George Edward Quick Trust v. Commissioner, 54 T. C. 1336 (1970)

The basis of a partnership interest inherited from a decedent must be reduced by the value of any income in respect of a decedent (IRD), such as the right to receive proceeds from zero basis accounts receivable for services rendered by the decedent.

Summary

Upon George Edward Quick's death, his estate inherited a partnership interest in Maguolo & Quick, which had ceased active business but held zero basis accounts receivable. The estate and later the trust elected to adjust the partnership's basis under sections 743 and 754. The Tax Court ruled that the right to receive proceeds from these receivables constituted IRD, thus the basis of the partnership interest could not include their fair market value at death. The court also found that the estate's 1961 tax year was barred from reassessment due to adequate disclosure of income on the partnership return.

Facts

George Edward Quick died owning a one-half interest in the Maguolo & Quick partnership, which had ceased active business operations in 1957 and was solely collecting on accounts receivable for services previously rendered. These receivables totaled $518,000 with a fair market value of $454,991. 02 at Quick's death and had a zero basis. Quick's estate succeeded to his interest, and later transferred it to the George Edward Quick Trust. The partnership elected under sections 754 and 743 to adjust the basis of its property to reflect the full fair market value of Quick's partnership interest at his death.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the estate's income taxes for the years 1961-1964 and in the trust's income tax for the year ending September 30, 1966. The trust, as transferee, contested these deficiencies. The Tax Court considered whether the partnership's basis should be increased to reflect the full fair market value of Quick's interest at death and whether the estate's 1961 tax year was barred from reassessment due to the statute of limitations.

Issue(s)

1. Whether the basis in the property of a partnership was properly increased, pursuant to sections 743 and 754, to reflect the full fair market value of the partnership interest of George Edward Quick at the date of death?
2. Whether assessment of the deficiency for the taxable year 1961 was barred under the provisions of section 6501 at the time the statutory notice for that year was issued?

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Holding

1. No, because the right to receive proceeds from the accounts receivable constituted income in respect of a decedent (IRD) under section 691(a)(1) and (3), and thus, under section 1014(c), the basis of the partnership interest at Quick's death cannot include the fair market value of these receivables.
2. Yes, because the estate's 1961 income tax return, together with the partnership return, adequately disclosed the gross income of the partnership, thus the 6-year limitation under section 6501(e)(1) does not apply, and the year 1961 is barred from reassessment.

Court's Reasoning

The court applied sections 742 and 1014 to determine the basis of the partnership interest inherited by the estate, finding that section 1014(c) excluded the value of IRD from the basis calculation. The court reasoned that the right to share in the collections from the accounts receivable was a right to receive IRD under section 691, as established by prior case law such as United States v. Ellis and Riegelman's Estate v. Commissioner. The court rejected the trust's argument that the partnership provisions of the 1954 Code adopted an entity theory that would preclude fragmentation of the partnership interest into its underlying assets. The court also noted that legislative history supported treating the right to income from unrealized receivables as IRD. On the second issue, the court found adequate disclosure of the omitted income in the partnership's Schedule M, which showed distributions to the estate far exceeding the reported income, thus barring reassessment for 1961 under the 3-year statute of limitations.

Practical Implications

This decision clarifies that when a partner dies holding an interest in a partnership with zero basis accounts receivable for services rendered, the value of the right to receive proceeds from these receivables must be treated as IRD, affecting the basis calculation of the inherited partnership interest. Practitioners must carefully consider the impact of IRD on basis adjustments under sections 743 and 754. The ruling also underscores the importance of adequate disclosure on tax returns to prevent the application of extended statutes of limitations. Subsequent cases have followed this decision, reinforcing the treatment of partnership interests involving IRD. Businesses and tax professionals should be aware of these implications when dealing with the estates of deceased partners and the subsequent tax treatment of partnership interests.

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