Kimmelman v. Commissioner, 72 T. C. 294 (1979)

Guaranteed payments to partners must meet the requirements of sections 162 and 263 to be deductible, and grapevines are not tangible personal property for additional first-year depreciation.

Summary

Sidney Kimmelman, a limited partner in several partnerships that invested in unprofitable vineyards, challenged the IRS's disallowance of certain deductions. The Tax Court held that the partnerships' guaranteed payments to the general partner for organization and syndication were not deductible as they were capital expenditures. Additionally, the court ruled that grapevines were not tangible personal property eligible for additional first-year depreciation under section 179, though they qualified for investment credit. The case clarified the treatment of guaranteed payments and the classification of grapevines for tax purposes.

Facts

Sidney Kimmelman was a limited partner in five partnerships that invested in real estate improved by unprofitable vineyards in California in 1971 and 1972. Each partnership made a guaranteed payment to the general partner, Occidental Land Research (OLR), for services related to organizing and syndicating the partnerships. The partnerships purchased the land from Occidental Construction Co. , Inc. (OCC), which acted as a nominee until the partnerships were formed. The partnerships attempted to lease the vineyards but were generally unsuccessful, focusing instead on holding the land for future resale. The IRS disallowed deductions for the guaranteed payments and the additional first-year depreciation claimed on the grapevines.

Procedural History

The Commissioner determined deficiencies in Kimmelman's federal income taxes for 1970, 1971, and 1972, leading to a dispute over the deductibility of the partnerships' guaranteed payments and the classification of grapevines as tangible personal property. The case was heard by the United States Tax Court, which issued its opinion on May 9, 1979.

Issue(s)

1. Whether a guaranteed payment under section 707(c) made by a partnership engaged in a trade or business is deductible without meeting the requirements of sections 162 and 263.
2. Whether the guaranteed payments were ordinary and necessary expenses or capital expenditures.
3. Whether grapevines are tangible personal property within the meaning of section 179(d), making them eligible for additional first-year depreciation.

4. What is the fair market value of the grapevines?

Holding

1. No, because guaranteed payments must meet the requirements of sections 162 and 263 to be deductible.
2. No, because the guaranteed payments were capital expenditures related to organizing and syndicating the partnerships.
3. No, because grapevines are not tangible personal property under section 179(d).
4. The fair market value of the grapevines was determined by allocating the actual purchase price between the land, vines, and other improvements proportionally based on the Commissioner's expert's analysis.

Court's Reasoning

The court followed *Cagle v. Commissioner*, which held that guaranteed payments under section 707(c) must meet the requirements of sections 162 and 263 to be deductible. The court found that the payments to OLR were for organizing and syndicating the partnerships, thus capital expenditures not deductible under section 162(a). Regarding the classification of grapevines, the court applied criteria from *Whiteco Industries, Inc. v. Commissioner* and concluded that grapevines were inherently permanent structures, not tangible personal property under section 179(d). The court also assessed the fair market value of the grapevines, rejecting the petitioner's valuation based on the possibility of transplantation as speculative and favoring the Commissioner's expert's analysis based on actual income and comparable sales.

Practical Implications

This decision clarifies that guaranteed payments for partnership organization and syndication must be capitalized, impacting how partnerships structure their agreements and financial reporting. Partnerships should carefully allocate payments between deductible operating expenses and non-deductible capital expenditures. The ruling also affects the tax treatment of agricultural assets like grapevines, confirming they are not eligible for additional first-year depreciation under section 179. Practitioners advising clients on partnership taxation and agricultural investments must consider these rulings when planning and reporting. Subsequent cases have applied these principles in similar contexts, reinforcing the importance of proper classification and valuation of partnership expenses and assets.

