Moore v. Commissioner, 70 T. C. 1024 (1978)

Retroactive allocation of partnership losses to a partner who was not a member when the losses accrued is prohibited under the Internal Revenue Code.

Summary

John M. and Barbara G. Moore, limited partners in Landmark Park & Associates, sought to deduct their share of losses from Skyline Mobile Home Park after Landmark purchased a partnership interest in Skyline on December 29, 1972. The issue was whether the partnership agreement could retroactively allocate Skyline's entire 1972 losses to Landmark. The U. S. Tax Court held that such retroactive allocation was not permissible under section 706(c)(2)(B) of the Internal Revenue Code, which requires partners' distributive shares to be determined based on their varying interests during the taxable year. The court affirmed the Commissioner's method of calculating the allowable loss for the short period after Landmark's entry into the partnership.

Facts

Skyline Mobile Home Park was a general partnership owned by Sarah and Sam Leake. On December 23, 1972, Landmark Park & Associates agreed to purchase a portion of the Leakes' partnership interest in Skyline, with the transaction completed on December 29, 1972. The agreement included purchasing 45% of the Leakes' capital, 49% of their profit interest, and 100% of their loss interest in Skyline for the 1972 taxable year. Skyline reported a significant loss for 1972, which it allocated entirely to Landmark. John M. and Barbara G. Moore, limited partners in Landmark, attempted to deduct their share of this loss on their personal tax return.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Moores' 1972 federal income tax and disallowed their deduction of the Skyline losses. The Moores petitioned the U. S. Tax Court, which heard the case and issued its opinion on September 19, 1978. The court ruled in favor of the Commissioner, holding that the retroactive allocation of Skyline's losses to Landmark was not permissible under the Internal Revenue Code.

Issue(s)

1. Whether, for federal tax purposes, partners can agree to allocate retroactively partnership losses to a partner who was not a member of the partnership at the time such losses accrued.
2. To what extent was a partnership loss incurred after the admission of a new partner.

Holding

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1. No, because section 706(c)(2)(B) of the Internal Revenue Code prohibits the retroactive allocation of partnership losses to a partner who was not a member when the losses accrued. The court held that the Moores could not deduct their share of Skyline's losses that accrued before Landmark's entry into the partnership.
2. The court sustained the Commissioner's method of calculating the allowable loss for the short period after Landmark's admission into the partnership, but adjusted the calculation to account for 1972 being a leap year.

Court's Reasoning

The court's decision was based on the interpretation of section 706(c)(2)(B) of the Internal Revenue Code, which requires a partner's distributive share to be determined by taking into account their varying interests in the partnership during the taxable year. The court found that allowing retroactive allocation of losses to a partner not a member when the losses accrued would violate the assignment-of-income doctrine, which states that income is taxable to the one who earns it and losses are deductible only by the one who suffers them. The court also relied on the Second Circuit's decision in Rodman v. Commissioner, which held that retroactive allocation of partnership income to a new partner was not permissible. The court rejected the Moores' argument that sections 702(a), 704(a), and 761(c) of the Code allowed for such retroactive allocations, finding that these provisions did not extend to attempted assignments of preadmission losses to new partners. The court also considered the practical implications of allowing retroactive allocations, noting that it would undermine the integrity of the tax system by allowing partners to manipulate their tax liabilities.

Practical Implications

The Moore decision has significant implications for partnership taxation and the structuring of partnership agreements. It clarifies that retroactive allocation of partnership losses to a new partner is not permissible under the Internal Revenue Code, preventing partners from using such allocations to manipulate their tax liabilities. This ruling reinforces the assignment-of-income doctrine and the principle that losses are deductible only by the partner who suffered them. Practitioners must carefully consider the timing of partnership interest transfers and ensure that partnership agreements do not attempt to allocate losses retroactively. The decision also highlights the importance of accurate record-keeping and the need to provide evidence of partnership income and expenses when challenging the Commissioner's determinations. Later cases, such as the Tax Reform Act of 1976, have codified this principle, further solidifying the prohibition on retroactive loss allocations.

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