

## PROBLEM 24P

Your clients, Steven Able, Bernard Bernstine and Tamarra Charles, received the following ruling in response to a ruling request submitted earlier by Joseph Palko, your partner. The request was submitted while you were away on vacation.

U.S. Treasury Department  
Internal Revenue Service  
Washington, D.C. 20224  
Date: Nov. 19, Year\*  
In Reply Refer to: T:1:1:1:2

Better Craft Homes  
1810 Request Street  
Topnotch, Utah 84774

Gentlemen:

This is in reply to your letter dated March 13, Year,\* requesting a ruling concerning the Federal income tax treatment of the members of your partnership as a result of the transactions described below.

Better Craft Homes is a general partnership organized in Year-7.\* The members of the partnership since its inception are Steven Able, Bernard Bernstine and Tamarra Charles. Able owns a one-half interest in the partnership; Bernstine and Charles each own a one-quarter interest in the partnership. The partnership buys land, improves and subdivides it and sells the lots to customers. The partnership uses the calendar year and the accrual method of accounting. The financial statement of the partnership immediately prior to the proposed transactions follows:

\* See explanatory footnote in Introduction page vii, note 1.

### Assets

	<u>Adjusted Basis</u> (x 1000)	<u>Fair Market Value</u> (x 1000)
Cash	\$ 200	\$ 200
Accounts Receivable	500	500
Plans, Blueprints	40	100
Machinery (net of depreciation)	300	300
Land	<u>720</u>	<u>1,000</u>
Total	\$1,760	\$2,100

### Liabilities and Capital

	<u>Per Books</u> (x 1000)	<u>Fair Market Value</u> (x 1000)
Current Liabilities	\$ 160	\$ 160
Mortgage Liability	300	300
Capital		
Able (50%)	650	820
Bernstine (25%)	325	410
Charles (25%)	<u>325</u>	<u>410</u>
Total	\$1,760	\$2,100

The adjusted bases of the partners in their partnership interests immediately prior to the proposed transactions are as follows: Able — \$880,000; Bernstine — \$440,000; Charles — \$440,000. Even though Able owns a one-half interest in the partnership, he is subject to a very low rate of income tax, whereas Bernstine and Charles are both subject to much higher rates of income tax. A purchaser, Paula Peters, has approached the partners and indicated an interest in acquiring the assets and assuming the liabilities of the partnership.

The partners propose that the partnership use \$160,000 of its cash to pay its current liabilities and then dissolve, distributing its assets and liabilities in the following manner. The partnership will distribute to Able the land subject to the mortgage, the plans and blueprints, and \$20,000 in cash. It will distribute to Bernstine one-half of the accounts receivable, one-half of the machinery and \$10,000 in cash. Charles will receive the same distribution as Bernstine. Able, Bernstine and Charles will retain the cash

distributed. Able will sell the land and the plans and blueprints to Peters, who will assume the mortgage. Bernstine and Charles will sell the accounts receivable and machinery to Peters.

Since the transactions described above amount, in substance, to a disposition of the entire continuing business of the partnership, the transactions will be treated as a sale of a partnership interest by each partner [see *Hatch's Estate v. Commissioner*, 198 F.2d 26 (9th Cir. 1952); *Herbert A. Nieman*, 33 T.C. 411 (1959); *Barran v. Commissioner*, 334 F.2d 58 (5th Cir. 1964); *Kinney v. United States*, 228 F. Supp. 656 (W.D. La. 1964), *aff'd per curiam*, 358 F.2d 738 (5th Cir. 1966); and G.C.M. 26379, 1950-1, C.B. 58]; or as a sale of the assets by the partnership, the purchaser assuming the current liabilities and mortgage liability, followed by a pro rata distribution of the cash held prior to the purchase and that received from the purchaser to the partners in termination of the partnership; or as a pro rata distribution of the assets of the partnership to the partners in termination of the partnership followed by a sale by the partners of the land, plans, blueprints, accounts receivable and machinery to the purchaser in return for cash and the assumption by the purchaser of the current liabilities and mortgage liability [see Rev.Rul. 72-172, 1972-1, C.B. 265]. Accordingly, the income tax result to Able will be a gain of \$170,000, \$30,000 of which will be capital gain and \$140,000 of which will be ordinary income. Bernstine and Charles will each have \$85,000 of gain, \$15,000 of which will be capital gain and \$70,000 of which will be ordinary income.

Very truly yours,

*Jessica Cohen*  
Jessica Cohen  
Chief, Individual  
Income Tax Branch