Demirjian v. Commissioner, 54 T. C. 1691 (1970)

Partnership elections under IRC § 703(b) must be made at the partnership level for involuntary conversions under IRC § 1033.

Summary

Anne and Mabel Demirjian operated a rental property as partners after dissolving their corporation. When the property was involuntarily converted through condemnation, they distributed the proceeds and reinvested individually. The Tax Court held that the election for nonrecognition of gain under IRC § 1033 must be made by the partnership itself, not by individual partners, pursuant to IRC § 703(b). The court rejected the taxpayers' arguments that they could elect nonrecognition individually and that the IRS was estopped from denying the election due to prior communications.

Facts

Anne and Mabel Demirjian owned a rental property through Kin-Bro Realty Corp. until its dissolution in 1960, when the property was transferred to them as partners trading as Kin-Bro Real Estate Company. In 1962, the property was sold through an involuntary condemnation proceeding. The proceeds were distributed equally to Anne and Mabel, who then individually reinvested portions of their shares in similar properties at different times. They filed partnership tax returns and claimed nonrecognition of gain under IRC § 1033 on their individual returns.

Procedural History

The Commissioner determined deficiencies in the taxpayers' 1962 income taxes, asserting that the nonrecognition of gain under IRC § 1033 could only be elected by the partnership, not by individual partners. The taxpayers petitioned the U. S. Tax Court, which heard the case and issued its decision on September 1, 1970, ruling in favor of the Commissioner.

Issue(s)

1. Whether Anne and Mabel Demirjian operated the rental property as partners or as tenants in common.
2. Whether individual partners can elect nonrecognition of gain under IRC § 1033 for involuntary conversions of partnership property.
3. Whether the Commissioner is estopped from denying the taxpayers' election under IRC § 1033 due to prior communications with the district director.

Holding

1. Yes, because the taxpayers intended to and did carry on their prior corporate venture in partnership form, operating the business property as partners.

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2. No, because under IRC § 703(b), the election to take advantage of IRC § 1033 must be made by the partnership, not by individual partners.
3. No, because the taxpayers did not rely on the district director's representations when deciding to reinvest individually, and the doctrine of estoppel does not prevent the Commissioner from correcting errors of law.

Court's Reasoning

The Tax Court found that Anne and Mabel operated the rental property as a partnership based on the deed, trade name certificate, and partnership tax returns filed. The court applied IRC § 703(b), which requires partnership elections affecting the computation of taxable income to be made by the partnership. The court rejected the taxpayers' argument that they could elect nonrecognition under IRC § 1033 individually, as this would lead to inconsistent treatment of partnership income. The court also found no estoppel, as the taxpayers did not rely on the district director's representations when deciding to reinvest individually, and the IRS is not estopped from correcting legal errors.

Practical Implications

This decision clarifies that partnership elections under IRC § 703(b) must be made at the partnership level, even for involuntary conversions under IRC § 1033. Practitioners should advise clients to make such elections through the partnership and ensure that any reinvestments are made by the partnership to qualify for nonrecognition of gain. The case also underscores that the IRS is not estopped from correcting legal errors, even if prior communications may have suggested otherwise. Subsequent cases, such as Rev. Rul. 66-191, have followed this ruling, emphasizing the need for partnership-level elections in similar situations.

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