Taube v. Commissioner, 88 T.C. 464 (1987)

A limited partnership's investment in films, financed by a recourse promissory note, was deemed to have a bona fide profit objective and genuine debt, allowing for depreciation deductions and investment tax credits despite projections of tax benefits.

Summary

Petitioners, limited partners in Andrama I, sought deductions and credits from the partnership's purchase of nursing training films. The Tax Court addressed whether the partnership genuinely purchased the films with a profit objective and whether a recourse promissory note constituted genuine debt for depreciation basis. The court held that Andrama I did purchase the films with a bona fide profit motive, evidenced by due diligence, business-like operations, and reasonable profit projections. It further found the recourse note to be genuine debt, includable in the depreciable basis, as the limited partners were personally liable, and the purchase price reflected fair market value at the time of the transaction. The court allowed the interest deductions and investment tax credits claimed by the petitioners.

Facts

Andrama I Partners, Ltd., a limited partnership, was formed in 1979. Petitioners Louis A. Taube and William C. Staib were limited partners. The partnership acquired "all right, title, and interest" in two nursing training films from Andrama Films for $750,000, consisting of cash and a $600,000 recourse promissory note due in 1987. Each limited partner signed an assumption agreement, becoming personally liable for a share of the note. Andrama I licensed ABC to distribute the films. Projections indicated potential profit, though sales were ultimately poor. The IRS challenged deductions and credits, arguing lack of profit motive and that the note was not genuine debt.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' federal income taxes for 1979. Petitioners challenged these deficiencies in the United States Tax Court. The cases were consolidated for trial, briefing, and opinion.

Issue(s)

1. Whether Andrama I purchased an ownership interest in the films.
2. Whether Andrama I entered into the transaction with a bona fide objective to make a profit.
3. Whether the recourse promissory note constituted genuine indebtedness fully includable in determining the films' basis for depreciation.
4. Whether Andrama I was entitled to deduct interest accrued, but not paid, in 1979.

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5. Whether production expenses for purposes of computing Andrama I's investment tax credit basis include amounts incurred, but not paid, in 1979.

Holding

1. Yes, because Andrama I acquired the benefits and burdens of ownership, including the risk of loss, and the transfer of rights was not illusory.
2. Yes, because Andrama I had an actual and honest objective of making a profit, evidenced by due diligence, business-like conduct, and reasonable (at the time) profit projections.
3. Yes, because the recourse promissory note was a genuine, legally enforceable obligation for which the limited partners were personally liable.
4. Yes, because all events had occurred to establish the liability, the amount was reasonably accurate, and repayment was likely at least in 1979.
5. Yes, because the deferred production costs were guaranteed by the recourse note and assumption agreements, and not contingent on future profits.

Court's Reasoning

The court determined Andrama I was the true owner of the films, emphasizing the transfer of "all right, title, and interest," and that Andrama I bore the risk of loss. The court found a bona fide profit objective, noting Kuschner's due diligence, reliance on experts, and business-like operation. The court stated, "the threshhold element in determining whether this requirement has been met is a showing that the activity in question was entered into with 'the actual and honest objective of making a profit.'" Reasonable profit projections at the time of investment, despite later poor performance, supported profit motive. The recourse note was deemed genuine debt because limited partners were personally liable through assumption agreements, and Andrama Films intended to enforce it. The court stated, "Each limited partner executed a legally binding assumption agreement which personally obligated him to pay off his pro rata share of the principal balance of the recourse note…" The purchase price was deemed to reflect fair market value at the time of purchase, based on income and cash flow projections. Accrued interest was deductible as the debt was genuine and repayment was likely in 1979. Deferred production costs were included in the investment tax credit basis because the recourse note guaranteed payment.

Practical Implications

Taube v. Commissioner clarifies the importance of demonstrating a genuine profit motive in tax shelter investments, particularly partnerships. It highlights that courts will assess profit objective at the partnership level, focusing on the general partner's intent and actions at the time of the transaction, not in hindsight. The case reinforces that recourse debt, where investors are genuinely personally liable, can be included in the basis for depreciation and credits, even in tax-sensitive transactions. It underscores the need for due diligence, reasonable projections, and

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business-like conduct to support a profit motive. Later cases distinguish *Taube* by focusing on situations where recourse debt is deemed not genuine or where profit motive is clearly lacking from the outset, often in more abusive tax shelter contexts. This case provides a benchmark for evaluating the economic substance and profit objective of investments challenged by the IRS as tax shelters.

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