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Partnership Terminations – What Changes, What Doesn't, and What is Unclear

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Just as the inevitable events of death and taxes, a partnership will eventually terminate for tax purposes, whether as the result of an actual termination of the legal entity or a deemed termination. Regs. §§301.7701-1(a)(2) and 301.7701-2(c)(1) [1] define a partnership as an unincorporated entity if there are two or more members who carry on a trade, business, financial operation, or venture, and divide the profits. When this definition no longer applies to the partnership, there is a termination of the partnership for tax purposes. This is known as a type A termination because it is a termination under §708(b)(1)(A), or a real termination. Section 708(b)(1)(A) states that a termination occurs where "no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership." This is an actual termination for tax purposes, even though the entity may continue to exist for legal purposes, as Regs. §301.7701-1(a)(1) states that whether a partnership exists is a matter of federal tax law rather than local law.

Another type of termination that occurs for tax purposes is a fictitious termination. Section 708(b)(1)(B) provides that a termination occurs where "within a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits." This is known as a type B termination or technical termination. [2]

REAL TERMINATIONS

Regs. §1.708-1(b)(1) provides that a real or type A termination occurs on the date on which "the winding up of the partnership affairs is completed." These regulations provide an example of a partnership, the partners of which agree in April to dissolve the partnership but carry on the business through a winding-up period ending in September of the same year when all remaining assets, consisting only of cash, are distributed. [3] For tax purposes, the partnership does not terminate because of the cessation of business until September.

For the purpose of the economic effect rules of §704(b), Regs. §1.704-1(b)(2)(ii)(*g*) provides that a partnership liquidation occurs upon the earlier of (i) the date upon which the partnership is terminated under §708(b)(1), or (ii) the date upon which the partnership ceases to be a going concern (even though it may continue in existence for the purpose of winding up its affairs, paying debts, and distributing any remaining balance to its partners).

The IRS takes the position that retaining even a nominal amount of continuing business or financial activity or the holding of any assets will not cause the partnership to terminate for tax purposes. The Ninth Circuit, in *Baker Commodities, Inc. v. Comr.* held that the sale of the primary partnership asset, standing alone, is insufficient to constitute a termination of the partnership. [4] The court stated that cessation of a "primary purpose" is not enough under §708; there must be a "complete cessation of all partnership business." Also, Regs. §1.708-1(b)(1) provides in an example showing that, even if operations are limited to winding up the business, the partnership is not considered terminated until "all remaining assets, consisting only of cash, are distributed" to the partners.

On the other hand, in *Goulder v. U.S.*, the Sixth Circuit held that the retention of some assets to pay anticipated liabilities, after the asset that constituted the partnership's entire business was sold, did not cause the partnership to continue. [5] The court stated: "There is no per se rule that the mere retention of certain assets or management of particular activities in anticipation of liabilities amounts to a continuation of a partnership." Accordingly, the court allowed the partners to claim a loss on liquidation.

In a 2004 case, *Harbor Cove Marina Partners Partnership v. Comr.*, [6] the Tax Court concluded that, while the managing general partner of the partnership may have subjectively intended to terminate the partnership for federal tax purposes, it failed to wind up the partnership's business operation in accordance with the procedures in the partnership agreement, which the partners as a whole had agreed would be applied in such a situation. Thus, the court found that business operations continued after the intended date of termination.

On the other hand, it should be noted that the IRS, in its *Partnership Audit Guide*, Ch. 8, uses the term "zombie partnerships" to describe partnerships that "no longer actively engaged in business but which still wander aimlessly about shedding tax benefits or postponing gain." Thus, in such cases, the retention of nominal assets, business activity, etc., may not cause the partnership to terminate.

Therefore, the liquidation of the partnership for tax purposes may take much more effort than the formation of the partnership. [7]

Another type of real termination is where a multi-member LLC becomes a single-member LLC. Rev. Rul. 99-6 [8] states that the partnership will terminate under §708(b)(1)(A) because the entity no longer has two or more members.

Some partnerships may elect out of the provisions of Subchapter K. There are two types: (i) investment and oil and gas type joint ventures described in Regs. §1.761-2(a)(2) and (3), and (ii) joint ventures between spouses described in §761(f). It appears that such elections would be treated as a §708(b)(1)(A) termination. However, such election out is for purposes of Subchapter K only, thus continuing the application of sections in other subchapters, e.g., depreciation under §168.

TECHNICAL TERMINATIONS

Technical terminations, or type B terminations, occur where there is a "sale or exchange" of 50% or more of the total interest in "capital and profits" within a 12-month period. [9]

There are some situations where there is arguably both a type A and a type B termination. One might make this argument when partners transfer all of their interest to their wholly owned corporation, or where one person in a two-person 50/50 partnership sells his/her interest to the other partner. However, in both situations, the IRS has ruled that the partnership terminates under §708(b)(1)(A). [10]

Not all partnerships are subject to the technical termination rules. Section 774(c) states that §708(b)(1)(B) does not apply to an "electing large partnership." Electing large partnerships are defined in §775 generally as partnerships that have 100 or more partners and make an election to be treated as electing large partnerships.

Although there may be a technical termination for federal tax purposes, that may not be the case for state income tax purposes, because the state may not follow the federal rules in this area. Also, even though the state may provide for technical terminations, what is deemed to occur for state tax purposes may not be the same as what is deemed to occur for federal tax purposes, as discussed below.

MEANING OF “SALE OR EXCHANGE”

Because a “sale or exchange” is required in a technical termination, the first question to be asked where a partnership interest has been transferred is what is meant by the term “sale or exchange.” The term “sale or exchange” is not defined in the Code or the regulations. A sale generally occurs if there is a disposition of property for cash, its equivalent, or the recipient's promise to pay. An exchange ordinarily implies a reciprocal transfer of assets other than cash, its equivalent, or the recipient's promise to pay. [11] There is no definition for §708 purposes.

However, the following transfers of interests are *not* “sales and exchanges”: [12]

- dispositions by gift (including assignment to a successor in interest), bequest, or inheritance;
- liquidations of an interest; and
- contributions of property to a partnership for an interest.

As to gifts, there is a possibility that the transfer could be part gift and part sale under Regs. §1.1001-1(e) where the basis of the interest gifted includes a share of partnership debt. [13] As to liquidations of an interest, even a partial liquidation of an interest is not a sale or exchange for §708 purposes. [14]

Contributions of partnership interests to other entities are considered “sales and exchanges.” This includes transfers to another partnership [15] as well as transfers to a corporation. [16]

Also, according to §761(e)(1), distributions of partnership interests are treated as exchanges for purposes of §708. This provision states that distributions of partnership interests are also exchanges for purposes of §743, dealing with adjustment of basis of partnership property in connection with sales and exchanges of interests and death partners, and for purposes of “any other provision of Subchapter K specified in regulations.” Regs. §1.761-1(e) does add that as to technical terminations, the deemed distribution of an interest in a new partnership by the partnership that terminates is not a sale or exchange of an interest in a partnership. But it adds that the deemed distribution of an interest in a new partnership by a partnership that terminates is treated as an exchange of the interest in the new partnership for purposes of §743.

As noted above, the regulations under §708(b)(1)(B) provide that the liquidation of a partnership interest is not a sale or exchange. [17] These regulations do not define “liquidation,” but Regs. §1.761-1(d) defines the term “liquidation of a partner's interest” as the termination of a partner's entire interest by means of a distribution or a series of distributions. Where the distribution is made over a period of time, the interest is not considered liquidated until the final distribution. This is also stated in Regs. §1.736-1(a)(1)(ii), dealing with payments to a retiring partner or a deceased partner's successor in interest. Regs. §1.708-1(b)(1)(i) does state that, upon the death of a two-person partnership, the partnership will remain in existence for tax purposes if the estate or successor in interest continues to share in the profits and losses of the partnership.

In Rev. Rul. 84-52, [18] the IRS ruled that the conversion of a general partnership interest to a limited partnership interest in the same partnership is not a sale or exchange. Likewise, in Rev. Ruls. 95-37 [19] and 95-55, [20] the IRS ruled that the conversion of an interest in a domestic partnership to an interest in a domestic LLC is not a sale or exchange.

As to tiered partnerships, Regs. §1.708-1(b)(2) makes clear that a sale or exchange of an interest in an upper-tier partnership will be treated as a sale or exchange of the upper-tier's interest in the lower-tier partnership, but only if there is a termination of the upper-tier partnership. [21] If the lower-tier entity is a single-member LLC, there is no impact on the single-member LLC, as it is disregarded for federal tax purposes.

Although Regs. §1.708-1(b)(2) states that contributions of property to a partnership in exchange for an interest are not sales and exchanges, there are some exceptions. Regs. §1.708-1(b)(2) states that this rule is subject to Regs. §1.731-1(c)(3), which addresses disguised sales of property that are covered by §707(a)(2)(B). Also, according to PLR 8444069, the issuance of an interest in a partnership in exchange for debt, such as addressed in §108(e)(8), is a sale or exchange for purposes of §708(b)(1)(B).

Transfers of interests between spouses should not be sales or exchanges. Section 1041 deals with transfers of property between spouses or incident to divorce. Section 1041(b)(1) states that, "for purposes of this subtitle," transfers between spouses shall be treated as acquired by the transferee by gift. "This subtitle" refers to Subtitle A, Income Taxes, of Title 26, which is the Internal Revenue Code. Thus, §708 is under Subtitle A. Because gifts are explicitly excluded from "sale or exchange" treatment as used in §708(b)(1)(B), transfers between spouses are not sales and exchanges. But what if the spouses subsequently divorce, and one spouse transfers his or her interest to a new spouse? Will this be covered by §1041? There is no guidance.

Is an abandonment of a partnership interest a sale or exchange? As noted above, the answer depends on whether the transferor has received consideration. In the partnership setting, because nonrecourse liabilities of the partnership are included in a partner's basis, an abandonment of a partnership interest will "relieve" the abandoning partners of his share of nonrecourse liabilities resulting in consideration being received. Therefore, in such situations, a sale or exchange will occur for purposes of §708(b)(1)(B). [22]

Is a foreclosure of an interest a sale or exchange? It would seem that §1001 would apply, causing such foreclosure to be a sale or exchange. [23]

Apparently, the bankruptcy of a partnership does not cause a termination of the partnership, as §1399 states that "no separate taxable entity shall result from the commencement of a case under title 11 of the United States Code." Furthermore, §1398(f)(1) and (2) clarify this by stating that transfers to or from a bankruptcy estate is not a "disposition" for purposes of the Internal Revenue Code.

Meaning of "Capital and Profits"

Because a technical termination occurs when there has been a sale or exchange of capital and profits, the next question to be answered is what is meant by capital and profits. Note that the Code states capital *and* profits, not capital *or* profits (emphasis added). [24] The regulations clearly reflect this conjunctive Code language, stating that the sale of a 30% interest in capital and a 60% interest in profits is not the sale or exchange of 50% or more of capital and profits. [25] But how is capital determined? Is capital determined using GAAP, tax, or capital accounts maintained under Regs. §1.704-1(b)(2)(iv)? Although not stated, capital is most likely determined under the §704(b) rules, as those rules attempt to track the economics of the parties. Regs. §1.704-1(e)(1)(v) states that, for purposes of §704(e), a capital interest means an interest in the assets of the partnership, which is distributable to the owner of the capital interest upon his withdrawal from the partnership or upon liquidation of the partnership. Thus, a hypothetical test is used. Such a test is used to distinguish a capital interest from a profits interest in connection with the transfer of an interest for services under Rev. Proc. 93-27. [26] In a recent case, *TIFD III-E Inc. v. U.S.* (*Castle Harbour*), [27] the court stated that, in determining whether a party to a partnership is a capital interest holder or a profits interest holder, courts have applied a hypothetical liquidation test.

In determining the percentage of capital to be reported on a partner's Schedule K-1 to Form 1065, the 2008 instructions instruct the taxpayer to enter the portion of the capital that the partner would receive if the partnership were liquidated by the distribution of undivided interests in partnership assets and liabilities. The instructions also state that if the partnership agreement does not express the partner's share of capital as a fixed percentage, the partnership may use any reasonable method, as long as the method is consistent with the partnership agreement and is applied consistently from year to year.

Because a technical termination also requires a sale or exchange of a profits interest, how is a partner's profits interest to be determined? Is it the partner's profit percentage for the year of transfer or over the projected life of the partnership? Are a partner's §704(c)(1)(A) gains (or losses) related to any contributed property, or reverse §704(c) due to revaluations, taken into account?

For purposes of allocating nonrecourse debt under Regs. §1.752-3(a), Tier Three liabilities are allocated based on the partners' profit interest. Regs. §1.752-3(a) states: “The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners.” Thus, could the interest in profits be determined by projecting the allocation of profits under the agreement over the estimated life of the partnership based on reasonable assumptions? This would be taking into account “all the facts and circumstances.”

The regulation mentions several methods that could be used, some taking into account built-in gains (and losses) under §704(c)(1)(A). Rev. Rul. 95-41 [28] permits the use of §704(c) gain for purposes of allocating liabilities under Tier Three of Regs. §1.752-3(a). However, the use of built-in gains under §704(c) is somewhat limited when determining a partner's share of nonrecourse debt for purposes of the disguised sale rules in Regs. §1.707-5(a)(2)(ii).

Thus, it is not clear exactly how a partner's profit percentage is to be determined for purposes of §708(b)(1)(B).

Regs. §1.707-1(c) makes clear that guaranteed payments do not constitute an interest in partnership profits for purposes of §708.

In determining the percentage of capital to be reported on a partner's Schedule K-1 of Form 1065, the 2008 instructions say that if the partnership agreement does not express the partner's share of profit, loss, and capital as fixed percentages, the partnership may use a reasonable method as long as such method is consistent with the partnership agreement and is applied consistently from year to year.

Note that regarding certain foreign entities, those that were not treated as corporations and were grandfathered when the check-the-box regulations were adopted, no longer enjoy the grandfather status where there is a termination of the entity under §708(b)(1)(B). [29] But what is interesting is that this regulation, when referring to §708(b)(1)(B), describes it parenthetically as a sale or exchange of 50% or more of the total interest in an entity's capital “or” profits within 12 months. As noted above, §708(b)(1)(B) states capital “and” profits.

Sales and Exchanges Within 12 Months

Section 708(b)(1)(B) concerns sales and exchanges of 50% or more of the capital and profits within a 12-month period. This is not necessarily within a calendar year but rather is any 12 consecutive months. When interests are transferred on different dates, the interests are added.

A transfer of the same interest more than once in a 12-month period is counted only once. Thus, if A sells its 30% interest on January 1, 2009 to D, who then sells the interest to E on August 1, 2009, there is no sale or exchange of 50% or more within 12 months. But if B sells a 30% interest on March 1, 2010 to C, there is a 60% change within 12 months ending on March 1, 2010.

But assume that A owns a 50% interest in the ABC partnership. In March 2009, A purchases a 40% interest from partner B; then in October 2009, A sells a 30% interest to D. The purchase of the 40% interest from B in March does not terminate the partnership. But will A's sale of a 30% interest to D in October terminate the partnership? Or is the 30% coming solely out of the 40% purchased in March so that it is not counted as a transfer and will not cause a termination? Or is the 30% coming out of the combination of A's initial 50% plus the 40% purchased in March, thus causing a technical termination? The answer is not clear. One possible way to analyze this is based on the IRS's position that a partner has only one basis in his interest, based on Rev. Rul. 84-53. [30] Using this approach, A may be deemed to have sold a portion of his original interest and the interest purchased in March. On the other hand, under Regs. §1.1223-3, a partner can have multiple holding periods for interests acquired. Under this approach, perhaps the interest sold in October could be traced to the interest purchased in March.

What Is Deemed to Occur in a Technical Termination

When a technical termination occurs, Regs. §1.708-1(b)(4) states that the following is deemed to occur: The assets and liabilities of the partnership are contributed to a deemed new partnership in exchange for an interest in the new partnership, followed by a distribution of the interest in the new partnership to the transferee of the interest that caused the technical termination and the remaining partners. These regulations were issued in 1997. [31]

These regulations ignore the momentary ownership by the terminating partnership of 100% of the interests in the deemed new partnership; otherwise the deemed new partnership would not be a partnership for a period of time, as the deemed new entity would be a single-member entity and thus disregarded.

Before the above regulation was issued, the regulations stated that the assets and liabilities of the old terminated partnership were deemed to be distributed to the transferee and the remaining partners who then contributed the assets and liabilities to the deemed new partnership.

CONSEQUENCES OF A TECHNICAL TERMINATION

The consequences of a technical termination can be grouped into three categories: items that do not change, items that do change, and items with respect to which it is not clear.

Items That Do Not Change

Surprisingly, there are a number of items that do not change, and the regulations are very clear on these.

Practitioners often are concerned that a technical termination will cause deficit capital accounts to be triggered as gain. Only in rare situations would this occur. Generally, the partners' share of partnership liabilities remain the same before and after the termination, so there is no shifting of liabilities that could cause a deemed distribution of cash under §752 in excess of the partner's tax basis that could result in gain under §731(a).

Surprisingly, even though a new partnership is deemed created, the partnership's employer identification number (EIN) for the deemed new partnership remains the same as the EIN of the deemed terminated partnership. [32]

There is also no change in basis of the assets of the partnership. Under §722, the basis of property contributed to a partnership is the basis of the property to the contributing partner plus any gain recognized under §721(b) relating to investment partnerships. Thus, the basis of the assets to the terminated partnership will carry over to the deemed new partnership. This is clearly illustrated in the example in Regs. §1.708-1(b)(4). Likewise, the holding period carries over under §735(b) and §1223(2).

Regs. §1.743-1(h)(1) explicitly provides that a partner's basis adjustment in partnership property in the deemed terminated partnership will carry over to the deemed new partnership, regardless of whether the new partnership makes a §754 election.

As to capital accounts maintained under Regs. §1.704-1(b)(2)(iv), according to Regs. §1.704-1(b)(5), Example 13(v), the deemed termination of the old partnership and the deemed contribution to the new partnership are disregarded for purposes of the capital account maintenance. Thus, there is no need to revalue capital accounts.

Under §704(c)(1)(A), where property is contributed to a partnership where the tax basis and value are different, this difference must be accounted for in determining income, gain, or loss. However, according to Regs. §1.704-3(a)(3)(i), no new §704(c) layer is created as a result of the deemed contribution. Nevertheless, it should be noted that if the transferor partner had contributed §704(c) property, the transferee partner would take the interest subject to the §704(c) component, but a §754 election would neutralize the impact of the §704(c) allocations under Regs. §1.704-3(a)(6)(ii) and Regs. §1.743-1(d)(1).

In the technical termination fiction, there is a deemed contribution and a deemed distribution; therefore, the disguised sale of property rules of §704(c)(1)(B) and §737 could apply, which could cause gain in some situations where the contribution/distribution occurs within seven years. However, Regs. §1.704-4(c)(3) clearly states that §704(c)(1)(B) does not apply to deemed distributions of interests in a new partnership caused by the termination of a partnership under §708(b)(1)(B). Regs. §1.704-4(a)(4)(ii) requires that a termination of a partnership under §708(b)(1)(B) does not begin a new seven-year period [33] with respect to the built-in gain or loss property. Also, Regs. §1.737-2(a) expressly states that §737 does not apply to the deemed distribution of interests in a new partnership caused by a technical termination. This regulation does state that a subsequent distribution of property by the new partnership to a partner of the new partnership that was formerly a partner in the terminated partnership is subject to §737.

Likewise, the disguised sale rules of §707(a)(2)(B) do not apply to transfers resulting from a technical termination. [34]

The regulations under §752, addressing the allocation of partnership liabilities among the partners, apply in general to liabilities incurred after certain dates specified in Regs. §1.752-5(a). Regs. §1.752-5(c) states that a technical termination will not cause partnership liabilities incurred or assumed before the termination to be treated as incurred or assumed on the date of termination. Thus, in this case, the liabilities are “grandfathered.”

Regarding what is known as -7 liabilities (generally, liabilities that do not create basis give rise to an immediate deduction or a nondeductible expense, and thus create built-in losses), Regs. §1.752-7(b)(4)(ii) states that, in determining whether a deemed contribution of assets and assumption of liability as a result of a technical termination is treated as a -7 liability transfer, only the -7 liabilities that were assumed by the terminating partnership as part of an earlier -7 liability transfer are taken into account, and only to the extent of the remaining built-in loss associated with that -7 liability.

Finally, as to liabilities in general, Regs. §1.752-1(f) provides for the netting of liability increases and decreases resulting from the same transaction. One of the transactions referred to in this regulation is a termination of the partnership under §708(b).

Section 731(c) addresses the treatment of distribution of "marketable securities" as defined in subsection (c)(2). These can include securities other than actively traded securities. Regs. §1.731-2(g)(2) states that a technical termination will be treated as if there is no termination for purposes of §731(c).

Section 741 provides that any gain or loss from the sale of a partnership interest is treated as a gain or loss from the sale of a capital asset, except to the extent of hot assets under §751. Regs. §1.741-1(b) clearly states that §741 will apply even though the sale of an interest results in a technical termination. It goes on to state that §741 will apply even in a two-person partnership where one member sells his interest to the other, or where both members sell their interests to a third party. Actually, Rev. Rul. 99-6 [35] addresses these situations and states that, even though the purchaser is treated as purchasing assets, the selling partner or partners are treated as selling partnership interests.

Regarding the deduction for domestic production activities under §199 ("DPAD"), Regs. §1.199-8(e)(1)(i) provides that, in connection with contributions to corporations under §351 and partnerships under §721, the activities of the transferee do not include the activities of the transferor. However, Regs. §1.199-8(e)(1)(ii) provides that in the case of a technical termination, the transferee partnership is treated as performing the activities performed by the transferor partnership.

Regarding the completed contract method of accounting under §460, Regs. §1.460-4(k) provides guidance for applying these rules in the case of a "mid-contract change in taxpayer" called the "constructive completion" rules. This is defined in part as a distribution of a contract to a partner or a distribution of an interest in a lower-tier partnership that holds such contract. However, Regs. §1.460-4(k)(2)(iv)(A) states that these rules do not apply to a technical termination of the partnership.

If the terminated partnership holds an installment note receivable subject to §453 and §453A, a technical termination should not cause the deferred gain to be accelerated. Section 453B provides that, if an installment note is disposed of, the deferred gain is accelerated. Regs. §1.453-9(c)(2) provides that, where the Code provides for exceptions to the recognition of gain or loss in the case of certain dispositions, no gain or loss shall result "under section 453(d)." This regulation lists contributions of property to a partnership by a partner under §721 as an example of such exceptions. The regulation refers to §453(d), which now applies to elections out of the installment provisions; dispositions are not contained in §453B. Presumably, the exception in the regulation remains applicable.

Although not explicitly stated in the Code or regulations, in connection with like-kind exchanges under §1031, the person relinquishing the property must be the person receiving the replacement property, because the Code and regulations refer to "the taxpayer." However, the

IRS has ruled privately that the replacement property can be received by the deemed new partnership in connection with a technical termination. [36]

Regarding minimum gain under Regs. §1.704-2, the regulations provide an example where a partnership terminates under §708(b)(1)(B), and states that the technical termination will be disregarded for purposes of maintenance of capital accounts and thus does not impact minimum gain.

Technical terminations should have no impact on a TEFRA audit or the status of the Tax Matters Partner for the audited year. The reason given by CCA 200908042 is that the partners, and not the partnership, are the parties to the TEFRA procedures. The CCA cited *Chef's Choice Produce, Ltd. v. Comr.* [37] Also, according to CCA 201004032, released on January 29, 2010, the termination would not apply for purposes of TEFRA because §708 applies "for purposes of this subchapter" and, thus, "arguably" would not apply to the TEFRA subchapter.

The check-the-box regulations of §301.7701-3 address technical terminations. Regs. §301.7701-3(e) states that an entity resulting from a transaction described in §708(b)(1)(B) is a partnership. Thus, an entity classified as a partnership will remain a partnership and will not default to an association.

If a partnership has a deficit restoration obligation (DRO), Regs. §1.704-1(b)(2)(ii)(*c*) requires that the DRO of a partner be satisfied upon the liquidation of the partner's interest. Presumably liquidation of the partner's interest in the terminated partnership does not trigger the DRO. For instance, Regs. §1.704-1(b)(2)(ii)(*b*)(*3*), which addresses obligations to restore deficit capital account balances, applies only after taking into account all capital account adjustments for the partnership under Regs. §1.704-1(b)(2)(iv). Regarding these rules, Regs. §1.704-1(b)(5), Example 13(v), provides that the deemed termination of the old partnership and the deemed contribution to the new partnership are disregarded for purposes of capital account maintenance.

Partners of the terminated partnership may have suspended losses under §469, the passive activity loss rules. Section 469(g) states that, in connection with a fully taxable disposition, any suspended loss is deductible. Will the technical termination result in these suspended losses being deductible in the year of the deemed termination? The answer is "no" because the transfer does not result in a taxable transaction in connection with a technical termination.

Section 1045 provides that, in the case of any sale of "qualified small business stock" held by a taxpayer for more than six months, under certain conditions the gain can be deferred if the taxpayer purchases other qualified stock. Section 1045(b)(2) states that a taxpayer is treated as having purchased any property if the unadjusted basis of such property would be the cost. Thus, if the terminated partnership was the original purchaser of the qualified small business stock, the deemed new partnership should also be treated as the purchaser.

Certain publicly traded partnerships that are traded on an "established securities market" or are "readily tradable on a secondary market" are taxed as corporations under §7704, enacted in 1987. These terms are not defined in §7704 but are defined in regulations effective for years after 1995. Regs. §1.7704-1(l)(2) provides for a transition period. Regs. §1.7704-1(l)(4) provides that a termination of a partnership under §708(b)(1)(B) is disregarded in determining whether a partnership qualified for the transition period. Also, in determining whether a partnership is an existing partnership for purposes of §7704, Regs. §1.7704-2(g)(2)(i) also provides that a technical termination does not by itself terminate the status of an existing partnership.

As to credits, a technical termination has no impact on certain credits, either specifically or under the “mere change in form” exception. Regs. §1.47-3(f) provides that no recapture occurs from a disposition of §38 property by reason of a mere change in form of conducting the business. A mere change in form occurs where the basis of the property to the transferee is determined in whole or in part by the basis of the transferor. [38] Section 38 includes 35 different credits. One of the requirements to meet the change-in-form exception is that the transferor retain a “substantial interest” in the §38 property. Regs. §1.47-3(f)(2) defines a “substantial interest” in the case of a partner as an interest equal to or greater than the partner's interest before the change. Thus, a technical termination of a partnership should be a mere change in form that should not cause credit recapture.

Prop. Regs. §1.45D-1(e)(4), issued on August 8, 2008, addresses the new markets tax credit under §45D (one of the 35 credits under §38), and clearly states: “A termination under section 708(b)(1)(B) of a [community development entity] that is a partnership is not a recapture event.” The reason for this is found in the Preamble to those proposed regulations:

If the terminating partnership is a CDE, because of the deemed distribution of interests in that new partnership to the purchasing partner and the other remaining partners, a recapture event may be triggered under §45D(g)(3)(C) and Regs. §1.45D-1(e)(2)(iii). However, because the sale of a QEI is not a recapture event under §45D(g)(3) and because the remaining partner or partners are not being cashed out, the IRS and the Treasury Department do not believe that the sale of a QEI that causes the termination of a CDE partnership under §708(b)(1)(B) should trigger recapture. Accordingly, the proposed regulations provide that a termination under section 708(b)(1)(B) of a CDE partnership is not a recapture event.

It is interesting that the IRS specifically addressed technical terminations in connection with the new markets credit but has not done so with all of the other 34 credits. Perhaps this is because the new markets credit is one of the newer credits.

Items That Do Change

Regs. §1.708-1(b)(3) clearly states that the partnership taxable's year closes on the date on which the partnership terminates. The regulation refers to Regs. §1.706-1(c)(1), which states that the termination of a partnership is not necessarily governed by the “dissolution, liquidation, etc.” of a partnership under local law. For fiscal year partners, this could cause a bunching of income or loss to the partners.

As a result of a technical termination, depreciation must be restarted, as if all of the assets are being placed in service. Section 168(i)(7)(B) lists transactions in which depreciation methods and lives carry over. [39] These transactions include contributions to partnerships and distributions from partnerships. However, §168(i)(7) (flush language) states that this rule does not apply in the case of a termination of a partnership under §708(b)(1)(B). Thus, a commercial building with a 39-year life having an original cost of $1,000,000 and accumulated depreciation of $333,000 after 13 years would be depreciated by the deemed new partnership based on $667,000 over 39 years. There is no “step into the shoes” concept.

As to qualified or 50% bonus depreciation property, Regs. §1.168(k)-1(b)(5)(iii) states that such property placed in service by the terminated partnership is treated as originally placed in service by the deemed new partnership on the date such property is deemed contributed to the new partnership. [40]

How is depreciation computed in the year of termination by both the terminated partnership and the deemed new partnership, as there are specific rules for dispositions and short tax years? Depreciable assets are subject to various conventions, such as the half-year convention, the mid-month convention, and the mid-quarter convention. The half-year convention treats all property disposed of during the year as disposed of on the midpoint of the year; the mid-month convention, which generally applies to real property, treats all property disposed of during a month as disposed of on the midpoint of the month. The mid-quarter convention treats all property disposed of during the year as disposed of on the midpoint of the quarter. Prop. Regs. §1.168-2(f)(1) addresses the computation of deprecation in connection with short years. However, those regulations were proposed in 1984 and address ACRS property, not MACRS property, which most of the property in use today is.

Although it is clear that the deemed new partnership restarts deprecation based on new lives using the adjusted basis of the property contributed by the terminated partnership, there is confusion as to how to apply the averaging convention rules to the short period returns. [41] Adding to the confusion is the fact that §168(i)(7)(A) addresses the deprecation by the transferee and not the transferor.

Although the impact on depreciation in some areas is unclear, it is not so with amortization under §197. A technical termination does not cause amortization to restart. Regs. §1.197-2(g)(2)(iv) provides that the carryover basis rules of Regs. §1.197-2(g)(2)(ii) apply.

Also, because there is a deemed new partnership, the new partnership must make any elections that it wants, e.g., recurring item under §446(h) and property tax accrual under §461(c). As to an election under §754 to adjust the basis of partnership property, Regs. §1.708-1(b)(5) provides that where there is a technical termination, a §754 election (including a §754 election on its final return) — that is in effect for the taxable year of the terminated partnership in which the sale occurs — applies with respect to the incoming partner. Therefore, the bases of partnership property are adjusted under §743 and §755 before their deemed contribution to the new partnership.

As to elections under §704(c)(1)(A) for methods of accounting for the difference between the basis and value of contributed property, Regs. §1.704-3(a)(2) provides that a new partnership formed as the result of the termination of a partnership under §708(b)(1)(B) is not required to use the same method as the terminated partnership used as to the property deemed contributed to the new partnership. And Regs. §1.704-3(a)(3) provides that property deemed contributed to a new partnership as a result of a technical termination is treated as §704(c) property in the hands of the new partnership only to the extent that the property was §704(c) property in the hands of the terminated partnership immediately before the termination.

Regarding employer qualified pension, profit-sharing and stock bonus plans under §401, Regs. §1.401-10(e)(1) and (2) state that a partnership is considered to be the employer of each of the partners. This regulation also states that a partnership is deemed to be continuing regardless of local law until such time as it is terminated within the meaning of §708. This includes real terminations and technical terminations. Thus, for purposes of §401, a technical termination is not disregarded. This rule is repeated in Regs. §1.401-12(e)(2)(i), relating to determining an employee's period of service.

Areas of Uncertainty

The first area of uncertainty relates to whether a specific group of costs can be deducted by the terminating partnership in the year of termination. These include start-up, organization, syndication, and loan costs.

The deductibility of start-up costs under §195 is unclear. Section 195(b)(2) states that if a “trade or business is completely disposed of by the taxpayer” the unamortized balance is deductible. So the question is whether a transfer of the assets and liabilities to the deemed new partnership is a “disposition” for this purpose. Also, who is “the taxpayer”? On the surface it would appear that the business has been completely disposed of as the transferee is a deemed new partnership (although it retains the same EIN of the transferor). On the other hand, §708(a) opens with “for purposes of this subchapter,” i.e., subchapter K dealing only with partnership; §195 is not a part of subchapter K. As to who is “the taxpayer,” §7701(a)(14) defines “taxpayer” as “any person subject to any internal revenue tax.” Section 7701(a) defines “person” as including a partnership. Although partnerships are not subject to income taxes, they are subject to other taxes such as employment and excise taxes. Therefore, in connection with a technical termination, the terminated partnership could be “the taxpayer.” However, it is not clear because of some the arguments the IRS could make, as discussed below in connection with organizational costs. Because of the uncertainty, in June 2009, both the ABA and the AICPA asked the IRS to addresses this issue.

As to organizational costs, §709(b)(2) states that “in any case in which a partnership is liquidated,” any deferred expenses may be deducted. Regs. §1.709-1(b)(2) states that if there is a “winding up and complete liquidation of the partnership” before the end of the amortization, the unamortized amount is a partnership deduction under §165 in its final year. Does “any case” as used in the Code apply to a technical termination? Unlike a deduction for the remaining balance of amortized start-up costs under §195 that require that a “business” be “completely disposed of,” §709(b)(2) requires that the partnership be “liquidated.” In connection with a technical termination, the partnership that incurred the organizational costs is terminated, so such costs should be deductible. However, the IRS could argue that the deemed new partnership is merely the old partnership's successor. The IRS ruled in Rev. Rul. 70-241 [42] that a corporation could not deduct its unamortized organizational costs under §248 where there was an §368(a)(1)(F) reorganization. Also, the IRS could argue that, because the costs relate to the organization of the partnership, and under local law the partnership did not terminate, the costs created a benefit that continues for the deemed partnership. Thus, as with start-up costs, it is not clear whether a technical termination results in a deduction for the remaining balance of unamortized organization costs. [43] In its June 2009 letter to the IRS, the AICPA asked that guidance be issued here as well.

As to syndication costs under §709, such costs would not be deductible in any case, as the Code clearly states that “no deduction” shall be allowed to the partnership or to the partner for syndication costs. For purposes of both the computation of tax basis and the capital account maintenance rules under §704(b), these costs are to be distributed to the partners in accordance with §705(a)(2)(B) and Regs. §1.704-1(b)(2)(iv)(*b*).

What about the treatment of unamortized loan costs? Courts have held that when a mortgage is prepaid or when the property subject to the mortgage is disposed of, the unamortized loan costs are immediately deductible. [44] In *Longview Hilton Hotel Co. v. Comr.*, a deduction was allowed when the corporation was dissolved and the mortgage was assumed by its shareholders. [45] In Rev. Rul. 86-67, [46] the IRS concluded that a taxpayer's death, corporate dissolution and a sale of mortgage property all terminate the use of loan proceeds and mark the time for the deduction of the unamortized loan costs. In citing several cases, including *Longview*, the IRS said that these cases “are not concerned with the nature of the termination of the taxpayer's liability. Thus, any form of termination of the taxpayer's liability with respect to the related debt should be sufficient to allow deduction of any amortized loan costs.” Based on this statement, it appears that loan costs should be deductible by the terminating partnership, although it is not clear that they are.

Another area of uncertainty is the application of §736, dealing with retirement payments. Section 736 allows partners in certain cases to treat retirement payments as §736(a) payments (generally ordinary income to the partner and deductible by the partnership) or §736(b) payments (generally capital gain to the partner and capitalizable by the partnership). So will the treatment agreed to by the partner and the terminated partnership be recognized by the deemed new partnership? Rev. Rul. 75-154 [47] holds that retirement payments being made to a retired partner under §736(a) would continue to be deductible by the deemed new partnership. This ruling was issued under the old technical termination regulations. Thus, one would think that the same conclusion would be reached by the IRS under the new regulations, especially because the IRS held in PLR 200812012, mentioned above, that in connection with a like-kind exchange under §1031, the replacement property can be received by the deemed new partnership in a technical termination.

Another area of uncertainty is the impact of condemnations under §1033. If the condemned property was owned by the terminated partnership, can the replacement be made by the deemed new partnership? Again, one would think that the IRS would allow the deemed new partnership to be treated as a continuation of the terminated partnership for this purpose, especially based on PLR 200812012 dealing with an exchange under §1031. On the other hand, the requirements of §1033 are in some cases much stricter than those in §1031. [48]

Another area of uncertainty relates to the possible acceleration of deferred income for advance payment for goods and long-term contracts under §451. Regs. §1.451-5(f) provides that acceleration occurs if the taxpayer "ceases to exist in a transaction other than one to which §381(a) applies." Does a technical termination cause the taxpayer to cease to exist? Rev. Proc. 97-27 [49] provides rules for changing one's accounting method. Section 7 of Rev. Proc. 97-27 addresses adjustments under §481 required as a result of a change in an accounting method. Under §481, a taxpayer that ceases business must take the balance of a §481 adjustment into income. Section 7.03(3)(b)(v) of Rev. Proc. 97-27 provides examples of transactions treated as cessation of a business, including where "the assets of a trade or business to which the §481(a) adjustment relates are contributed to a partnership." Because the assets of the terminated partnership are deemed contributed to the new partnership, would this trigger the balance of any §481 adjustment? This too is an area where both the ABA and the AICPA requested guidance from the IRS in June 2009.

Section 724 provides that if inventory is contributed to a partnership, it remains inventory to the partnership for five years even if, as to the business of the partnership, it is not inventory or property held for sale. Presumably the contribution to the deemed new partnership will not cause the five-year period to start over as there would be no policy reason for extending the taint. However, there is no guidance in §724, nor are there regulations under §724.

Section 1202 provides a partial exclusion for gain from certain "small business stock." One of the requirements for such stock is that the seller generally must be the original holder of the stock. Section 1202(h) provides exceptions for certain tax-free transfers. Paragraph (2) lists transfers by gift, at death, and "from a partnership to a partner." Regs. §1.1202-2(d) provides additional guidance for transfers in connection with death, divorce, and disability and mental incompetency. There is no guidance on stock contributed to a partnership, which would be the case in connection with a technical termination. This area remains unclear as well.

Likewise, the application of §1244, which provides for ordinary loss treatment on §1244 stock, is unclear. Section 1244 applies only to the individual or partnership to whom the stock is issued by the corporation. Accordingly, Regs. §1.1244-1(b)(2) states that ordinary loss treatment is not available to a partner to whom the stock is distributed by a partnership. Nothing is said in the regulation regarding stock acquired by a partnership from a contribution of the stock by a partner. Therefore, it is unclear whether the deemed new partnership would be entitled to ordinary loss treatment on §1244 stock sold. There is no original cost basis rule for either §1202 or §1045, as there is for the gain deferral for qualified small business stock in §1245(b)(2).

Finally, as discussed earlier, there is some uncertainty in how depreciation is to be computed in the year of termination for both the terminated partnership and the deemed new partnership under the various averaging conventions.

TAX RETURNS IN YEAR OF TERMINATION

Generally, two short year returns will be required for the year of termination: the first one covering from the beginning of the partnership's year and ending on the date of termination as required under §443(a)(2), Regs. §1.706-1(c)(1), and Regs. §1.708-1(b)(3); the second one covering from the date of termination to the partnership's required year-end under §706(b). Beginning with the 2008 Form 1065, the IRS added a box to check on page one of the Form 1065 for technical terminations. The instructions also instruct, along with checking the technical termination box, to check the box for either an initial return (for the deemed new partnership) or a final return (for the terminated partnership).

As noted above, the deemed new partnership is to use the same EIN as the terminated partnership. The IRS issued Notice 2001-5, [50] specifically addressing the technical termination of a partnership in light of the using same EIN.

The short period return of the terminated partnership is due the 15th day of the fourth month following the close of the year due to the termination. This is the same due date for any partnership year-end. This can create problems for publicly traded partnerships where it is often difficult to determine whether the same units or different units are being traded, which can delay the determination of whether a technical termination has occurred. In June 2009, the AICPA requested that the IRS either grant optional relief from the technical termination rules for publicly traded partnerships or provide that the short period return of the terminated partnership be due at the time the deemed new partnership's return is due. In addition, it asked that only one set of Schedule K-1s be filed rather than one set for the terminated partnership and one set for the new partnership. [51]

A question often raised by preparers is how to show the capital accounts and balance sheet on the final return. Should the ending balances reflect zero or the balances immediately before the termination? There is no guidance in the instructions to the Form 1065. One preparer source states that probably the best result is achieved by zeroing out the capital accounts and balance sheet, while providing supplemental schedules that include the balances before the termination. [52]

If the tax return reports zero ending capital accounts and balance sheet, the distribution line for partners' capital will have to show an amount to get to zero. Because this would be a deemed distribution, as opposed to an actual distribution, consideration should be given to providing the partners with a statement of some type, especially if actual distributions have been made to the partners during the short period.

There is also a question among preparers as to what to report in the capital accounts and on the balance sheet of the deemed new partnership. Should the beginning capital and balance sheet be zero, or should they report the carryover of the capital accounts and balance sheet of the terminated partnership? Again, neither the regulations nor the Instructions to Form 1065 provide guidance. Perhaps a statement of some type should be attached.

The authors of this article disagree that the ending and beginning balance sheet and capital accounts should be zeroed out on the deemed terminated and new partnership returns, respectively. The logic of retaining the balances immediately before and after the termination is more consistent with the regulatory language of the capital account maintenance rules discussed earlier, in the DRO area of this article.

As to terminations under Rev. Rul. 99-6, where the partnership is terminated when the interest or interests is acquired by one member, causing a real termination under §708(b)(1)(A), the capital accounts and balance sheets should be zeroed out, as there is a real termination.

Neither the regulations nor the instructions to Form 1065 provide for any statements to be attached to a terminated partnership. However, it is possible that a statement should be included stating the fact and date of the transaction that caused the technical termination. There is also no requirement in the regulations or instructions that the partners attach a statement.

Form 8308, Report of a Sale or Exchange of Certain Partnership Interests, must be attached where the partnership has so-called "hot assets" defined in §751, which are ordinary-income-type assets. This would be attached to the return of the terminating partnership. The partnership must also furnish this form to both the transferor and transferee partner. The transferor partner must attach a statement to his or her return. [53]

AVOIDING A TECHNICAL TERMINATION

Because a technical termination occurs when there is a sale or exchange of 50% or more of the interest in capital and profits within a 12-month period, there are several variables to work with in order to avoid a technical exchange. One is spread the sale or exchange over more than 12 months. In several PLRs, the IRS has allowed a transfer of less than 50% of capital and profits followed by a transfer of the balance after 12 months. [54] These were allowed even though it was in connection with a prearranged plan and thus is an exception to the step-transaction doctrine often applied by the IRS.

Another way to avoid a technical termination is to carefully examine the transferor's capital interest and profit interest. On the surface it may appear that the transferor's interest is 50% or greater, but on close analysis, as discussed earlier in this article, the transferor may not own 50% or greater of both.

Another method may be to transfer one's capital interest or one's profits interest, or some combination thereof, assuming this can be done under local law. [55] However, if the partnership agreement is drafted with allocations based on targeted allocations, it will be difficult, if not impossible, to bifurcate a transfer into a transfer of capital interests and a transfer of profits interests.

Also, a purchase of one's interest might be structured as a redemption, which is not a sale or exchange, according to the regulations. However, there are several other differences between a redemption and a sale of one's interest, and sometimes it is difficult to determine which will be recognized. [56]

Finally, tiered partnerships might be used to avoid a technical termination. Playing off the language in the regulations, if at the time a partnership is being formed, a member holding a 50% or greater interest might dispose of the interest causing a termination, consideration should be given to using a tiered partnership structure. The partnership might be structured so that the to-be-50%-or-greater partner owns a direct interest of less than 50% in the partnership, with the balance of the intended interest held in an upper-tier partnership with the other intended partner or partners. The ownership interest in the upper-tier partnership would be set to give the partner his or her intended ownership through the direct and indirect ownership.

For example, if X and Y intend to form a partnership with X owing 70% and Y owning 30%, the partnership could be structured with X owing a direct interest of 48% with another upper-tier partnership also consisting of X and Y owning 52%. The interest of X in this upper-tier partnership would be set at 42.3%, resulting in X indirectly owning 22% of the lower-tier partnership. Thus, X would own the lower-tier 48% directly and 22% indirectly. When X disposes of his total direct and indirect ownership interests, there would be no technical termination of either partnership even though X has disposed of his 70% interest in the business.

CONCLUSION

Real terminations are distinctively different from fictitious or technical terminations. Tax advisors should therefore choose their words carefully when discussing partnership terminations because of the various differences and consequences. The tax advisor should not jump to any conclusions as to whether a technical termination has occurred. A thorough analysis of the transfer that is believed to cause the termination must be made to determine whether a sale or exchange has actually occurred and, if so, whether it was a sale or exchange of a 50% or more interest in both capital and profits. Once it is determined that a technical termination has occurred, then the advisor must be aware of what is deemed to occur and the consequences. As to the consequences, there are areas that do not change, areas that do change, and areas that are not clear.

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[1] All section references are to the Internal Revenue Code and the regulations thereunder, unless otherwise indicated.

[2] For additional commentary on partnership terminations, see Manning, 718 T.M., *Dispositions of Partnership Interests or Partnership Business; Partnership Termination*, at II. Disposition of Partnership Interests; Partnership Terminations.

[3] In this example, the liquidating distribution consisted of cash only. However, it should be noted that there is no requirement that liquidating distributions consist of cash only.

[4] 415 F.2d 519 (9th Cir. 1969); *see Foxman v. Comr.*, 41 T.C. 535 (1964), *aff'd*, 352 F.2d 466 (3d Cir. 1965).

[5] 64 F.3d 663 (6th Cir. 1995).

[6] 123 T.C. 64 (2004). *See* Cuff, “It Ain't Over ‘Til It's Over: When Partnership Tax Vessels Make Ill—Advised Journeys and Wind-Up at Harbor Cove Manner,” *Business Entities* (Sept./Oct. 2004).

[7] Regs. §1.6031-1(a)(3)(i) provides that a return for a domestic partnership is not required for a taxable year in which the partnership has no income, deductions, or credits for federal income tax purposes. In contrast, a corporation is required to file a return upon incorporation.

[8] 1999-6 I.R.B. 6.

[9] §708(b)(1)(B).

[10] See Rev. Rul. 84-111, 1984-2 C.B. 88, involving three ways to incorporate a partnership, all resulting in a §708(b)(1)(A) termination, and Rev. Rul. 99-6, 1999-6 I.R.B. 6, involving the termination of a two-person partnership.

[11] *See La Rue v. Comr.*, 90 T.C. 465 (1988) (stating that the touchstone for sale or exchange treatment is consideration, and that any consideration, even if nominal in amount, will cause the transaction to be classified as a sale or exchange). Note that sometimes the term "sale or other disposition" rather than "sale or exchange" is used, e.g., §165(b) and Regs. §1.752-7(b)(8)(iv).

[12] Regs. §1.708-1(b)(2).

[13] *See Robinson v. U.S.*, 88-1 USTC ¶9120 (E.D. Pa. 1987).

[14] Rev. Rul. 92-15, 1992-1 C.B. 215.

[15] *See* PLRs 8116041 and 8229034. *See also* Regs. §1.708-1(b)(2) (if the sale or exchange of an interest in an upper-tier partnership results in a termination of the upper-tier partnership, the upper-tier partnership is treated as exchanging its entire interest in the capital and profits of the lower-tier partnership; if the sale or exchange of an interest in an upper-tier partnership does not terminate the upper-tier partnership, the sale or exchange of an interest in the upper-tier partnership is not treated as a sale or exchange of a proportionate share of the upper-tier partnership's interest in the capital and profits of the lower-tier partnership"). However, in PLR 8819083, the IRS ruled that the contribution of 99% interest in a partnership to an upper-tiered holding partnership was not an exchange where the beneficial ownership interests in the partnership did not change as a result of the contribution. Also, note that Regs. §1.1001-2(a)(4)(iv) states that, for purposes of Regs. §1.1001-2, dealing with discharge of liabilities, contributions and distributions of property between a partner and a partnership are not sales or other dispositions of property.

[16] *See* Rev. Rul. 81-38, 1981-1 C.B. 386 (contribution of a 50% interest in a partnership to a wholly owned subsidiary in a §351 transaction is an exchange under §708(b)(1)(B)); Rev. Rul. 87-110, 1987-2 C.B. 159 (transfer of a partnership interest in a transaction qualifying under §§361 and 368(a)(1) is an exchange for purposes of §708(b)(1)(B); PLR 9209009 (deemed sale of assets resulted from a §338 election).

[17] Regs. §1.708-1(b)(2).

[18] 1984-1 C.B. 157.

[19] 1995-1 C.B. 130.

[20] 1995-2 C.B. 313.

[21] These regulations issued in 1997 incorporate the holdings in Rev. Ruls. 87-50 and 87-51 as to tiered partnerships, obsoleted by T.D. 8717.

[22] If there are no liabilities allocated to the transferor, then an abandonment may not be a sale or exchange. *See Citron v. Comr.*, 97 T.C. 200 (1991). Also, if the only liabilities allocated to the transferor are with recourse to the transferor, and the transferor partner remains liable, then there may be no sale or exchange. *See Weiss v. Comr.*, 956 F.2d 242 (11th Cir. 1992), *vacating and remanding* T.C. Memo 1990-492.

[23] *See also Weiss v. Comr.*, T.C. Memo 1990-492, *vacated and remanded*, 956 F.2d 242 (11th Cir. 1992) (involving the forfeiture of a partnership interest); Rev. Rul. 66-264, 1966-2 C.B. 248 (addressing a transaction recast from a partnership court-ordered asset sale to a partnership interest sale).

[24] Other places in the Code and regulations use the phrase "capital or profits," e.g., §707(b)(3), dealing with transactions between a partner and a partnership, and Regs. §1.1563-3(b)(2), dealing with determining stock ownership.

[25] Regs. §1.708-1(b)(2).

[26] 1993-2 C.B. 343.

[27] 2009-2 USTC ¶50,676 (D. Conn. 2009), *on remand from* 459 F.3d 220 (2d Cir. 2006), *rev'g* 342 F. Supp. 2d 94 (D. Conn. 2004). This case is commonly known as "*Castle Harbour*" because it involved Castle Harbour Limited Liability Company, a partnership set up by the taxpayer. The issue before the court was whether certain Dutch banks were lenders or partners.

[28] 1995-1 C.B. 132.

[29] Regs. §301.7701-2(d)(3)(i)(B).

[30] 1984-1 C.B. 159.

[31] T.D. 8717, 62 Fed. Reg. 25498 (5/9/97), as revised by T.D. 8925, 66 Fed. Reg. 715 (1/4/01). These regulations apply to terminations occurring on or after May 9, 1997. The discussion in this article addresses only these regulations and not the prior regulations, unless otherwise stated.

[32] Regs. §301.6109-1(d)(2)(iii).

[33] The regulation says five-year period, but §704(c)(1)(B) was later amended to increase the five-year period to seven years. The regulation has not yet been amended to conform it to the amended statute.

[34] Regs. §1.707-3(a)(4).

[35] 1999-6 I.R.B. 6.

[36] PLR 200812012.

[37] 95 T.C. 388 (1990).

[38] In *Siller Brothers, Inc. v. Comr.*, 89 T.C. 256 (1987), the court held that recapture occurred when a 50% partner purchased the interest of the other 50% partner. Such a transaction is addressed in Rev. Rul. 99-6, 1999-6 I.R.B. 6.

[39] For a special rule involving New York Liberty Zone property and technical terminations, see Regs. §1.1400L(b)-1(g)(2).

[40] *See also* Regs. §1.168(k)-1(f)(1)(ii) (addressing dispositions of qualified property in the same year the property is placed in service).

[41] For a detailed discussion of these complex and confusing depreciation rules as to terminations, see McKee, Nelson & Whitmire, *Federal Taxation of Partnerships and Partners*, ¶13.05[2][k].

[42] 1970-1 C.B. 84.

[43] If an election has not been made to amortize organization or start-up costs, then the balance of the capitalized costs carry over to the deemed partnership as any other costs. The only deductible costs are those where an election is made.

[44] *See S&L Building Corp. v. Comr.*, 19 B.T.A. 788 (1930) (deduction allowed in year mortgage was assumed by the purchaser of the property). *See also Anover Realty Corp. v. Comr.*, 33 T.C. 671 (1960).

[45] 9 T.C. 180 (1947).

[46] 1986-1 C.B. 2338.

[47] 1975-1 C.B. 186.

[48] For example, in Rev. Rul. 67-25, 1967-1 C.B. 156, the IRS ruled that raw land was not like-kind to a building for purposes of §1033, although these appear to be like-kind under §1031.

[49] 1997-1 C.B. 680.

[50] 2001-3 I.R.B. 327.

[51] The authors understand that at least one region of the IRS has in the past permitted publicly traded partnerships that had a technical termination to file the return for the terminated partnership with the return for the new partnership and provide only one set of K-1s. However, the National Office of the IRS put a stop to such so-called “super extension” treatment.

[52] *PPC 1065 Handbook*, Key Issue 38D; *see also* Illustrations 38-1, 38-2, and 38-3.

[53] Regs. §1.751-1(a)(3).

[54] *See, e.g.*, PLRs 9805017, 9529037 and 9332026.

[55] *See* Banoff, “Mr. Popeil Pushes Partial Partnership Interests Through the Veg-O-Magic: You Can Slice ‘Em, You Can Dice ‘Em, But How Do You Tax ‘Em?” 72 *TAXES* 833 (Dec. 1994).

[56] For a discussion of these areas, see Williford, Sinnett, and Erickson, “Planning for Partnership Distributions with Respect to Redemptions, Withdrawals, Retirements, Dismissals, Expulsions, Terminations, Liquidations, and Deaths of Partners,” Practising Law Institute, 2009 Course Book, *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances*.