Long v. Commissioner, 71 T. C. 1 (1978)

An estate can increase its basis in a partnership interest for payments made to satisfy partnership liabilities, even if those payments were also deducted for estate tax purposes.

Summary

Marshall Long, beneficiary of his father's estate, sought to utilize capital loss carryovers from the estate upon its termination. The estate, which succeeded to the decedent's interest in Long Construction Co. , paid off partnership liabilities and deducted these under section 2053 for estate tax purposes. The estate then increased its basis in the partnership interest by these payments, allowing the utilization of partnership losses that were passed to Long. The Tax Court held that the estate could increase its basis upon payment of partnership liabilities, including contingent claims once they were fixed or liquidated, and that section 642(g) did not prohibit this basis increase despite the estate tax deduction.

Facts

John C. Long, a partner in Long Construction Co. , died in 1963, leaving his partnership interest to his estate. At his death, the partnership and its partners had substantial liabilities, including bank loans and lawsuits against the partnership. The estate valued the partnership interest at zero for estate tax purposes but later paid off these liabilities. The estate deducted these payments under section 2053 in computing its estate tax and then increased its basis in the partnership interest for these payments, claiming a capital loss upon liquidation of the partnership. This loss was passed through to Marshall Long, the beneficiary of the estate, who sought to use the loss carryover on his personal tax return.

Procedural History

The Commissioner of Internal Revenue disallowed Marshall Long's claimed loss carryover, leading to a deficiency notice. Long petitioned the U. S. Tax Court, arguing that the estate correctly increased its basis in the partnership interest upon paying the partnership liabilities. The Tax Court addressed the Commissioner's arguments regarding the estate's basis calculations and the double deduction issue.

Issue(s)

1. Whether the estate's payment of partnership liabilities can increase its basis in the partnership interest.
2. Whether the estate's deduction of these payments under section 2053 for estate tax purposes prohibits a basis increase under section 642(g).

Holding

1. Yes, because the estate’s payment of partnership liabilities is treated as an individual assumption of those liabilities under section 752(a), resulting in a basis increase under section 722.
2. No, because section 642(g) only disallows double deductions, not basis adjustments that result in tax benefits.

Court’s Reasoning

The court analyzed the estate’s basis in the partnership interest, starting with its value at John C. Long’s death, which was zero. The court allowed an increase in basis for the estate’s share of partnership liabilities under section 1. 742-1 of the regulations. For contingent liabilities, the court held that these could increase basis once they became fixed or liquidated. The court also treated the estate’s payment of partnership liabilities as an individual assumption of those liabilities, allowing a basis increase under sections 752(a) and 722. The court rejected the Commissioner’s argument that the estate did not assume the liabilities, noting that the estate paid the liabilities from its separate funds. Regarding the double deduction issue, the court clarified that section 642(g) only disallows double deductions, not basis adjustments that result in tax benefits. The court emphasized that estate and income taxes are different in theory and incidence, and Congress has prescribed specific rules for double deductions in section 642(g).

Practical Implications

This decision impacts how estates should calculate their basis in partnership interests when paying off partnership liabilities. Estates can increase their basis for these payments, even if they also deduct them for estate tax purposes, allowing beneficiaries to utilize partnership losses that would otherwise be wasted. Practitioners should carefully calculate basis adjustments and consider the timing of when contingent liabilities become fixed or liquidated. The decision also clarifies that section 642(g) does not prohibit all double tax benefits, only double deductions, which is a crucial distinction for tax planning. Subsequent cases have applied this ruling in similar contexts, reinforcing its importance in estate and partnership tax planning.

