Citron v. Commissioner, 97 T. C. 200 (1991)

A partner may claim an ordinary loss under IRC section 165 for the abandonment of a partnership interest when no partnership liabilities exist.

Summary

B. Philip Citron invested $60,000 in Vandom Productions, a limited partnership aimed at producing a film. Due to disputes over the film's negative and the subsequent decision to dissolve the partnership without any profits, Citron abandoned his interest. The Tax Court held that this abandonment qualified for an ordinary loss under IRC section 165 since no partnership liabilities existed at the time of abandonment. The court rejected the Commissioner's arguments for treating the loss as capital, emphasizing the absence of a sale, exchange, or distribution. The decision underscores the importance of partnership liabilities in determining the nature of a loss from abandonment.

Facts

B. Philip Citron invested $60,000 in Vandom Productions, a limited partnership formed to produce a film called "Girls of Company C. " The film was completed, but the negative was held by an executive producer, Millionaire Productions, who refused to return it. Vandom retained only a work print unsuitable for commercial release. After failed attempts to retrieve the negative, the limited partners, including Citron, decided not to invest further or participate in an X-rated version of the film. At the end of 1981, Vandom had no profits, liabilities, or assets, and the partners voted to dissolve the partnership. Citron did not expect any further distributions and claimed a $60,000 loss on his 1981 tax return.

Procedural History

The Commissioner issued a notice of deficiency disallowing Citron's claimed loss, asserting it should be treated as a capital loss limited to $3,000. Citron petitioned the U. S. Tax Court, arguing for an ordinary loss due to abandonment or theft. The Tax Court found no theft or embezzlement but allowed an ordinary loss for abandonment, as there were no partnership liabilities at the time of abandonment.

Issue(s)

1. Whether Citron's loss from the Vandom Productions partnership should be characterized as an ordinary loss due to abandonment under IRC section 165.
2. Whether the loss should be characterized as a capital loss due to a deemed sale or exchange under IRC sections 731 and 741.
3. Whether Citron's basis in his partnership interest was reduced by any distributions received.

Holding

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1. Yes, because Citron abandoned his partnership interest without receiving any consideration and no partnership liabilities existed at the time of abandonment.
2. No, because there was no sale or exchange, and the absence of partnership liabilities precluded the application of IRC sections 731 and 741.
3. Yes, Citron's basis was reduced by $6,000 due to interest payments made on his behalf by Vandom, resulting in an adjusted basis of $54,000 and an ordinary loss of that amount.

Court's Reasoning

The court reasoned that abandonment of a partnership interest can result in an ordinary loss under IRC section 165 if no partnership liabilities exist at the time of abandonment. Citron's actions demonstrated an intent to abandon through his refusal to invest further and participation in the partnership's dissolution. The court rejected the Commissioner's argument that the loss should be treated as capital under IRC sections 731 and 741, as these sections require a distribution or sale/exchange, which was absent in this case. The court also determined Citron's basis was reduced by $6,000 due to interest payments made by Vandom, despite no formal obligation to repay these amounts. The dissent argued that Citron's relief from debts owed to Vandom constituted consideration, suggesting a sale or exchange or distribution occurred.

Practical Implications

This decision clarifies that partners can claim ordinary losses for abandoning their interests when no partnership liabilities exist, potentially allowing for more favorable tax treatment. Practitioners should carefully assess partnership liabilities before claiming abandonment losses. The ruling may encourage partnerships to ensure all liabilities are settled before dissolution to avoid disputes over the nature of losses. This case has been cited in subsequent decisions addressing the abandonment of partnership interests, reinforcing the distinction between ordinary and capital losses based on the presence of liabilities.

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