27 T.C. 701 (1957)

When a partner purchases the interest of another partner, the remaining partner may allocate the purchase price to the partnership's assets and amortize that basis over the life of those assets for tax purposes.

Summary

C.E. Silling, Sr. and L.G. Tucker were partners in an architectural firm. Silling purchased Tucker's partnership interest, with the price based on the estimated profits from ongoing contracts. Silling sought to amortize the cost allocated to these contracts to reduce his taxable income. The Tax Court held that Silling could allocate the purchase price to the contracts and amortize the basis established, despite the contracts having a zero basis in the hands of the original partnership. The court reasoned that the purchase effectively terminated the partnership, creating a sole proprietorship, and Silling acquired the contracts as assets with an adjusted basis equal to the purchase price.

Facts

C.E. Silling, Sr. and L.G. Tucker formed an architectural partnership in 1938. In 1945, they entered into an agreement with C.L. Bowyer, an employee, for profit sharing. On March 10, 1951, Silling purchased Tucker's partnership interest for $40,000, based on the estimated profits from existing contracts. At the time of the sale, the partnership's tangible assets were minimal; its primary assets were architectural contracts. Silling continued the business as a sole proprietorship, using the name "Tucker & Silling" for the pre-existing contracts until their completion. The firm received substantial fees from the contracts between March 1951 and February 1953. The firm's tax returns, prepared by an accountant, incorrectly listed Tucker as a continuing partner and reported payments to Tucker as partnership income. The purchase price was paid in installments.

Procedural History

The case began as a deficiency in income tax determined against C. E. Silling, Sr. and Marian R. Silling for the year 1951. The initial issue was whether the payment to Tucker was his share of partnership profits or a purchase price for his partnership interest. The Tax Court initially held that Tucker sold his interest to Silling, and the $24,000 paid in 1951 was part of the purchase price. The petitioners then raised an alternative argument regarding amortization. The court allowed amended pleadings and additional hearings to address the amortization issue. The Tax Court ruled in favor of Silling on the amortization issue.

Issue(s)

1. Whether the $24,000 payment made by Silling to Tucker for his partnership interest should be treated as the purchase price of a capital asset or as a deductible

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expense.

2. Whether Silling, upon purchasing Tucker's partnership interest, acquired certain "wasting assets" (the architectural contracts) for which he is entitled to amortization.

Holding

1. Yes, the payment was treated as a capital expenditure, not a deductible expense, because it was for the purchase of Tucker's interest in the partnership.

2. Yes, Silling was entitled to amortize the portion of the purchase price allocated to the architectural contracts.

Court's Reasoning

The court applied the general rule that a partnership interest is a capital asset, and its purchase price is not immediately recoverable from gross income. However, the court distinguished the situation where one partner buys out another and continues the business, which terminates the partnership and creates a sole proprietorship. The remaining partner is deemed to have acquired all partnership assets, with a basis equal to the original partnership interest plus the purchase price paid. The court reasoned that even though the architectural contracts had a zero basis in the partnership's hands, Silling was entitled to a stepped-up basis for the contracts, allowing him to amortize their cost over their useful life. The court specifically noted the fact that C.L. Bowyer was not considered a partner, despite receiving a percentage of profits. The court distinguished the case from cases involving purchases of accounts with indefinite life, noting that the value of the contracts here was exhausted once they were completed.

The court cited several cases, including *Autenreith v. Commissioner*, which stated that partnership interest is a capital asset. The court also pointed out, "This basis must be allocated proportionately among the various assets of the business…petitioner is entitled to a stepped-up basis in computing the gain realized upon their completion by him as a sole proprietor." The court distinguished the case from *Balis v. United States*, where amortization was denied, and *Anderson v. United States*, where the court found the partnership continued to exist.

Practical Implications

This case provides guidance on the tax treatment of a partner's purchase of another partner's interest, particularly when the partnership's primary assets are contracts or other assets with a limited lifespan. It clarifies that, in these circumstances, the purchasing partner may step up the basis of those assets and amortize the cost over their useful life. This can significantly affect the tax implications of the transaction. Attorneys advising clients on partnership buyouts should: (1) structure agreements to ensure the transaction is treated as a purchase of assets, not a continuation of the

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partnership (2) accurately value the assets acquired, and (3) consider the tax implications of amortization when negotiating the purchase price. The case highlights the importance of carefully documenting the intent of the parties and the nature of the agreement to ensure that the tax consequences are consistent with the economic substance of the transaction. The holding of the case is applicable to law firms, accounting firms, and other professional service partnerships.

Meta Description

This case establishes that when a partner buys out another, the buyer can amortize the cost of the partnership’s assets, like contracts, to reduce taxable income. Essential for understanding partnership tax implications.

Tags

Silling v. Commissioner, Tax Court, 1957, Partnership, Amortization, Capital Asset, Partnership Buyout

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