Bennion v. Commissioner, 88 T. C. 684 (1987)

A taxpayer is considered at risk with respect to borrowed amounts used in an activity if they are personally and ultimately liable for repayment, even if intermediate creditors in the chain of liability have prohibited interests in the activity.

Summary

In Bennion v. Commissioner, the Tax Court addressed whether a taxpayer, Sam H. Bennion, was at risk regarding his share of a joint venture's debt obligations related to leasing an IBM check sorter. The joint venture assumed a $443,009 obligation from a bank loan and a $41,681 promissory note. The court ruled that Bennion was at risk for his pro rata share of the bank loan because he was ultimately liable to the bank, which had no interest in the activity other than as a creditor. However, Bennion was not at risk for the promissory note because the creditor, Lloyd, had a prohibited interest in the joint venture. The decision hinged on analyzing personal liability and creditor interests at each link in the chain of liability.

Facts

Matrix Computer Funding Corp. purchased three IBM check sorters in 1979, financed by a $1,305,341. 70 loan from the Bank of America. Matrix leased the sorters back to the seller and later sold one to Lloyd in 1980. Lloyd assumed a $443,009 obligation on Matrix's bank loan and gave a $41,681 promissory note. Shortly after, Lloyd sold the check sorter to a joint venture with Sam H. Bennion, who assumed the same obligations. Bennion sought to deduct losses from the joint venture's activities, claiming he was at risk for his share of these debts.

Procedural History

The IRS issued a notice of deficiency to Bennion in 1984, asserting a tax deficiency for 1980. Bennion filed a timely petition with the U. S. Tax Court, challenging the IRS's determination that he was not at risk for the joint venture's debt obligations. The Tax Court heard the case and issued its opinion in 1987.

Issue(s)

1. Whether Bennion was at risk within the meaning of IRC § 465 with respect to his pro rata share of the joint venture's $443,009 obligation on the bank loan.
2. Whether Bennion was at risk within the meaning of IRC § 465 with respect to his pro rata share of the joint venture's $41,681 promissory note obligation to Lloyd.

Holding

1. Yes, because Bennion was personally and ultimately liable for repayment of the bank loan, and the bank had no interest in the activity other than as a creditor.

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2. No, because Lloyd had a prohibited interest in the activity as a member of the joint venture, disqualifying Bennion's at-risk status for the promissory note.

Court's Reasoning

The court applied IRC § 465, which limits losses to amounts for which a taxpayer is at risk. Bennion was deemed at risk for the bank loan because he had ultimate liability for repayment, and the bank was an independent creditor with no other interest in the activity. The court noted that the prohibition on at-risk amounts borrowed from persons with interests other than as creditors must be analyzed at each link in the chain of liability. For the promissory note, Lloyd's interest as a joint venture member was considered a prohibited interest under IRC § 465(b)(3)(A), thus disqualifying Bennion's at-risk status. The court emphasized the policy behind IRC § 465(b)(3)(A) to exclude amounts borrowed from creditors unlikely to act independently due to their other interests in the activity.

Practical Implications

This decision clarifies that taxpayers can be at risk for ultimate debt obligations even if intermediate creditors have prohibited interests, as long as the ultimate creditor is independent. Legal practitioners should carefully analyze each link in the chain of liability when assessing at-risk status. The ruling impacts how joint ventures and partnerships structure debt obligations, ensuring that ultimate creditors have no other interest in the activity to preserve at-risk amounts. This case has been cited in subsequent rulings to support the principle that personal and ultimate liability to an independent creditor can establish at-risk status.

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