Abramson v. Commissioner, 86 T. C. 360 (1986)

A limited partner's personal guarantee of a partnership's nonrecourse obligation can increase both the partner's basis and amount at risk in the partnership.

Summary

Edwin Abramson and other partners invested in Surhill Co. , a limited partnership formed to purchase and distribute the film "Submission. " The IRS challenged the tax treatment of losses claimed by the partners, focusing on whether Surhill was operated with a profit motive and if the partners' guarantees of a nonrecourse note could increase their basis and at-risk amounts. The Tax Court found that Surhill was indeed operated for profit, and the partners' personal guarantees of the nonrecourse note allowed them to include their pro rata share in their basis and at-risk amounts. However, the court disallowed depreciation deductions due to insufficient evidence of total forecasted income.

Facts

Edwin Abramson, a certified public accountant, formed Surhill Co. , a New Jersey limited partnership, in 1976 to purchase the U. S. rights to the film "Submission. " Abramson and his corporation, Creative Film Enterprises, Inc. , were the general partners, while several investors were limited partners. Surhill acquired the film for $1. 75 million, payable with $225,000 in cash and a $1. 525 million nonrecourse promissory note due in 10 years, guaranteed by the partners. Surhill entered into a distribution agreement with Joseph Brenner Associates, Inc. , which required exhibition in multiple theaters and included an advance payment. Despite efforts to distribute the film, it did not achieve commercial success.

Procedural History

The IRS issued statutory notices disallowing the partners' share of Surhill's losses, leading to petitions filed with the U. S. Tax Court. The court consolidated the cases of multiple petitioners and addressed the common issue of the tax consequences of their investment in Surhill. The court held hearings and issued its opinion in 1986.

Issue(s)

1. Whether Surhill was organized and operated with an intention to make a profit.
2. If issue (1) is decided affirmatively, whether the partners may include in their basis the amount of a nonrecourse note guaranteed by them.
3. If issue (1) is decided affirmatively, whether Surhill is entitled to an allowance for depreciation under the income forecast method for the tax year 1977.
4. If issue (1) is decided affirmatively, whether the depreciation deductions claimed by Surhill for the years 1977 and 1978 were properly computed in accordance with the income forecast method.
5. If issue (1) is decided affirmatively, whether the partners were at risk under

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section 465 for the amount of the nonrecourse note by reason of their guarantees.

Holding

1. Yes, because the purchase price was determined through arm's-length negotiations and distribution efforts resulted in substantial expenditures, indicating a profit motive.
2. Yes, because the partners' personal guarantees of the nonrecourse note increased their share of the partnership's liabilities, thereby increasing their basis.
3. No, because there was insufficient evidence to support the total forecasted income required for the income forecast method of depreciation.
4. No, because without evidence of total forecasted income, the depreciation deductions could not be properly computed.
5. Yes, because the partners' personal guarantees made them directly liable for their pro rata share of the note, increasing their at-risk amounts.

Court's Reasoning

The court applied the factors from section 183 regulations to determine Surhill's profit motive, focusing on the arm's-length nature of the film's purchase and the substantial efforts to distribute it. The court distinguished this case from Brannen v. Commissioner by noting the good-faith nature of the transaction and the reasonable expectations of profit. For the basis and at-risk issues, the court relied on sections 752 and 465, emphasizing that the partners' personal guarantees created direct liability, allowing them to include their pro rata share in their basis and at-risk amounts. The court also distinguished Pritchett v. Commissioner, where limited partners were not directly liable to the lender. Regarding depreciation, the court adhered to the income forecast method outlined in Revenue Ruling 60-358, disallowing deductions due to lack of evidence on total forecasted income.

Practical Implications

This decision has significant implications for how limited partners' guarantees of partnership liabilities are treated for tax purposes. It clarifies that such guarantees can increase a partner's basis and at-risk amounts, impacting the deductibility of losses. This ruling may influence the structuring of partnership agreements and the use of guarantees in tax planning. The case also underscores the importance of maintaining detailed records and forecasts for depreciation deductions under the income forecast method. Subsequent cases, such as Smith v. Commissioner, have built on this precedent, further defining the treatment of guarantees in partnership tax law.

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