could not rely upon the technical words in the Code, because these rules supported the taxpayer’s position. Instead, the court had to look at the substance of the transaction (rather than its form) to find that the foreign party was not a “partner” to whom income could be allocated.

**What About Anti-Abuse Rules?** Recent years have seen significant legislative and regulatory developments in the partnership area. Many of the newest rules can only be described as “anti-abuse” provisions which are intended to address one particular transaction or another that was considered to be abusive. The result is that the laws concerning partnership taxation have metamorphosed from the broad, general principles that were established in the 1950s into particularized rules that attempt to address every potential abuse. Of course, it is impossible to cover every conceivable situation, so Congress and the IRS have crafted numerous rules that unfortunately can be aptly described as “heads I win, tails you lose.”

Several examples illustrate the approach taken by Congress in these new rules. For example, I.R.C. §§ 737, 721(b), and 731(c) all provide for the potential recognition of gain, but not loss, in certain situations. If the transaction is an appropriate event to trigger the recognition of gain, why is it not also an appropriate event for the recognition of loss?

---

13. 76 T.C.M. (CCH) 325 (1998), *aff’d*, 201 F.3d 505 (D.C. Cir. 2000), *cert. denied*, 531 U.S. 871 (2000).

Likewise, the basis rules in I.R.C. §§ 734 and 743 were amended in 2004 to address situations in which partners could benefit from not making an election under I.R.C. § 754 to adjust the basis of partnership assets. Basically, the amendment functions so that: (1) if there would be a basis increase that would potentially benefit partners, an election must be filed, and if no election is timely filed, the partners could face double recognition of gain, but (2) if there is a loss that would result in a significant basis reduction (which benefits the IRS), an election will be deemed to have been filed except in some very limited circumstances. This provision is a classic “heads I win, tails you lose” situation<sup>14</sup> and is representative of the approach taken in recent legislation and Regulations.

**How Do the Tax Rules Affect Partnerships?** Any practitioner who has worked with partnerships is well aware that the tax laws affect every single transaction. It would be naïve to assume that a partnership would be formed, enter into transactions, distribute its profits, bring in new partners and redeem old ones, incur liabilities, and (eventually) dissolve without looking at the applicable tax rules each and every step of the way. In fact, because partnerships receive more favorable tax treatment than corporations (one level of taxation instead of two), it is possible that even more attention is paid to the tax consequences of partnership transactions than to corporate ones.

The impact of the tax rules can be seen in everyday transactions. For example, assume that Jack wants to contribute property to a partnership, and Jill wants to contribute money. The contributing partners will need to consider numerous tax issues in forming their partnership, including the impact of any built-in gain or loss with respect to the contributed property, the manner in which basis will be allocated and depreciation calculated, the potential application of the disguised sale rules as distributions are made to Jack, the allocation of liabilities that encumber the property, and on and on. Even the simplest transaction can result in significant confusion.

If the goal of partnerships is to allow people or corporations to pool their efforts for the common good, then partnership tax rules should be judged by whether they make it easier or more difficult to attain this goal. Many of the more complex rules in the Code will certainly fail to meet this goal. Indeed, the most significant issue in partnership taxation is the complexity, much of which arises from more recent rules and Regulations.

Take, for example, the potential application of the disguised sale rules to the partnership formed by Jack and Jill. Even a simple transaction, in which one partner contributes property and the other contributes cash, will need to be carefully reviewed to make sure that the transaction is not treated as a disguised sale. Moreover, all distributions by the partnership to Jack and Jill will need to be carefully

---

14. This provision was enacted to address a transaction, undertaken by Enron Corporation prior to its demise, in which a failure to make an I.R.C. § 754 election resulted in basis duplication.

monitored for at least seven years to make certain that Jack is not treated as having engaged in a “mixing bowl” transaction. Thus, the simple contribution of property to a partnership can result in years of diligence. This complexity is one of the banes of the partnership tax rules at the present time.

**The Spirit of Partnership Taxation.** If there is an underlying “spirit” to partnerships, it is people getting together to conduct business in a manner which provides mutual benefits. This is how partnerships have always been used, and this is why partnerships have generally been treated as non-taxable entities, because it is the partners (and not the partnership as an entity) that should be subject to income taxation.

The tax rules for partnerships should be approached with the intention of furthering this goal by allowing persons to enter into mutually beneficial economic arrangements, the tax consequences of which can be simply (and definitively) determined. Moreover, the tax results should be self-evident to both the partners in the transaction and their tax advisors. The spirit which underlies partnership taxation should be the same as the spirit underlying partnerships — partnerships should be taxed in a manner which reflects the underlying business arrangements of the partners. If partnerships are a “basic” form of human economic organization, the tax rules for partnerships should also be built on the “basics” that tax consequences should be related to the underlying economic relationships of the partners.

The remainder of this book will be filled with discussion of the actual rules for partnership taxation. You will encounter complex rules, with exceptions, exceptions to the exceptions, and “heads I win, tails you lose” anti-abuse rules. We will leave it to you to determine whether each of these rules — particularly the more recent statutory and regulatory limitations on partnerships and their transactions — are consistent with or contrary to the underlying spirit of partnerships and their transactions.

The foregoing said, it is purely wishful thinking to believe that the partnership tax rules can return to the days of yore, in which there were a few simple rules and general principles guiding partnership taxation. Complexity is here to stay, and the ongoing trend is to make the rules more complex rather than simpler. Moreover, as tax practitioners find ways to take advantage of the rules, it can be anticipated that Congress and the IRS will continue to attempt to make the rules for partnership taxation more one-sided than ever.

**How Practitioners Can Further the Spirit of Partnerships and Partnership Taxation.** The following chapters will illustrate many of the aspects of partnership taxation. You will learn about the definition of a partnership, the tax consequences of forming a partnership, the effect of contributions to the partnership and distributions by the partnership, the determination of basis, the tax treatment of partnership liabilities, the calculation and allocation of partnership income, the disposition of partnership interests and the tax treatment of retiring partners, the tax treatment of transactions between a partnership and its partners, partnership mergers and divisions, and the myriad anti-abuse rules that are now part of the partnership



tax universe. Each of these areas has its own rules, some of which are instinctual, some of which are artificial, and many of which are subject to complex rules and Regulations.

As a tax practitioner in the partnership area, you will need to be fully conversant with the rules that are discussed herein. But you also need to have a fundamental understanding of the “spirit” which underlies these rules, which is that a partnership provides a means for different persons to jointly conduct economic arrangements. The tax consequences of the partnership should be linked inextricably to the underlying economic arrangement, and although the rules are complex, they are generally intended to reach that result. Indeed, it is most likely that an anti-abuse rule will apply any time that the partnership tax rules lead to a result which is non-economic or does not appear to be consistent with the underlying economic arrangement of the partners. And in those situations which happen to lie outside of one of the anti-abuse rules, it is still possible that a court would attempt to recharacterize the transaction — whether under substance over form principles or simply on the basis of “economic reality” — so as to cause the tax consequences of the transaction to comport with the economic arrangement of the partners.

When you are advising partnerships, therefore, you should always be mindful of the underlying economic arrangement. The partnership agreement, and all of the other documents evidencing the partnership and the arrangements of the partners, should be drafted so as to clearly embody and further the partners’ intent. Indeed, it often is best to state clearly in the agreement both the intended economic effect and intended tax consequences of the partnership transaction. If it cannot be stated clearly and succinctly, or if the partners are not willing to allow their intent to see the light of day, then the practitioner should be concerned about the substance of the transaction and the resulting tax consequences. However, if the partners’ economic arrangement is clear and the intended tax consequences flow inevitably from the partners’ economic arrangement, then it is likely that both will be respected. The practitioner’s goal should be to create partnership arrangements and transactions where, notwithstanding the complexity of the Code, the Regulations, the rulings, and the case law, there is little doubt as to what the tax consequences will be.

