Siller Bros. , Inc. v. Commissioner of Internal Revenue, 89 T. C. 256, 1987 U. S. Tax Ct. LEXIS 112, 89 T. C. No. 22 (1987)

A partner must recapture investment tax credit upon liquidation of a partnership, even if continuing the same business, if the basis of distributed assets is not determined by the partnership's basis in those assets.

Summary

Siller Bros. , Inc. , a 50% partner in Tri-Eagle Co. , purchased the other 50% interest from Louisiana-Pacific Corp. , causing the partnership to liquidate. Siller Bros. continued the logging business using Tri-Eagle's investment credit property but incorrectly treated the transaction as an asset purchase rather than a partnership interest purchase. The issue was whether Siller Bros. had to recapture its previously claimed investment tax credits. The U. S. Tax Court held that the partnership must be treated as an entity for recapture purposes, and since the "mere change in form" exception did not apply due to the basis rule, Siller Bros. was required to recapture the credits. This decision clarifies the treatment of partnerships as entities for investment tax credit recapture and the importance of basis rules in determining exceptions.

Facts

Siller Bros. , Inc. and Louisiana-Pacific Corp. each owned a 50% interest in Tri-Eagle Co. , a partnership engaged in logging. From 1975 to 1980, Tri-Eagle purchased property qualifying for investment tax credits, which passed through to the partners. On March 17, 1980, Siller Bros. purchased Louisiana-Pacific's interest for $7. 5 million, causing Tri-Eagle to liquidate under Section 708(b)(1). Siller Bros. continued the business without interruption, using the partnership's investment credit property. Siller Bros. incorrectly treated the transaction as a purchase of 50% of the assets and continued to use Tri-Eagle's basis and depreciation methods, while also amortizing the excess of the purchase price over the basis as a separate item.

Procedural History

The Commissioner determined deficiencies in Siller Bros. ' federal income tax for the years ended April 30, 1978, 1979, and 1980. Most issues were settled, leaving the question of whether Siller Bros. had to recapture investment tax credit after acquiring partnership property in a liquidating distribution. The case was submitted fully stipulated and decided by the U. S. Tax Court, resulting in a ruling that Siller Bros. was required to recapture the investment tax credit.

Issue(s)

1. Whether a partner is required to recapture investment tax credit under Section 47(a)(1) when acquiring partnership property in a liquidating distribution and continuing to use the property in the same business.

2. Whether the “mere change in form” exception under Section 47(b) applies to the transaction, exempting Siller Bros. from recapture.

Holding

1. Yes, because the partnership must be treated as an entity for investment tax credit recapture purposes, and Tri-Eagle disposed of its Section 38 property early, triggering recapture under Section 47(a)(1).
2. No, because the basis of the Section 38 property in Siller Bros. ‘ hands was not determined by reference to Tri-Eagle’s basis in the property, failing to satisfy the requirement under Section 1. 47-3(f)(1)(ii)(d) of the Income Tax Regulations for the “mere change in form” exception.

Court’s Reasoning

The Tax Court held that for investment tax credit recapture, a partnership must be treated as an entity distinct from its partners, citing prior cases like Moradian v. Commissioner and Southern v. Commissioner. The court applied Section 47(a)(1), which mandates recapture when Section 38 property is disposed of early. Regarding the “mere change in form” exception under Section 47(b), the court determined that the basis of the distributed property must be determined by reference to the transferor’s basis, as per Section 1. 47-3(f)(1)(ii)(d) of the Income Tax Regulations. Since Siller Bros. ‘ basis in the distributed property was determined solely by its basis in its partnership interest under Section 732(b), and not by Tri-Eagle’s basis, the exception did not apply. The court rejected Siller Bros. ‘ argument that its basis in the partnership interest was equal to Tri-Eagle’s basis in its assets, clarifying that a partner owns a percentage interest in the entire partnership, not specific assets. The court also upheld the validity of the basis requirement in the regulation, despite its lack of direct alignment with the statutory purpose, following the Sixth Circuit’s reasoning in Long v. United States.

Practical Implications

This decision impacts how partnerships and their partners handle investment tax credit recapture in liquidation scenarios. It emphasizes the importance of treating partnerships as entities for recapture purposes, requiring careful analysis of the basis of distributed assets. Practitioners should note that the “mere change in form” exception is narrowly construed, and the basis of distributed property must directly relate to the partnership’s basis to avoid recapture. This ruling may influence business planning, especially in transactions involving the purchase of partnership interests and subsequent liquidation. Future cases involving similar transactions will need to consider this precedent, and businesses should be cautious about how they structure such deals to avoid unintended tax consequences.

