***IPO II v. Comm'r, 122 T. C. 295 (U. S. Tax Court 2004)***

In IPO II v. Comm'r, the U. S. Tax Court ruled that a recourse liability incurred by a partnership must be allocated entirely to the partner who personally guaranteed the loan, rejecting the notion that the liability could be allocated to another partner based on indirect relationships. The court's decision clarified that economic risk of loss must be directly borne by the partner, impacting how recourse liabilities are treated for tax basis purposes in partnerships.

**Parties**

IPO II, a partnership, and Gerald R. Forsythe, its tax matters partner (TMP), were the petitioners. The respondent was the Commissioner of Internal Revenue.

**Facts**

IPO II, treated as a partnership for Federal income tax purposes, was owned by Indeck Overseas Ltd. (Indeck Overseas), an S corporation, and Gerald R. Forsythe (Mr. Forsythe), an individual. Mr. Forsythe owned 100% of Indeck Overseas, 70% of Indeck Energy Services, Inc. (Indeck Energy), and 63% of Indeck Power Equipment Co. (Indeck Power). In 1996, IPO II purchased an aircraft, funding the purchase with a loan from Nationsbanc Leasing Corp. The loan was guaranteed by Mr. Forsythe, Indeck Energy, and Indeck Power, but not by Indeck Overseas. The Commissioner determined that the liability was recourse and fully allocable to Mr. Forsythe. IPO II argued that part of the liability should be allocated to Indeck Overseas due to its relationship with Indeck Energy, which had guaranteed the loan.

**Procedural History**

The Commissioner issued a notice of final partnership administrative adjustment (FPAA) to Mr. Forsythe, as TMP, adjusting IPO II's Federal tax returns for 1998 and 1999. Initially, the Commissioner determined the liability to be nonrecourse, but later conceded it was recourse and fully allocable to Mr. Forsythe. IPO II petitioned the U. S. Tax Court for a redetermination of the adjustments, arguing for partial allocation of the liability to Indeck Overseas. The case was submitted fully stipulated, and the court's decision was rendered based on the stipulations and applicable law.

**Issue(s)**

Whether any of the recourse liability incurred by IPO II with respect to the purchase of an aircraft is allocable to Indeck Overseas, given that Indeck Overseas is related to Indeck Energy, a guarantor of the loan, through common ownership by Mr. Forsythe?

**Rule(s) of Law**

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Under section 752(a) of the Internal Revenue Code, an increase in a partner's share of partnership liabilities is treated as a contribution by the partner to the partnership, increasing the partner's basis in the partnership interest. Section 1. 752-2 of the Income Tax Regulations defines a partnership liability as recourse to the extent that any partner or related person bears the economic risk of loss. The related partner exception in section 1. 752-4(b)(2)(iii) provides that persons owning interests directly or indirectly in the same partnership are not treated as related persons for determining economic risk of loss on partnership liabilities.

**Holding**

The court held that the recourse liability incurred by IPO II with respect to the purchase of the aircraft is fully allocable to Mr. Forsythe and none is allocable to Indeck Overseas. The court reasoned that Indeck Overseas did not directly bear economic risk of loss for the liability, and the related partner exception prevented the attribution of Mr. Forsythe's economic risk of loss to Indeck Overseas through common ownership.

**Reasoning**

The court's reasoning focused on the application of the related partner exception in section 1. 752-4(b)(2)(iii) of the Income Tax Regulations. The court interpreted the exception as preventing the shifting of basis from a party bearing actual economic risk of loss to one who does not. The court found that Mr. Forsythe bore the economic risk of loss through his personal guarantee of the loan, and the related partner exception precluded treating Mr. Forsythe and Indeck Overseas as related persons for purposes of allocating the liability. The court rejected the argument that Indeck Overseas could be considered related to Indeck Energy, a guarantor of the loan, through Mr. Forsythe's common ownership, as this would allow indirect attribution of economic risk of loss, which is not permitted under the regulations. The court emphasized that the allocation of recourse liabilities must be based on direct economic risk of loss, ensuring that tax basis adjustments reflect the actual economic consequences faced by partners.

**Disposition**

The court's decision was to be entered under Rule 155, affirming the Commissioner's determination that the recourse liability was fully allocable to Mr. Forsythe.

**Significance/Impact**

IPO II v. Comm'r is significant for clarifying the allocation of recourse liabilities in partnerships under the Internal Revenue Code and regulations. The decision underscores the importance of direct economic risk of loss in determining liability allocation, preventing the shifting of basis through indirect relationships. This ruling

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impacts how partnerships structure their financing and guarantees, as well as how they report and allocate liabilities for tax purposes. Subsequent cases have followed this precedent, reinforcing the principle that recourse liabilities must be allocated to the partner directly bearing the economic risk of loss. The decision also highlights the need for careful consideration of the related partner exception when structuring partnerships and related entities to avoid unintended tax consequences.

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