Park Realty Co. v. Commissioner, 77 T. C. 412 (1981)

Payments received by a partner from a partnership for predevelopment costs are treated as non-taxable distributions when the partner contributes the entire property interest to the partnership.

Summary

Park Realty Co. developed a shopping center, incurring $351,575. 11 in costs, and entered into tentative agreements with anchor stores. Due to insufficient financing, Park Realty formed a partnership, transferring its property interest in exchange for a partnership interest. The partnership reimbursed Park Realty $486,619 upon securing binding agreements with the anchor stores. The Tax Court held that the transfer was a non-taxable contribution under IRC § 721, and the reimbursements were non-taxable distributions under IRC § 731, as they did not exceed Park Realty's basis in the partnership.

Facts

Park Realty Co. acquired land in 1968 and began developing a shopping center. By 1974, it had tentative agreements with Sears, Montgomery Ward, and the May Co. to serve as anchor stores. Unable to secure adequate financing, Park Realty formed a partnership with the Springfield Simon Co. , transferring its land and development rights in exchange for a 25% limited partnership interest. The partnership agreement stipulated that Park Realty would be reimbursed $486,619 for its development costs upon the anchor stores executing binding agreements. These agreements were executed in 1975, and the partnership paid Park Realty the agreed amount.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Park Realty for 1972 and 1975, treating the reimbursements as taxable income under IRC § 707(a). Park Realty petitioned the U. S. Tax Court, arguing the payments were non-taxable distributions under IRC § 731. The Tax Court decided in favor of Park Realty, ruling that the transaction was a contribution under IRC § 721 and the reimbursements were distributions under IRC § 731.

Issue(s)

1. Whether the transfer of property by Park Realty to the partnership was a contribution of property under IRC § 721 or a sale under IRC § 707(a).
2. Whether the payments received by Park Realty from the partnership were taxable as proceeds from a sale under IRC § 707(a) or non-taxable distributions under IRC § 731.

Holding

1. No, because the transfer of the entire property interest, including predevelopment costs, was a contribution to the partnership in exchange for a partnership interest under IRC § 721.
2. No, because the payments received by Park Realty were distributions within the purview of IRC § 731, and did not exceed Park Realty's basis in the partnership, thus not taxable.

Court's Reasoning

The Tax Court examined the substance over the form of the transaction. It found that Park Realty's transfer of the entire property interest, including any enhancement from development costs, was a contribution under IRC § 721. The court rejected the Commissioner's argument that the reimbursement for development costs was a separate sale under IRC § 707(a), noting that the development costs were not separable from the land and were not treated as such by the parties. The court emphasized that the payments were contingent upon the anchor stores' agreements, directly benefiting the partnership, and thus were properly treated as distributions under IRC § 731. The court also relied on its previous decisions in *Otey v. Commissioner* and *Barenholtz v. Commissioner* to affirm that the substance of the transaction aligned with its form as a contribution.

Practical Implications

This decision clarifies that when a partner transfers an entire property interest to a partnership, including predevelopment costs, and receives payments contingent upon certain partnership events, those payments are likely to be treated as non-taxable distributions under IRC § 731 rather than taxable proceeds from a sale under IRC § 707(a). Legal practitioners should carefully draft partnership agreements to reflect the intent of contributions rather than sales when structuring similar transactions. This ruling impacts how partnerships and their tax advisors structure deals involving contributions of property with embedded costs, ensuring that such costs are not treated as separate assets for tax purposes. Subsequent cases, such as *Barenholtz*, have distinguished this ruling based on the nature of the transaction, emphasizing the importance of the substance over the form in tax law.

