Neubecker v. Commissioner, 65 T. C. 577 (1975)

A partner cannot recognize a loss upon withdrawal from a partnership unless the partnership terminates and the partner receives a liquidating distribution consisting solely of money, unrealized receivables, or inventory.

Summary

Edward Neubecker, a partner in a law firm, withdrew with another partner to form a new partnership, taking minimal assets. He claimed a loss on his partnership interest due to the difference between his capital account and the value of assets taken. The Tax Court held that no loss was recognizable because the original partnership did not terminate under IRC Section 708 and the distribution did not meet the requirements of Section 731(a)(2) for recognizing a loss. The court also upheld a penalty for late filing of the Neubeckers' tax return.

Facts

Edward Neubecker was a partner in the law firm Frinzi, Catania, and Neubecker until its dissolution in early 1969. He and Catania then formed a new partnership, taking with them only certain physical assets of minimal value and some clients. At dissolution, Neubecker's capital account was $2,425. 57. He claimed a $2,425. 57 loss on his 1969 tax return, asserting it as a short-term capital loss, limited to $1,000 due to statutory restrictions. The Neubeckers filed their 1969 tax return late and were assessed a penalty.

Procedural History

The Commissioner of Internal Revenue disallowed the claimed loss and assessed a late filing penalty. Neubecker petitioned the Tax Court for a redetermination of the deficiency and penalty. The Tax Court found for the Commissioner on both issues.

Issue(s)

1. Whether Neubecker sustained a recognizable loss with respect to his partnership interest in Frinzi, Catania, and Neubecker upon its dissolution.
2. Whether the Neubeckers are liable for the addition to tax for late filing of their 1969 tax return.

Holding

1. No, because the partnership did not terminate under IRC Section 708, and the distribution did not meet the criteria of Section 731(a)(2) for recognizing a loss.
2. Yes, because the Neubeckers failed to carry their burden of proof regarding the late filing penalty under IRC Section 6651(a).

Court's Reasoning

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The court applied IRC Sections 708 and 731(a)(2) to determine whether Neubecker's withdrawal resulted in a recognizable loss. Section 708 distinguishes between dissolution and termination, and since part of the business continued in the new partnership, the original partnership was not considered terminated. The court also found that the distribution to Neubecker did not consist solely of money, unrealized receivables, or inventory as required by Section 731(a)(2). Neubecker's arguments of abandonment or forfeiture loss were dismissed because they did not fit within the framework of subchapter K, and the factual premise that he received nothing was disproven. The court cited previous cases but found them inapplicable due to factual distinctions and the comprehensive nature of the 1954 Code's partnership provisions. For the late filing penalty, the court upheld it because the Neubeckers did not provide evidence to rebut the Commissioner's determination.

Practical Implications

This decision clarifies that a partner cannot recognize a loss upon withdrawal from a partnership unless specific statutory conditions are met. It impacts how partners must structure their withdrawal to achieve tax recognition of losses, emphasizing the importance of formal termination and the nature of distributions. Legal practitioners must advise clients on the tax implications of partnership dissolution and the necessity of meeting statutory requirements for loss recognition. The ruling also serves as a reminder of the burden of proof on taxpayers regarding penalties for late filings. Subsequent cases have followed this ruling, reinforcing its impact on partnership tax law.

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