Bartolme v. Commissioner, 62 T. C. 821 (1974)

A transferee partner may allocate part of the purchase price to intangible assets not listed on the partnership books, such as prepaid interest, and amortize this basis over the asset's remaining life.

Summary

Bartolme purchased a 3% interest in a limited partnership, Simi Valley Investment Co. , which had previously prepaid interest on a land purchase. The partnership elected under IRC § 754 to adjust the basis of partnership properties. The key issue was whether Bartolme could allocate part of his purchase price to "unamortized prepaid interest," an intangible asset not listed on the partnership's books, and amortize it. The Tax Court held that Bartolme could allocate part of his purchase price to this asset and amortize it over the remaining 37. 5 months of the prepaid interest period, emphasizing that this allocation did not result in a double deduction but allowed Bartolme to recover his additional cost.

Facts

In 1964, Simi Valley Investment Co. (SVIC) purchased land, prepaying $580,000 in interest for 53. 5 months, which it deducted as an expense. In 1965, Bartolme and an investor group purchased a 33. 3% interest in SVIC from M. Sears & Co. for $312,312 cash and assumed $623,526 in partnership liabilities. SVIC elected under IRC § 754 to adjust the basis of partnership properties for the new partners. Bartolme claimed a portion of his purchase price was attributable to "unamortized prepaid interest" and sought to amortize this over the remaining 37. 5 months of the prepaid interest period.

Procedural History

The Commissioner of Internal Revenue disallowed Bartolme's deductions for amortization of the prepaid interest and issued a notice of deficiency. Bartolme petitioned the U. S. Tax Court, which held that he could allocate part of his purchase price to the prepaid interest and amortize it over its remaining life.

Issue(s)

1. Whether Bartolme may allocate part of his purchase price to an intangible asset designated as "unamortized prepaid interest," which was not listed on the partnership's books.

2. Whether Bartolme may amortize the allocated basis in the prepaid interest over its remaining life of 37. 5 months.

Holding

1. Yes, because the prepaid interest had value at the time of transfer, and Bartolme paid for an interest in it, justifying an allocation under IRC § 743(b).

2. Yes, because the prepaid interest is an intangible asset with a known limited period of use, allowing for amortization under the regulations.

Court's Reasoning

The court applied IRC § 743(b) and § 755 to allow Bartolme to allocate part of his purchase price to the prepaid interest, reasoning that this intangible asset had value at the time of transfer despite not being listed on the partnership books. The court rejected the Commissioner's argument that allocating basis to an asset that had been previously expensed would result in a double deduction, clarifying that Bartolme was only seeking to amortize his own additional cost in the asset. The court used the formula in Treasury Regulation § 1. 755-1(c) to determine the proper allocation between the prepaid interest and the land. The court also cited Revenue Ruling 68-643 and its decision in Sandor to support the amortization of the allocated basis over the remaining life of the prepaid interest.

Practical Implications

This decision allows transferee partners to allocate basis to intangible assets, such as prepaid interest, not listed on partnership books when these assets have value and are considered in the purchase price. This can have significant tax planning implications for partnerships and their partners, especially in real estate transactions involving prepaid interest or other intangible assets. The ruling clarifies that such allocations do not result in a double deduction but allow the transferee to recover their additional cost. Practitioners should carefully document the consideration given to such assets in purchase agreements and ensure proper elections under IRC § 754 are made. This case may also influence how partnerships and their partners handle similar transactions in the future, potentially affecting the structuring of partnership interests and the allocation of purchase prices in partnership agreements.

