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RECENT AMENDMENTS OF PARTNERSHIP TAX LAW—COMPLEXITIES PREVENT MEANINGFUL REFORM

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In discussing the partnership provisions of the Internal Revenue Code,[1] Judge Raum of the United States Tax Court observed:

> The distressingly complex and confusing nature of the provisions of subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years of experience in the tax field. . . . Surely a statute has not achieved "simplicity" when its complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries.[2]

Thus, when amendments are made to the provisions of subchapter K, it is interesting to probe into the evils which Congress perceived to be lurking in the partnership tax law and to determine whether or not the legislation was effective to eliminate them. This article will examine the reasons for and the effectiveness of the recent changes in four areas of subchapter K: retroactive allocations, special allocations, limitations on loss deductions, and partnership organization and syndication expenses.

RETROACTIVE ALLOCATIONS

Abuse Perceived

The evil sought to be ended by congress in the area of retroactive partnership allocations can best be illustrated by example.

Suppose, that the XYZ Limited Partnership was formed on January 1, 1976, in order to construct and operate an apartment house.

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1. I.R.C. subchapter K.
2. Foxman v. Commissioner, 41 T.C. 535, 551 n.9 (1964).

During 1976, the partnership incurred a substantial tax loss as a result of deductions for syndication fees, construction interest, taxes and depreciation. At the end of November 1976, after determining that the partnership losses would amount to $150,000, limited partnership interests (or units) were marketed and sold to individual taxpayers, who had by that time determined that they would have high personal income during the year and thus would have large taxes to pay. Assume further that on December 30, 1976, taxpayer A purchased a limited partnership unit entitling him to 10% of the partnership losses. On that same day, the partnership agreement was modified to admit A as a limited partner and to allocate 10% of the partnership loss ($15,000) to A, treating A as if he had been a partner during the entire calendar year of 1976. Although: (1) all deductible expenses of the partnership had been paid prior to A's entry; and (2) although A was a limited partner for only one full day in 1976, A would be entitled to share in the partnership losses just as if he had been a partner for the complete partnership year. In other words, 10% of the deductible expenses of the partnership would be allocated to A, retroactively to the first day of the taxable year. This is known as "retroactive allocations of partnership losses."

Authority for Retroactive Allocations under Old Law

Prior to the Tax Reform Act of 1976[3] the partnership provisions of the Internal Revenue Code of 1954 seemed to permit retroactive allocations. Section 704(a) stated that a partner's share of partnership income or loss was to be determined by the partnership agreement.[4] The term "partnership agreement" was defined by section 761(c) as including any modification of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year.[5] Thus, if a partnership agreement were amended, either on the last day of the taxable year, or thereafter, as long as the modification was not made *later* than the time for filing of the partnership income tax return, the combination of section 704(a) and section 761(c) seemed to permit the modification of the partnership agreement in order to admit a new partner and to retroactively allocate partnership losses to him for

3. Pub. L. No. 94-455, 90 Stat. 1520 (1976).
4. Int. Rev. Code of 1954, ch. 1, § 704(a), 68A Stat. 239 (now I.R.C. § 704(a)).
5. Int. Rev. Code of 1954, ch. 1, § 761(c), 68A Stat. 252-53 (now I.R.C. § 761(c)).

the entire taxable year. The only limitation on the foregoing was contained in section 704(b)(2), which provided that in the event the principal purpose of any provision of the partnership agreement respecting a partner's distributive share of any *item* of income, gain, loss, deduction, or credit was the avoidance or evasion of any Internal Revenue tax, then in such event the partner's distributive share of such *item* would be determined in accordance with his distributive share of taxable income or loss of the partnership.[6] However, the use of the word "item" without including the composite of taxable income or loss of the partnership apparently limited the application of section 704(b)(2) to special allocations of certain *items* of income or deduction as permitted by section 704(a) and the Treasury regulations thereunder[7] rather than to the aggregate of taxable income or loss, under section 702(a)(9).[8] This position was enforced by dicta in *Kresser v. Commissioner.*[9] There, the taxpayer was a partner in two real estate ventures, both of which were dominated by a man named Appleton. In December 1965, by oral amendment of the partnership agreement, Appleton was retroactively allocated all of the partnership income for the year in order to prevent his loss of a large personal net operating loss carry-over from former years.[10]

The Tax Court held that the evidence presented to it was insufficient to prove a bona fide modification of the partnership agreement under section 761(c), and thus the court was not required to squarely face the issue of whether the special allocation was barred by the tax avoidance or evasion rule of section 704(b)(2).[11] However, in a note to the opinion, the court implied that the "avoidance or evasion" rule of section 704(b)(2) was inapplicable to retroactive allocations of the aggregate of partnership taxable income.[12]

Retroactive allocations, not involving the "evasion or avoidance" rule of section 704(b)(2) were clearly permitted where retroactive allocations did not involve new partners.[13] However, where new partners entered and retroactive allocations were made, the law was unclear. The entrance of new partners into a partnership necessarily diminishes the percentage partnership interests of the original part-

6. Int. Rev. Code of 1954, ch. 1, § 704(b)(2), 68A Stat. 240 (now I.R.C. § 704(b)(2)).
7. Treas. Reg. § 1.704-1(a) (1964).
8. Int. Rev. Code of 1954, ch. 1, § 702(a)(9), 68A Stat. 239 (now I.R.C. § 702(a)(8)).
9. 54 T.C. 1621 (1970).
10. *Id.* at 1631-32.
11. *Id.* at 1632.
12. *Id.* at 1631 n.5.
13. Smith v. Commissioner, 331 F.2d 298 (7th Cir. 1964).

ners, whether such original partners stay on as partners in an enlarged partnership or whether such original partners dispose of their entire interests in the partnership.[14] In the latter case, section 706(c)(2)(A)(i) provided that the partnership taxable year closed with respect to such old partner.[15] The retiring partner was required to include his distributive share of the partnership operations up to the date of sale and the new partner was required to include his distributive share of the partnership operations, commencing on the date of his entrance.[16] Where a partner disposed of only a portion of his partnership interest to a new partner, section 706(c)(2)(B) required the old partner to determine his distributive share of partnership income or loss "by taking into account his varying interests in the partnership during the taxable year."[17]

Where a new partner purchased his partnership interest from the partnership directly, the law was ambiguous. If the old partners' partnership interests were deemed to be "reduced", as undoubtedly they were,[18] then the rule of section 706(c)(2)(B) required each of the old partners to take into account their varying interests in the partnership during the taxable year. However, because of the language of section 704(a), the provisions of section 706(c)(2)(B) seemingly were inferior to the rule of section 704(a). Specifically, section 704 stated that a partner's distributive share of partnership income or loss was to be determined by the partnership agreement, "except as otherwise provided in this *section*".[19] Thus, because the "varying interests rule" of section 706(c)(2)(B) was included in a different

14. Suppose A is a limited partner in the A-B limited partnership. Assuming that the partnership agreement provides that profits and losses are distributed 50-50 to the general and limited partners, the entrance of C as a limited partner entitled to share in 20% of partnership profits and losses would necessarily reduce A's share to 30%. This would be true, regardless of whether A sold a portion of his limited partnership interest to C directly, or whether C purchased the interest from the partnership.

15. I.R.C. § 706(c)(2)(A)(i) states:

(c) **Closing of partnership year.—**

. . . .

(2) **Partner who retires or sells interest in partnership.—**

(A) **Disposition of entire interest.—**The taxable year of a partnership shall close—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership. . . .

16. Treas. Reg. § 1.706-1(c)(2) (1956).

17. Int. Rev. Code of 1954, ch. 1, § 706(c)(2)(B), 68A Stat. 243 (now I.R.C. § 706(c)(2)(B)).

18. Treas. Reg. § 1.704-1(a) (1964).

19. Int. Rev. Code of 1954, ch. 1, § 704(a), 68A Stat. 240 (now I.R.C. § 704(a)).

"section," the general rule of section 704(a) necessarily controlled. Such was the holding of the tax court in the case of *Rodman v. Commissioner.*[20] It was on authority such as this that limited partnership interests, which contemplated retroactive allocations of partnership losses were marketed in the closing months of each taxable year.[21]

Changes Caused by Tax Reform Act of 1976

Section 213 of the Tax Reform Act of 1976[22] amended sections 704(a), 704(b)(2), and 706(c)(2)(B) of the Code in such a manner as to effectively prohibit the allocation to an entering partner of losses incurred prior to such partner's entrance into the partnership. Briefly, the changes in each of the sections are as follows:

1. Section 704(a) was amended by the change of one word. The word "chapter" was substituted for the word "section" in order to make it clear that the terms of the partnership agreement would not control if other provisions of the Code limited the application of the partnership agreement.[23]

2. Section 704(b)(2) was amended to specifically apply the "tax avoidance or evasion" rule to retroactive allocations.[24] The amended section 704(b)(2) now provides that allocations to a partner of income or loss, in the aggregate, as well as specially allocated items of income, gain, loss, deduction or credit, are subject to the "tax avoidance or evasion" rule.[25]

20. Norman Rodman, 1973 T.C. M. ¶ 73,277 (P-H), *aff'd on other grounds*, 542 F.2d 845 (2d Cir. 1976). In reversing the Tax Court's holding with respect to the retroactive allocation issue, the Second Circuit held that, superimposed on the statutory framework of the Code, were the assignment of income principles of Helvering v. Horst, 311 U.S. 112 (1940). Dicta in the opinion may prove troublesome even after the amendments in the partnership taxation area. *See* Pub. L. No. 94-455, § 213(c)(1), (c)(2), (d), 90 Stat. 1547 (1976).

21. H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 122 (1976). *See also* S. Rep. No. 94-938, 94th Cong., 2d Sess. 95 (1976); House-Senate Conference Committee Report, H.R. Rep. No. 94-1515, 94th Cong., 2d Sess. 421 (1976).

22. Pub. L. No. 94-455, § 213(c)(1), (c)(2), (d), 90 Stat. 1547-48 (1976).

23. H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 125 (1976). As proposed, both the House and Senate bills made section 704(a) subject only to other provisions of subchapter K, the partnership chapter of the Code. The Conference Committee broadened this to "except as provided in this chapter," but was silent as to the reasons for the extension of coverage.

24. However, as will be discussed, the "tax avoidance or evasion" rule has been renamed the "substantial economic effect" rule.

25. I.R.C. § 704(b)(2), as amended, states:

(b) **Determination of distributive share**—A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts

3. Section 706(c)(2)(B) has been amended to provide that regardless of how a partner's interest in the partnership is reduced, whether by sale to a new partner, or by sale of a partnership interest directly from the partnership, the continuing partner must take into account his varying interests in the partnership for the partnership year. By implication, an entering partner must also take into account his varying interests in the partnership (ranging from a 0% interest at the beginning of the year to his final percentage interest at the end of the year) in determining his distributive share of partnership income or loss for the taxable year of the partnership.[26]

Effectiveness of Legislation

The changes in sections 704 and 706 were made prospectively for taxable years beginning after December 31, 1975.[27] In applying the "varying interests rule," the committee reports state that a partnership may distribute partnership income or losses among the original and entering partners on a pro rata basis, based upon the number of days each held his respective interest in the partnership, or, if easier, on the basis of a fictional closing of partnership books on the date of entry of a new partner.[28] Examples of each method follow for purposes of clarification.

Pro rata Basis—B, a limited partner in the A-B Limited Partnership, owned a 30% interest in the profits and losses of the partnership on January 1, 1977, the first day of the partnership taxable year. On July 1, 1977, C purchased a 10% limited partnership interest and thereby reduced B's interest to 20%. Assuming the A-B Limited Partnership incurs losses of $10,000 for its taxable year ending December 31, 1977, B and C would share the losses as follows:

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and circumstances), if—

. . . .

(2) The allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

26. Treas. Reg. § 1.706(c)(2)(ii) (1956).

27. The Joint Committee Reports make it clear that Congress expressed no opinion about the propriety of retroactive allocations under prior law. JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, H.R. Doc. No. 10612, 94th Cong., 2d Sess. 94 (1976).

28. *Id.*

B's Distributive Share		
30% of ($10,000) × ½ year	=	$1,500
20% of ($10,000) × ½ year	=	$1,000
B's Distributive Share of Partnership Losses	=	$2,500
C's Distributive Share		
0% of ($10,000) × ½ year	=	$ 0
10% of ($10,000) × ½ year	=	$ 500
C's Distributive Share of Partnership Losses	=	$ 500

"Fictional Closing" of Tax Year—Assuming the same facts as the preceding example, the "fictional closing of the books" rule would require the partnership to compute taxable income or loss as of July 1, and again as of December 31. Assuming that, as of July 1, the partnership had incurred only $4,000 of the $10,000 loss, the distributive share of B and C would be as follows:

B's Distributive Share		
1/1/77 - 6/30/77 "Tax Year" — 30% of ($4,000)	=	$1,200
7/1/77 - 12/31/77 "Tax Year" — 20% of ($6,000)	=	$1,200
B's Distributive Share of Partnership Losses	=	$2,400
C's Distributive Share		
1/1/77 - 6/30/77 "Tax Year" — 0% of ($4,000)	=	$ 0
7/1/77 - 12/31/77 "Tax Year" — 10% of ($6,000)	=	$ 600
C's Distributive Share of Partnership Losses	=	$ 600

The choice of either the "pro rata" or the "fictional closing" methods of allocating partnership losses presents planning opportunities which approach the benefits of the old retroactive allocations. Because most partnerships are cash basis taxpayers, deductions are not allowed until actually paid.[29] Thus, (1) if payment of expenses are deferred until after the entrance of new partners, and (2) if the "fictional closing of the tax year" method is utilized, losses will inure to the benefit of the entering partners in the same manner and to the same extent losses were retroactively allocated under the old law.[30] It remains to be seen whether the Treasury regulations will try to prevent this result.

29. I.R.C. § 461(a), as explained by Treas. Reg. § 1.461-1(a) (1957), authorizes a taxpayer utilizing the cash receipts and disbursements method of accounting to deduct allowable deductible expenses *only* for the taxable year in which actually paid.

30. The Joint Committee Report recognized this possibility and actually approved it. However, the Second Circuit opinion in *Rodman* suggested that allocations among old and new partners might well be subject to the same assignment of income principals which the

PARTNERSHIP SPECIAL ALLOCATIONS

The law concerning partnership allocations has made surprisingly little progress in the twenty-two years that have expired between the initial authorization of partnership special allocations, and the Tax Reform Act of 1976. A considerable amount of uncertainty was generated by section 704(b)(2) and the underlying regulations immediately following the introduction of the initial provisions of the Internal Revenue Code of 1954. This air of uncertainty has continued to the present even in view of the 1976 Tax Reform Act amendments.

Pre-1976 Statutory Case Law

Under statutes prior to the 1954 Code, all items of partnership income and loss had to be divided pro rata between the partners, with the following exceptions:[31] (1) partners could elect to distribute profits differently than losses,[32] (2) the loss from a specific event could be allocated to a partner if he guaranteed the other partners against that loss,[33] and (3) income from foreign sources could be specially allocated under the theory that the organization was really a sharing arrangement between two different partnerships.[34] Other than these recognized exceptions, the courts refused to allow special allocations among the partners until the advent of the 1954 Code.[35] In view of this background, the 1954 statutory authorization for special allocations introduced a substantial degree of flexibility theretofore unknown to partnership tax law.

The special allocation provisions involve a circuitous relationship between sections 702 and 704 of the Code. Section 702(a)[36] requires

court relied upon to strike down the retroactive allocation at issue in the *Rodman* case. This language by the Second Circuit will be troublesome to those practitioners who wish to rely on the congressional intent, as expressed in the Joint Committee explanation.

31. *See* Comment, *Special Allocations Within Partnerships: A Comprehensive Test for Substantial Economic Effect*, 31 Sw. L.J. 579 (1977). *See also* O.D. 140, 1 C.B. 174 (1919); Charles C. Ruprecht, 16 B.T.A. 919, *acq. in*, VIII-2 C.B. 46 (1929), *aff'd*, 39 F.2d 458 (5th Cir. 1930).

32. I.T. 1849, II-2 C.B. 6 (1923).

33. Lederer v. Parrish, 16 F.2d 928 (3d Cir. 1927); John G. Curtis, 12 T.C. 810 (1949), *aff'd*, 183 F.2d 7 (7th Cir. 1950).

34. G.C.M. 17255, XV-2 C.B. 243 (1936).

35. Rev. Rul. 134, 1956-1 C.B. 649. *See also* Rev. Rul. 138, 1957-1 C.B. 543.

36. I.R.C. § 702. **Income and credits of partner**

(a) **General rule.**—In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

each partner to take into account separately in determining his income tax, his distributive share of any partnership taxable income or loss, frequently referred to as bottom-line income or loss. The Regulations[37] provide that, except as otherwise provided in sections 704(b) and (c), a partner's distributive share of income, gain, loss, deduction or credit shall be determined by the partnership agreement. Finally, the partnership agreement consists of the original agreement and any modifications agreed to by all the partners, or adopted in any other manner provided by the partnership agreement.[38] The period within which the agreement may be amended with respect to a particular taxable year is no later than the original date prescribed by law for filing the return.[39] Therefore, without more, the partner's distributive shares of the items of income, gain, loss, deductions or credit may be specially allocated in varying amounts at any time prior to the due date for filing the partnership return.

The underlying theory of section 704(a) is that the interests of each partner in partnership income, gain, loss, deduction or credit will promote a self-regulating mechanism, in which these items will

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(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

(3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in section 170(c)),

(5) dividends with respect to which there is provided a credit under section 34, an exclusion under section 116, or a deduction under part VIII of subchapter B,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) partially tax-exempt interest on obligations of the United States or on obligations of instrumentalities of the United States as described in section 35 or section 242 (but, if the partnership elects to amortize the premiums on bonds as provided in section 171, the amount received on such obligations shall be reduced by the reduction provided under section 171(a)(3)),

(8) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary or his delegate, and

(9) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

Id.

37. Treas. Reg. § 1.704-1 (1956). **Partner's Distributive share**

(a) **Effect of partnership agreement.** A partner's distributive share of any item or class of items of income, gain, loss, deduction, or credit of the partnership shall be determined by the partnership agreement unless otherwise provided by section 704 and paragraphs (b) through (e) of this section. For definition of partnership agreement see section 761(c).

Id.

38. I.R.C. § 761(c). *See also* Treas. Reg. § 1.761-1(c) (1956).

39. I.R.C. § 761(c); Treas. Reg. § 1.761-1(c) (1956).

only be allowed to the partner deserving of them.[40] However, notwithstanding that protection of the Treasury's interest will come from arm's length bargaining among the partners, the 1954 Code retained the power to redetermine a partner's distributive taxable income or loss if the principal purpose of any provision of the partnership agreement with respect to a partner's distributive share was the avoidance or evasion of tax.[41] And so it is this elusive and all-encompassing concept of whether a special allocation had the principal purpose of avoiding or evading a tax that generated so much uncertainty and instability in the field of partnership allocations.

Generally, when the 1954 Code was introduced, there were extensive explanations of the theoretical background of the Code provisions, including numerous authorizing regulations.[42] However, there was virtually no legislative discussion concerning section 704, which was one of the more novel and far-reaching provisions in the realm of partnership tax law. Indeed, the entire explanation of the House Committee on Ways and Means dealing with section 704(b) was as follows:

> Subsection (b) of section 704 further provides that if the principal purpose of any provision in the partnership agreement dealing with a partner's distributive share of a particular item is to avoid or evade the Federal income tax, the partner's distributive share of that item shall be redetermined in accordance with his distributive share of partnership income or loss. For example, if the provisions of a partnership agreement allocate all partnership loss on the sale of depreciable property used in trade or business to one partner or allocate a greater portion of the foreign tax credit to one partner than to another partner, such provisions may be disregarded, and such items attributed to all the partners in accordance with the provisions of the partnership agreement for sharing partnership income or losses.[43]

40. A. WILLIS, HANDBOOK OF PARTNERSHIP TAXATION § 1.04 (1971).

41. I.R.C. § 704(b)—**Distributive share determined by income or loss ratio**
A partner's distributive share of any item of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a)(9), for the taxable year, if—

(1) the partnership agreement does not provide as to the partner's distributive share of such item, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such item is the avoidance or evasion of any tax imposed by this subtitle.

42. *See* Comment, *Special Allocations within Partnerships: A Comprehensive Test for Substantial Economic Effect*, 31 Sw. L.J. 579 (1977).

43. H.R. REP. No. 1337, 83d Cong., 2d Sess. A223 (1954).

That the originating committee of such an expansive section of the partnership tax law gave so brief a discussion of its interpretation of this proposed new Code provision indicates that it only vaguely understood what it was trying to do.

Inasmuch as the House Ways and Means Committee failed to authoritatively explain the reasoning behind the expansion of the allocation privilege, and the general circumstances within which such a special allocation would be disallowed, the Committee Report of the Senate Finance Committee appears as the only significant Congressional statement of the purposes and limitations of section 704 prior to its final adoption.[44] Even so, the Senate Finance Committee Report[45] is of scarcely more value than the Report of the House Ways and Means Committee in ascertaining the parameter of section 704. The Senate discussion permitting special allocations closely paralleled that of the Ways and Means Committee. However, the Senate Finance Committee did mention for the first time the concept of "substantial economic effect":

> Where, however, a provision in the partnership agreement for a special allocation of certain items has substantial economic effect and is not merely a device for reducing the taxes of certain partners without actually affecting their shares of partnership income, then such a provision will be recognized for tax purposes. For example, a partnership agreement whereby a member of the firm who is resident in Puerto Rico is to receive a percentage of the income derived from sources within Puerto Rico which is greater than his distributive share of partnership income generally, will be recognized for tax purposes. Similarly, an agreement under which one partner is to receive all the interest income of the partnership from tax exempt bonds and the other partner is to receive all the dividend income from stock, will be given effect, unless it is a device for the allocation of the interest exemption without any real economic effect on either partner's share of the total partnership income.[46]

The Senate Finance Committee Report indicates that the statutory language in the form of a "principal purpose" test would furnish little assistance to a taxpayer desiring some degree of certainty with respect to the tax consequences flowing from a special alloca-

44. *See* Comment, *Special Allocations Within Partnerships: A Comprehensive Test for Substantial Economic Effect*, 31 Sw. L.J. 579 (1977).

45. S. REP. No. 1622, 83d Cong., 2d Sess. 379 (1954).

46. *Id.*

tion.[47] It is for this reason that the Finance Committee elaborated on the "principal purpose" test by providing that to the extent a special allocation has "substantial economic effect" and is not merely a device for reducing taxes of certain partners independently of their shares of partnership income, then the allocation will be recognized. Thus, the intent of the Finance Committee appears to have been to assure taxpayers that even though a special allocation may reduce the total taxes paid by all partners, such reduction, standing alone, will not be deemed to be a "principal purpose for the avoidance of taxes" as long as the allocation has "substantial economic effect."[48]

The regulations promulgated under section 704 listed six factors to be scrutinized in ascertaining whether the principal purpose of a special allocation is the avoidance or evasion of tax.[49] Although listed as second of the six, the "substantial economic effect" test has surfaced as the primary consideration in evaluating a proposed special allocation. This is due primarily to the presence of that test in the Senate Finance Committee Report, the examples in the Regulations,[50] the few Revenue Rulings,[51] and cases on the matter.[52] Notwithstanding the existence of five other factors, in addition to

47. Fossum & Wolfen, *Partnership Elections and Special Allocations*, 1973 So. CALIF. TAX INST. 385.

48. *Id. See also* Driscoll, *Tax Problems of Partnerships— Special Allocation of Specific Items*, 1958 U. So. CAL. TAX INST. 421.

49. Treas. Reg. § 1.704-1(b)(2) (1964).

> If the principal purpose of any provisions in the partnership agreement determining a partner's distributive share of a particular item is to avoid or evade the Federal income tax, the provisions shall be disregarded and the partners' distributive shares of that item shall be determined in accordance with the ratio in which the partners divide the general profits or losses of the partnership (as described in section 702(a)(9)). In determining whether the principal purpose of any provision in the partnership agreement for a special allocation is the avoidance or evasion of Federal income tax, the provision must be considered in relation to all the surrounding facts and circumstances. Among the relevant circumstances are the following: whether the partnership or a partner individually has a business purpose for the allocation; whether the allocation has "substantial economic effect," that is, whether the allocation may actually affect the dollar amount of the partners' shares of the total partnership income or loss independently of tax consequences; whether related items of income, gain, loss, deduction, or credit from the same source are subject to the same allocation; whether the allocation was made without recognition of normal business factors and only after the amount of the specially allocated item could reasonably be estimated; the duration of the allocation; and the overall tax consequences of the allocation.

Id.

50. Treas. Reg. § 1.704-1(b)(2) Exs. (1-5) (1964).

51. Rev. Rul. 68-139, 1968-1 C.B. 311; Rev. Rul. 66-187, 1966-2 C.B. 246.

52. The three principal cases in this area will be discussed *infra*.

the "substantial economic effect" test, to be analyzed in making the "principal purpose" determinations, it has been suggested that the presence or absence of these five factors are of little significance in deciding the tax avoidance question until such time as an administrative or judicial decision is rendered relying on the other factors in a situation where no "substantial economic effect" could result from the allocation.[53] However, Professor Willis cautions that presumably, the regulations intend that all of the prescribed items will be utilized to the extent applicable, in determining whether a special allocation will be recognized.[54] Thus, the allocation will not be automatically approved merely because it meets one of the six tests, nor will it be denied because it fails to meet one of the six tests.

That the "substantial economic effect" test has become the primary factor in evaluating the impact of a special allocation is evident in *Orrisch v. Commissioner*,[55] the leading case on partnership special allocations. That case involved two married couples, the Orrisches (taxpayers) and the Crisafis, who entered into a partnership arrangement in 1963 to operate two apartment houses. Initially, the Orrisches contributed $26,500 and the Crisafis $12,500, but shared partnership profit and losses equally. In 1966 taxpayers and the Crisafis orally agreed to specially allocate depreciation for 1966 and subsequent years to the Orrisches. This arrangement was based on the Orrisches' need for deductions to shelter their income from other sources, whereas the Crisafis had substantial losses from other sources and were unlikely to have any taxable income for several years. The remainder of the agreement was that gain or loss from the partnership business, computed without regard to any deduction for depreciation, would be divided equally. Furthermore, in the event the partnership property was sold at a gain, all gain to the

53. Fosum & Wolfen, *Partnership Elections and Special Allocations*, 1973 So. Calif. Tax Inst. 385 n.83 states:

> The only circumstances referred to in the Regulations are, in our view, primarily of make-weight significance. For example, if, at or after the end of a partnership's taxable year, two partners allocate all section 1231 gain to one partner and all long-term capital gain to the other, knowing at that time the precise amounts involved in each allocation, it can be suggested that the allocation fails because it was made "only after the amount of the specially allocated item could reasonably be estimated." Fundamentally, however, the allocation can have no economic significance apart from its tax consequences since neither partner is incurring any economic risk at the time the allocation is made. We believe that emphasis on the economic significance or actual risk-shifting resulting from a special allocation aids analysis.

54. 1 A. Willis, Partnership Taxation § 25.03 (2d ed. Supp. 1976).

55. 55 T.C. 395 (1970), *aff'd per curiam*, 31 A.F.T.R.2d 73-1069 (9th Cir. 1973).

extent of depreciation taken by taxpayers would be charged back to taxpayers' capital account such that the burden of the capital gains tax would be borne by taxpayers. Interestingly enough, there was no evidence introduced as to any agreement between taxpayers and the Crisafis as to the treatment of capital accounts, should the partnership be liquidated at a time when the Orrisches' capital account was low or in a deficit position in comparison with the Crisafis, or as to the distribution of partnership assets upon termination of the partnership.

Noting that the only issue for decision was whether the special allocation was to be given tax effect, the Tax Court paid lip service to the six factors set forth by the Regulations to be consulted in determining whether the principal purpose of the special allocation was the avoidance or evasion of tax, and readily determined that the test of paramount importance was whether the allocation had "substantial economic effect" independent of tax consequences. The court observed that the reference to "substantial economic effect" in the Senate Finance Committee Report[56] was apparently added to allay fears that special allocations of income or deductions would be denied effect in every case where the allocation resulted in a reduction in the income tax liabilities of one or more of the partners. Thus, the court evidenced an attitude to respect and recognize special allocations "if they have business vitality apart from their tax consequences."[57]

As against the Orrisches' contention that an allocation has economic effect if it is merely reflected on the capital accounts of the partners, which, in turn, is sufficient to show a business rather than tax avoidance purpose, the court determined that the Regulations require an analysis of the economic impact of the allocation. According to the Regulations, an allocation has economic effect if it "may actually affect the dollar amount of the partners' shares of the total partnership income or loss independently of tax consequences."[58] Although use of the word "may" indicates that the Regulations do not actually require the allocation to affect dollar flow to the partners, the *Orrisch* court interpreted the phrase to require an analysis of the allocation at a time when it is not known whether

56. S. Rep. No. 1622, n.46, 83d Cong., 2d Sess. 379 (1954).

57. Orrisch v. Commissioner, 55 T.C. 395, 400-01, *aff'd per curiam*, 31 A.F.T.R.2d 73-1069 (9th Cir. 1973).

58. Treas. Reg. § 1.704-1(b)(2) (1956); see note 49 *supra* for text.

the allocation will or will not have an economic effect in the future.[59] In making such a determination, the court analyzed the allocation in view of a hypothetical sale at a gain and at a loss. In the context of a sale at a gain, the court found that taxpayers had agreed to pay tax on any gain that might result from the sale of the partnership property to the extent they had been specifically allocated depreciation that otherwise would have been deductible by the Crisafis. However, the court further found that, to the extent gain remained after the charge-back for depreciation, such gain would be shared equally by the partners. Thus, in the court's opinion, the Crisafis were relinquishing a current depreciation deduction in exchange for protection from capital gain tax in the event the property was sold at a gain whereas taxpayers enjoyed a present deduction for depreciation at the expense of future capital gains tax. Clearly, "if the property is sold at a gain, the special allocation will affect only the tax liabilities of the partners and will have no other economic effect."[60]

Having found no economic effect if the building was sold at a gain, the court proceeded to determine who would bear the economic burden of depreciation if the building was sold at a loss. The court observed that:

> Under normal accounting procedures, if the building [was] sold at a gain less than the amount of such disparity petitioners would either be required to contribute to the partnership a sum equal to the remaining deficit in their capital account after the gain on the sale had been added back or would be entitled to receive a proportionately smaller share of the partnership assets on liquidation. Based on the record as a whole, we do not think the partners ever agreed to such an arrangement. On dissolution, we think the partners contemplated an equal division of the partnership assets which would be adjusted only for disparities in cash contributions or withdrawals. Certainly there is no evidence to show otherwise. That being true, the special allocation does not "actually affect the dollar amount of the partners' share of the total partnership income or loss independently of tax consequences" within the meaning of the regulation referred to above.[61]

59. Caruthers, *Real Estate Tax Shelters: Special and Retroactive Allocations Under the Tax Reform Act of 1976*, 4 J. REAL EST. TAX. 119 (1977).

60. Orrisch v. Commissioner, 55 T.C. 395, 403, *aff'd per curiam*, 31 A.F.T.R.2d 73-1069 (9th Cir. 1973).

61. *Id.* at 403-04.

The only other authoritative case in the area of special allocations is *Harris v. Commissioner.*[62] In that case, taxpayer (Harris) had formed a corporation (Artlah Realty Corporation) for the purpose of purchasing real property and constructing thereon a shopping center. In view of the corporation's less than anticipated performance, and in order to save franchise taxes, taxpayer liquidated the corporation and continued to operate the shopping center in the form of a limited partnership so that the individual partners could obtain the benefit of losses produced. Principal partners in the partnership were Harris and the Charro Corporation, the majority of the stock of which was owned by Mr. Kramer.

Realizing that partnership depreciation and interest deductions were gradually becoming smaller and soon would be insufficient to shield rental income used to amortize the purchase money debt on the property, taxpayer negotiated with Kramer to liquidate his interest in the partnership. In 1967 the partnership sold a ten percent interest in the shopping center real estate, subject to debt thereon, to Kramer and his attorney, (Goodell), in trustee capacities. Neither Kramer nor Goodell was a partner in the partnership. Prior to this sale, it had been agreed that the proceeds of the sale would be allocated to taxpayer, as would the entire amount of the loss resulting from the sale. Taxpayer's interest in the partnership and capital account would be reduced by an amount equal to the loss, and there was a simultaneous reduction in his distributive share of partnership taxable income.

In 1968 taxpayer withdrew from the partnership and received in complete liquidation of his partnership interest an undivided thirty percent interest in the shopping center real estate. Approximately two months later, taxpayer sold his thirty percent interest to Kramer and Goodell at a loss. In each of years 1967 and 1968, taxpayer reported the losses as ordinary losses from the sale of section 2131 assets.

Before discussing the court's opinion in the case, it should be observed that all participants were either first cousins or their attorneys, and that the cash changing hands was nominal in comparison with the tax advantages involved. Indeed, taxpayer received only $13,000 cash, but utilized ordinary loss deductions in excess of a quarter of a million dollars.[63] Notwithstanding these facts, which

62. 61 T.C. 770 (1974).

63. Weidner, *Partnership Allocations and Tax Reform,* 5 FLA. ST. L. REV. 1 (1977).

might have justified a different result, the court proceeded to analyze the allocation strictly in accordance with the "economic effect" test. The allocation agreement, the court observed, provided that in return for taxpayer receiving the sales proceeds and loss allocation, his capital account and share of future profits, losses, and liquidation proceeds was proportionately reduced. For these reasons the court held the allocation clearly had economic effect separate and apart from tax consequences, and was, therefore, readily distinguishable from *Orrisch.*[64]

The obvious conclusion from *Orrisch* and *Harris* is that the "substantial economic effect" test is the paramount determinant in ascertaining whether an allocation will be disallowed on the basis of being for the principal purpose of avoiding taxes. However, what remains uncertain are the factors involved in applying the test and the method by which it is applied. The proper analysis of these cases appears to be as follows:

> *Orrisch* therefore contains a strong suggestion that initial contribution to capital is not an appropriate determinant of the allocation of depreciation deductions if initial capital contributions do not also control the allocation of any of the economic benefits or burdens of the partnership. Stated differently, depreciation deductions may not be allocated according to the ratio of what the partners put into the partnership unless that ratio also determines the allocation of some economic incident of what the partners pull out of the partnership. More specifically, it is not persuasive to assert that the substantial business purpose of an allocation of depreciation is to compensate selected partners for their greater cash investment if the allocations of partnership's cash benefits fail to reflect a similar purpose. This analysis need not be confined to allocations of depreciation deductions. It would appear to be equally applicable to allocations of overall partnership loss.
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> . . . .
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> It should be emphasized that the court (in *Harris*) did not approve the allocation of losses simply because it had been reflected by a charge against Harris' capital account. The capital accounts of the partners receiving special allocations were charged in both *Orrisch* and *Harris.* Although all the depreciation was charged against the Orrisches' capital account, it was never intended that capital accounts would affect the division of economic benefit or loss. Stated differently, the special allocation of depreciation was not accompa-

64. Harris v. Commissioner, 61 T.C. 770, 786 (1974).

nied by any change in the sharing of the economic consequences of the partnership. In this respect, *Harris* is at the other extreme. Harris received all the tax and cash benefits of the 1967 sale, and the charge against his capital account reflected a direct reduction of his economic interest in the partnership. There was a pro rata reduction of his interest in operating profits and losses and of his interest in proceeds of any refinancing or sale. In short, the allocation of the depreciation deductions in *Orrisch* affected none of the economic arrangements of the partners whereas the allocation of the loss in *Harris* affected all of the economic arrangements of the partners.[65]

Kresser v. Commissioner[66] was an attempt to avoid the "principal purpose" rule of section 704(b)(2) by way of a bottom-line allocation via section 702(a)(9). That case involved two real estate partnerships controlled by William Appleton under oral partnership agreements. Appleton had a large net operating loss which was due to expire if not utilized prior to the end of 1965. In an effort to obtain tax-free income and shield his fellow partners from income tax attributable to income from the two partnerships, Appleton called a meeting of less than all the partners in which it was agreed by those present to allocate all taxable income of the partnership to Appleton for the year 1965. In return for this privilege, 1965 income was to be restored to the other partners in subsequent years.

The case was ultimately decided upon a finding that the partnership agreement was not amended as provided by section 761(c) and the underlying regulations, so that no bona fide allocation of income was actually made. However, the case is significant in the area of partnership allocations by reason of a footnote appearing in the discussion of section 704(b)(2):

> We do not here pass upon the Government's argument that section 704(b)(2) is fatal to the petitioner's position in this case. While we are fully prepared to accept the contention that the principal purpose of the alleged modifications was the "avoidance or evasion" of tax on Appleton within the meaning of section 704(b)(2), we are faced with the petitioner's troublesome argument that section 704(b)(2) applies only to "items" of income, etc., dealt with in pars. (1) through (8) of section 702(a) and does not govern par. (9) relating to the composition of all of the partnership's income (sometimes referred to as its "ordinary income") which are here involved. The point is not without difficulty.[67]

65. Weidner, *Partnership Allocations and Tax Reform*, 5 FLA. ST. L. REV. 1 (1977).
66. 54 T.C. 1621 (1970).
67. *Id.* at 1630-31.

Thus, by raising the question but expressly refraining from giving an answer, the court created a new area of uncertainty as to whether or not an allocation of bottom-line income or loss is subject to the "principal purpose" test of section 704(b)(2).

Assuming that bottom-line allocations are subject to section 704(b), the issue becomes how to reallocate the partner's distributive shares of a disallowed item of taxable income or loss. Under section 704(b), a disallowed allocation will be reallocated according to the partners' ratio for sharing "taxable income or loss" of the partnership, as was described in section 702(a)(9). Clearly, the reallocation mechanism is not the partnership's bottom-line for purposes of section 702(a), because no purpose would be served by such a reallocation requirement. The correct interpretation of the reallocation rule therefore appears to be that it refers to the partner's ratio for sharing economic profits and losses. In this respect, a disallowed allocation of taxable income or loss must be redetermined in view of the partner's ratio for sharing net cash flow, proceeds for refinancing activities, sales proceeds, and such other facets of the partnership that comprise its economic vitality.[68]

1976 Tax Reform Act Changes

The Tax Reform Act of 1976 completely rewrote the 1954 version of section 704(b). A comparison of the new section 704(b) with the earlier version reveals three principal changes from the old law, namely, that (1) the "principal purpose" test was eliminated; (2) a new reallocation mechanism was added for determining disallowed allocations; and (3) bottom-line allocations (partnership taxable income or loss) were expressly brought within the ambit of section 704(b). By eliminating the "principal purpose" rule in favor of the "substantial economic effect" test, the question foremost in the minds of tax practitioners immediately following the Tax Reform Act of 1976 was whether new section 704(b) was intended as a substantive change of existing law. The proposal of the House Ways and Means Committee, after discussing the then present statutory law as interpreted by the case law, clearly evidenced an intent to narrow a partner's latitude in the area of special allocations, by requiring the partner receiving the special allocation to prove that the allocation itself is the product of a business purpose, and that it will result

68. *See* Weidner, *Partnership Allocations and Tax Reform*, 5 Fla. St. L. Rev. 1 (1977).

in no significant tax avoidance.[69]

Because of the lack of discussion in the Report of the Senate Finance Committee, it is difficult to determine the Senate's assessment of the House bill. It is unclear whether the Finance Committee was opposed to reducing the flexibility of special allocation by adopting the Ways and Means Committee's twofold test, or whether it was satisfied with the flexibility permitted by the House, but doubtful because of the interpretive difficulties that might follow from approval of the House bill.[70] The footnote appearing in the Report of the Finance Committee appears to indicate that the Senate was concerned with both problems. It did not want to diminish the flexibility inherent in the then present law relating to special allocation, but neither did it want to create additional uncertainty by permitting the use of a vague phrase which would equip courts with the authority to disallow a special allocation satisfying then current law by having a business purpose and economic substance.[71] With this in mind, the Senate explained its amendment to the House bill as follows:

> The House bill differs from the committee amendment in two respects. First, the committee amendment disallows a special allocation lacking "substantial economic effect", while the House bill does so with respect to a special allocation lacking "a business purpose" or where "significant avoidance or evasion of any tax . . . results from such allocation." While there is a difference in language, the intent of the committee amendment and the House bill are essentially the same—both versions seek to prevent the use of special allocations for tax avoidance purposes, while allowing their use for bona fide business purposes.[72]

When the House bill and Senate amendment went to the Joint Committee, it was ultimately agreed to follow the Senate amendment in view of the current development of the case law concerning special allocations, and because of interpretive difficulties posed by the House bill.[73]

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69. H.R. REP. No. 94-658, 94th Cong., 1st Sess. 126 (1976).

70. *Id.* at 126.

71. S. REP. No. 94-938, 94th Cong., 2d Sess. 100-01 (1976). Footnote 11 of that report is as follows: "Because of the use of the phrase 'significant avoidance of any tax . . . *results*' (emphasis supplied) under the House bill a conceivable interpretation might cause the disallowance of a special allocation to a high bracket taxpayer, notwithstanding that the allocation had a business and economic substance."

72. H.R. REP. No. 94-658, 94th Cong., 1st Sess. 100-01 (1976).

73. HOUSE-SENATE CONFERENCE COMMITTEE REPORT, H.R. REP. No. 95-1515, 94th Cong.,

The second change brought about by newly revised section 704(b) concerns the reallocation mechanism. As described in the discussion of *Kresser v. Commissioner,*[74] old law required a disallowed special allocation to be redetermined in accordance with the partner's "distributive share of taxable income or loss of the partnership, as described in section 702(a)(9)." Although it did not explain its reasoning, the Ways and Means Committee was obviously displeased with this reallocation formula, possibly because of the problems described in the discussion of the *Kresser* case, and proposed a new reallocation method:

> If an allocation made by the partnership is set aside, a partner's share of the income, gain, loss, deduction or credit (or item thereof) will be determined in accordance with the partnership's permanent method of allocating the taxable income or loss (described under section 702(a)(9)), or, if there is no such method, in accordance with the partner's interest in the partnership, taking into account all facts and circumstances.
>
> A partnership will ordinarily be considered to have a "permanent method" of allocating taxable income or loss if (1) it has consistently applied such method over a number of years, and (2) it meets both the business purpose and significant tax avoidance tests provided under the amended section 704(b).
>
> In determining a "partner's interest in the partnership", [*sic*] all the facts and circumstances are to be taken into account. Among the relevant factors to be taken into account are the interests of the respective partners in cash flow and their rights to distributions of capital upon liquidation.[75]

The reference to "permanent" presumably denotes the percentage participation to which the partners agree upon reaching the break-even point. However, the significance of this first alternative is not clear in view of the language used, and also because of the statement in the second alternative that the facts and circumstances will control absent a "permanent" method.[76]

Again, the Finance Committee was quite obviously dissatisfied with the House proposal, primarily because of the ambiguities involved in determining the "permanent method" of allocating items. In an effort to avoid problems created by the House bill, the Senate

2d Sess. 421 (1976).

74. 54 T.C. 1621 (1970).

75. H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 126-27 (1976).

76. Lee, *Tax Shelters Under the Tax Reform Act of 1976,* 22 Vill. L. Rev. 223 (1977).

amendment, as finally adopted by the Conference Committee, abandoned the two-step approach of the House, and replaced it with a single criterion: "the partner's interest in the partnership, taking into account all facts and circumstances."[77]

The third major change brought about by the revision to section 704(b) concerns the speculation caused by *Kresser*, with respect to bottom line allocations. Both the House Ways and Means Committee and the Senate Finance Committee were in agreement in their desire to reverse whatever impact *Kresser* may have had with respect to overall allocation of taxable income or loss of the partnership.[78] In view of the modifications made in section 704(b), it is readily apparent that the footnote in *Kresser* will no longer generate any uncertainty with respect to whether bottom-line allocations are subject to the limitations of section 704(b)(2). Thus, in the words of Professor Willis:

> One of the specific accomplishments of the amendments to Section 704(b) is to eliminate any question as to whether "bottom line" profit or loss may be specially allocated without running afoul of the substantial economic effect test of Section 704(b)(2). It is now clear that Section 704(b) does apply to a special allocation of bottom line profit or loss as well as to a special allocation of a particular item of income, gain, loss, deduction or credit.[79]

Effectiveness of 1976 Tax Reform Act Changes

Although the avowed purpose of reform acts in the tax law is generally either to plug so-called "loopholes," or to clarify ambiguous Code provisions or provisions that have become of uncertain interpretation by reason of judicial gloss, one wonders why section 704(b) was revised in view of what was done. The only decisive action taken was to forever eliminate any speculation that might have existed with respect to bottom-line allocations. Certainly the tax bar was not surprised that the "substantial economic effect" rule was elevated to a Code provision, but there was great disappointment in Congress' failure to precisely explain the meaning and concept of substantial economic effect, or to accompany that test with clarifying examples. Furthermore, the statement in the Fi-

77. S. REP. No. 94-938, 94th Cong., 2d Sess. 100 (1976).

78. H.R. REP. No. 94-658, 94th Cong., 1st Sess. 126 (1976); S. REP. No. 94-938, 94th Cong., 2d Sess. 99 (1976).

79. 1 A. WILLIS, PARTNERSHIP TAXATION § 25.03 (2d ed. Supp. 1976).

nance Committee Report that "other factors that could possibly relate to the determination of the validity of an allocation are set forth under the present regulations (1.704-1(b)(2))" is wholly unsatisfactory in adding any stability to partnership allocation law in view of the fact that no additional examples or regulations were promulgated.

The result of the revisions to section 704(b) is that tax lawyers and the courts will be forced to continue to examine the same cases and rulings that arose under pre-1976 law in search of a clearer understanding of "substantial economic effect." Moreover, while settling one question relating to overall allocations, the Act has created a new area of uncertainty with respect to what interest a partner has in the partnership that may be used as the foundation on which to base his allocation because of the statement that, to the extent an allocation is set aside, a partner's distributive share of such item shall be determined in accordance with his interest in the partnership, "taking into account all facts and circumstances."[80] In sum, the general failure of Congress to clearly delineate the concepts it established through the 1976 revisions to section 704(b) has created an immediate need for clarifying regulations.

Limitations on Loss Deductions Amendments to I.R.C. Section 704(d)

Abuse Perceived by Congress

Among the evils which Congress attempted to ban by the Tax Reform Act of 1976 was the marketing of tax shelters which allowed losses far in excess of the amounts which the investors were required to contribute to the venture.[81] Typically, tax shelters were formed with an eye toward shielding an investor's extraordinary income with losses generated from the limited partnership in the manner described below.

A, a high income taxpayer, purchases a limited partnership interest in the XYZ Limited Partnership for $6,000. A is not required to make any further contributions and additionally is shielded from liability for partnership debts by virtue of his status as limited

80. Comment, *Special Allocations Within Partnerships: A Comprehensive Test for "Substantial" Economic Effect,* 31 Sw. L.J. 579 (1977).

81. Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., Committee Member Selections of Proposals for Consideration in First Phase of Tax Reform 3 (Comm. Print 1975).

partner. In the year of his entrance into the partnership, A's distributive share of partnership losses totals $10,000. Further loss deductions are allocated to A in later years. These deductions are allowed to A, notwithstanding the facts that: (1) A's total contribution to the partnership is $6,000 and (2) A has no obligation to make further contributions to the partnership nor is A personally liable for partnership liabilities.

The reason for this strange situation was rooted in the holding of the United States Supreme Court in the *Crane* case.[82] There, Mrs. Crane was devised an apartment building at her husband's death in 1932. The apartment building was subject to a mortgage on which Mrs. Crane was not personally liable and for which Mrs. Crane did not subsequently assume personal liability. The Supreme Court held that Mrs. Crane's unadjusted basis in the apartment building, for purposes of depreciation and for purposes of later disposition of the property, included not only the equity in the building at the time of receipt, but also the face amount of the mortgage to which the apartment building was subject, regardless of the fact that Mrs. Crane never became personally liable for the payment of the mortgage.[83]

Following the rule in the *Crane* case, the Internal Revenue Code provides that all partners, whether limited or general partners, are entitled to increase their respective adjusted bases in their partnership interests, by their pro rata share of non-recourse partnership liabilities. This is accomplished by the interrelationship of sections 722[84] and 752.[85] Section 722 provides that the basis of a partner's interest in the partnership is generally the sum of the amount of money and the adjusted basis of all property which such partner contributes to the partnership. Section 752 generally treats a partner's share of partnership liabilities as a contribution of money by the partner to the partnership.[86] Where none of the partners has personal liability with respect to a particular partnership liability, each partner is treated as if he made a contribution of money to the

82. Crane v. Commissioner, 331 U.S. 1 (1947).

83. *Id.* at 11.

84. I.R.C. § 722.

85. I.R.C. § 752.

86. I.R.C. § 752(a) states as a general rule:

(a) **Increase in partner's liabilities.**—Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, *shall be considered as a contribution of money* by such partner to the partnership. (emphasis added) partnership in an amount which is the product of his distributive share of partnership profits (expressed as a percentage) multiplied by the face amount of the specific non-recourse liability of the partnership.[87]

To illustrate the foregoing, assume that taxpayer A in the above example contributes $6,000 in exchange for a limited partnership interest in the XYZ Limited Partnership, A being entitled to receive 50% of the partnership profits. Assume further that the partnership purchases income-producing property for cash and the execution of a non-recourse purchase money obligation of $48,000. A's adjusted basis in his partnership interest is $30,000, consisting of (1) his cash contribution of $6,000 and (2) 50% of the face amount of the non-recourse liability of $48,000. This holds true, notwithstanding the fact that A can lose no more than $6,000, the total amount of money which he has "at risk" in the venture.

The partnership provisions existing prior to the Tax Reform Act of 1976 limited a partner's income tax deduction resulting from partnership losses, to such partner's adjusted basis in his partnership interest.[88] However, as we have seen, a partner's adjusted basis in his partnership interest included not only his actual investment, but also his proportionate share of non-recourse liabilities of the partnership. Thus, in the example presented above, although A's actual investment in the partnership is only $6,000, his adjusted basis in the partnership amounts to $30,000, and A would be entitled to deduct the entire $10,000 which was his distributive share of losses from the XYZ Partnership.

Congressional Intent

It was in light of the foregoing rules that Congress enacted the "at risk" limitations on loss deductions in the Tax Reform Act of 1976.[89] These provisions added section 465 to the Code and amended section 704(d). Section 465, which applies to all taxpayers and business entities except corporations (other than subchapter S corporations and personal holding companies),[90] limits loss deductions to amounts "at risk" if the taxpayer is involved in one of four specific business activities—production or distribution of motion picture

87. Treas. Reg. § 1.752-1(e) (1956).
88. Int. Rev. Code of 1954, ch. 1, § 704(d), 68A Stat. 241 (now I.R.C. § 704(d)).
89. Pub. L. No. 94-455 §§ 204(a), 213(e), 90 Stat. 1531, 1548 (1976).
90. I.R.C. § 465(a).

films or videotapes, farming, equipment leasing, or oil and gas exploration.[91]

In the partnership area, section 704(d) was amended to provide that in deducting his distributive share of partnership losses, a partner may not utilize the portion of his adjusted basis in his partnership interest which arises out of partnership liabilities with respect to which the partner has no personal liability.[92] As will be seen, however, the amendments to section 704(d) do not necessarily accomplish the desired goal of prohibiting a partner from utilizing his non-"at risk" basis in deducting partnership losses.

Congressional Action

The *Haskell Amendment*[93] would have amended section 752 to prohibit a limited partner in a partnership from increasing the adjusted basis of his partnership interest by any portion of partnership non-recourse liabilities. The amendment was passed by the Senate (there was no corresponding House version), but the House-Senate Conference altered the provision to amend section 704(d) instead. The conference report[94] is silent on the reasons for the change. As amended, section 704(d) now provides that, for purposes of limiting a partner's distributive share of partnership losses, the adjusted basis of such partner's interest in the partnership shall not include any portion of any partnership liability with respect to which the partner has no personal liability. The amending language limits the application of the new rule *solely* to subsection (d) of section 704. In other words, the use of the portion of a partner's adjusted basis attributable to non-recourse liabilities, is limited only in the area of deductibility of partnership losses. For all other purposes, the use of the total adjusted basis is still available.[95] As will be seen, this

91. Int. Rev. Code of 1939, ch. 1199, § 465, 64 Stat. 1210 (now I.R.C. § 465(c)).

92. As noted in the text, the amendments to section 704(d) limit their applicability to cases in which section 465 does not apply, and to the cases in which the partnership involved does not deal primarily in real property investments. It is upon the limited scope of the amendments that the balance of this discussion focuses.

93. Unprinted amendment no. 75 to amend H.R. 10612, § 210, 94th Cong., 2d Sess., 122 CONG. REC. 10106 (1976). The *Haskell Amendment* was sponsored by Sen. Haskell of Colorado and co-sponsored by Sen. Kennedy of Massachusetts, Sen. Hollings of South Carolina, and Sen. Hathaway of Maine.

94. H.R. REP. No. 94-1515, 94th Cong., 2d Sess. 421 (1976).

95. For example, section 731(a) permits a partner to receive cash distributions from the partnership without the imposition of income taxation *until* the cash distributed exceeds such partner's "adjusted basis." This presents planning opportunities to partnerships, as will be noted later. It is amusing to note that the limited application of the section 704(d) amend-

limited applicability of the partnership "at risk" rule presents numerous planning opportunities and virtually eliminates the effectiveness of the legislation.

Planning Opportunities—Application of Section 704(d)

We will illustrate the effect of the amendments to section 704(d) utilizing our original example and present two alternative planning opportunities which avoid the impact of the new law achieving the same benefits which were available prior to the Tax Reform Act.

Facts Restated—A is a limited partner, entitled to 50% of partnership profits in the XYZ Limited Partnership. A contributes $6,000 to the partnership, which purchases income-producing property for cash and the execution of a non-recourse purchase money mortgage in the amount of $48,000. The partnership experiences a $20,000 loss in its initial year, $10,000 of which is distributable to A.

A's adjusted basis in the partnership under prior and present law is $30,000, consisting of his initial cash contribution of $6,000 and 50% of the partnership liabilities (50% of $48,000) or $24,000. However, for purposes of section 704(d), A's adjusted basis is limited to his actual cash investment of $6,000.

Although A's distributive share of the partnership loss is $10,000, A will be entitled to deduct only $6,000, representing the amount of his economic risk in the partnership. The excess, or $4,000, will be held in suspense until A's "at risk" adjusted basis is increased by new contributions to the partnership or by taxable income generated by the partnership.[96]

Alternative One—Suppose the partnership agreement in the above example required A to contribute an additional $4,000 to the partnership. If on December 31, A contributes the cash, then his "at risk" adjusted basis would be increased to $10,000 (his original investment of $6,000 plus the $4,000 additional cash contribution).[97] Under such conditions, section 704(d) would allow A to deduct his entire distributive share of the partnership loss.

ments creates problems identical to the problems presumably eliminated by the amendment to section 704(a).

96. Int. Rev. Code of 1954, ch. 1, § 705(a), 68A Stat. 242 (now I.R.C. § 705(a)). Additionally, the sale of a partnership interest would presumably allow a partner to utilize the "suspended losses," as well as the rest of his non-"at risk" adjusted basis in his partnership interest. *See* JOINT COMMITTEE ON TAXATION, 94th Cong., 2d Sess., GENERAL EXPLANATIONS OF THE TAX REFORM ACT OF 1976 H.R. Doc. No. 10612, 94th Cong., 2d Sess. 36 n.4 (1976).

97. Int. Rev. Code of 1954, ch. 1, § 722, 68A Stat. 245 (now I.R.C. § 722).

Suppose in the following taxable year the partnership makes a cash distribution of $4,000 to partner A. The distribution would be non-taxable to A; since for these purposes, A would be entitled to utilize his non-"at risk" basis.[98] Therefore, A would be in exactly the same position as he was under pre-Tax Reform Act of 1976 law since: (1) A would be entitled to the full loss deduction in 1977, notwithstanding the new rules; and (2) A's cash position would be the same, at least after the cash was returned in 1978.

Properly planned, it would seem that taxpayer A could continue this process each year to take advantage of current losses of the partnership and to utilize the entire non-"at risk" portion of the adjusted basis of his partnership interest.[99]

Alternative Two—A second possibility for deducting the entire portion of A's distributive share of loss, without regard to the new "at risk" provision, is presented by the very language of section 704(d). Section 704(d) limits its application to partnership *losses* and is silent on the topic of specially allocated partnership *deductions.* Therefore, suppose that the partnership specially allocates $4,000 of deductions to A, thereby reducing A's distributive share of partnership loss to $6,000. Since section 704(d) limits its application to the loss deductions and since specially allocated deductions are not, technically speaking, losses, the "at risk" limitation of section 704(d) would not be applicable.[100] Hence, utilizing the rule of section 704(d), A would be entitled to a $6,000 loss deduction (to the extent of his "at risk" adjusted basis) and additionally would be entitled to a specially allocated partnership deduction of $4,000, (which would reduce his non-"at risk" adjusted basis) placing him in the same position as he was under prior law.[101]

98. See text accompanying note 95, *supra.*

99. *See* Lee, *Tax Shelters Under the Tax Reform Act of 1976,* 22 VILL. L. REV. 223, 241 (1977), where a similar conclusion was reached.

100. Treas. Reg. § 1.704-1(d)(2), T.D. 6771, 1964-2 C.B. 177, apparently recognized this. In dealing with specially allocated items, the regulations limited the scope of section 704(d) to specially allocated "loss" items. This regulation has been superseded by Temp. Treas. Reg. § 7.704-1, 41 F.R. 55344 (1976), which, at the time of writing, does not mention the issue.

101. I.R.C. § 705(a)(2)(B) reduces a partner's adjusted basis in his partnership deductions. As in the case of section 731, the "adjusted basis" utilized as a starting point for section 705 is the total adjusted basis, *including* "at risk" and non-"at risk" amounts. Thus, although the partnership loss deduction would be limited by the rule of section 704(d), the deduction for the specially allocated depreciation deduction would not be so limited.

Summary

Code provisions regarding distribution of partnership losses are confusing and are obviously not fully understood or appreciated by Congress.[102] The amendments to section 704(d) can, by careful planning, be minimized or avoided. One would hope that any future amendments in this area would be more thoroughly reasoned.[103]

PARTNERSHIP ORGANIZATION AND SYNDICATION EXPENSES

The partnership syndication and organization expenditure provisions of the Tax Reform Act of 1976 appear to have been more in the nature of clarifying the status of pre-1976 law rather than introducing new revenue producing measures. In order to properly assess the impact of the 1976 changes, however, examination must be made of the status of the law in this area as it existed prior to the Reform Act.

Pre-1976 Statutory and Case Law

As the 1954 legislative history of section 707 indicates, the tax treatment of partners and partnerships was in a state of chaos before

102. The floor debate accompanying the passage of the *Haskell Amendment* demonstrates this. Senator Pastore of Rhode Island presented the following hypothetical case to clarify the pre-Tax Reform Act law:

> Mr. PASTORE: May I give a hypothetical case: Let us assume that the project is a $100,000 project, and the individual invests, let us say, 20 percent, which is $20,000 in the project, and the project goes under. Does the Senator mean to tell me he can deduct from his taxes more than $20,000?
>
> Mr. BENTSEN: No. He has only lost the $20,000.
>
> Mr. PASTORE: How much does he deduct?
>
> Mr. KENNEDY: The answer is $100,000.

122 CONG. REC. 10110 (daily ed. June 22, 1976). Senator Kennedy's response was clearly erroneous, based upon the rule of Parker v. Delaney, 186 F.2d 455 (1st Cir. 1950). Assuming that the "project went under" in Senator Pastore's example, the financing institution would presumably foreclose on the property. The taxpayer would realize $80,000 upon foreclosure, according to *Parker v. Delaney*. Therefore, the taxpayer would be able to deduct only $20,000 (his total investment), computed under Int. Rev. Code § 1001(a) as follows:

Amount Realized	$80,000
Minus: Adjusted Basis	100,000
Equal: Loss Realized	$20,000

The fact that Sen. Kennedy was a co-sponsor of the amendment makes this writer wonder whether many of the "at risk" abuses sought to be corrected were more imagined than real.

103. Apparently this will not be the case. At the time of writing, two amendments to section 704(d) have been proposed: H.R. 1040, 95th Cong., 1st Sess. 312 (1977), and H.R. 6715, 95th Cong., 1st Sess. § 2(o) (1977). Both of these proposed amendments deal only with the real property investment exception of section 704(d). Neither proposed amendment attempts to change the obvious inadequacies of the 1976 amendment.

enactment of the 1954 Code.[104] During this time, the tax treatment of compensation paid for a partner's service was generally based upon the aggregate rather than the entity theory of partnerships. Since a partner could not be regarded as an employer and employee at the same time under the aggregate theory, compensation for services was considered a part of his distributive share of partnership profits or losses. To the extent partnership profits were sufficient to cover the salary payment, such distributions were not permitted to be deducted in computing partnership net income.[105] However, if partnership profits were insufficient to cover salaries paid, such amounts were deemed to be reductions of the partners' capital in the partnership. In this respect, a return of invested capital was not a taxable event. Notwithstanding this, if it was determined that a partner received compensation from the partnership attributable to capital of his fellow partners, such compensation was taxable income, thereby permitting a deduction for ordinary and necessary business expenses to the other partners.[106] It was this clumsy and archaic aggregate theory of partnerships that led to the 1954 amendments to partnership tax law.

The Congress clearly elected to adopt the entity theory of partnerships when it initially enacted section 707. The 1954 version of section 707(c)[107] states that for purposes of sections 61(a) and 162(a) only shall payments to a partner for services, to the extent determined without regard to income of the partnership, be regarded as made to one who is not a partner in the partnership. In view of the problems Congress was trying to remedy with the introduction of section 707(c) in the 1954 Code, it appeared to be clear that section 707(c) did not automatically require deduction of guaranteed payments under the auspices of section 162(a). Rather, Congress intended that, having adopted the entity theory of partnerships for purposes of section 707, guaranteed payments may qualify for de-

104. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A226-A227 (1954).

105. Lloyd v. Commissioner, 15 B.T.A. 82 (1929).

106. *Id.*

107. Int. Rev. Code of 1954, ch. 1, § 707(c), 68A Stat. 244 (now I.R.C. § 707(c)).

Transactions between partner and partnership

. . . .

(c) **Guaranteed payments.**—To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses).

Id.

duction as a section 162(a) expenditure if the requirements of that section are satisfied.

Notwithstanding the apparent attempt to place partnerships on a relative par with corporations, attempts were made to take advantage of the literal language of section 707(c) in derogation of the status of the law in the year that section was enacted. In *Cagle v. Commissioner,*[108] a promoter (Eulich) formed a partnership with taxpayer (Cagle) for the purpose of purchasing land and developing an office-showroom. All organizational and promotional activities were performed for the partnership by Eulich, doing business as the Vantage Company, pursuant to a management contract. The services performed by Vantage for which it was paid $90,000 were in the nature of capital expenditures, such as economic forecasts, market analysis, architectural services, construction activity and procurement of financing for the venture. No portion of the management fee was for managing the property after it was completed. The partnership deducted the entire management fee as a guaranteed payment, thereby generating a substantial loss for the first year's operation.[109]

The sole issue in the Tax Court was whether the management fee was currently deductible, or whether it must be capitalized as in the case of corporate organizational and promotional fees. In response to Cagle's primary argument that "the payment in question is a guaranteed payment under section 707(c) and that such payment is automatically deductible by the partnership as a section 162(a) expense without regard to the requirements of that section" Judge Sterrett, writing for the Tax Court, made the following analysis.

> If we were to allow a section 162(a) deduction in the case of a partner's rendering services to his partnership which are capital in nature, it would be the only instance that such a deduction would be allowed for a capital expenditure. We see no reason why employment of the entity theory of partnerships in this facet of partnership taxation should require the automatic deductibility of guaranteed payments and hence make such a holding an anomaly in tax law as far as capital expenditures are concerned. By the above-discussed legislative history we do not, as petitioners' premise would necessarily lead us to conclude, see a conscious attempt on Congress' part to treat partnerships more favorably than other taxpayers. Rather we think that in employing the entity theory, Congress only meant to require

108. 63 T.C. 86 (1974), *aff'd,* 539 F.2d 409 (5th Cir. 1976).
109. Cagle v. Commissioner, 539 F.2d 409, 413 (5th Cir. 1976).

> inclusion and test deductibility of guaranteed payments in a manner similar to that of other recognized taxable entities because of the simplicity of that approach as opposed to the pre-1954 Code treatment of partners' salaries.[110]

On appeal taxpayer made the same argument—the clear intent of Congress, as supported by the legislative history and the actual language used in section 707(c), was that the section requires deductibility of all payments and expenses coming within the definition of a "guaranteed payment."[111] In response to taxpayer's contentions, the Fifth Circuit held that Congress effectively placed partnerships on an "entity theory" basis for purposes of section 707(c). In this respect, guaranteed payments made to a partner were intended to be given the same treatment as payments made to a non-partner. Thus, an expense of the partnership would be deductible if it was an ordinary and necessary business expense as required by section 162(a) irrespective of whether it was made to a partner or non-partner. However, expenditures capital in nature should not produce a different result merely because made to a partner.[112]

Thus, the appellate court's opinion, in supporting and affirming the Tax Court, was of significance in clarifying the proper interpretation to be given the pre-1976 version of section 707(c). However, it is to be noted that the appellate opinion in *Cagle* was not reported until September 22, 1976. For this reason, during the formative stages of the Tax Reform Act of 1976, there was only the Tax Court opinion in *Cagle*, which although decisive, did not fully resolve all the questions in this area.

1976 Tax Reform Act Changes

Prior to the time the House Ways and Means Committee began discussions of partnership syndication and organizational expenses, the common practice for limited partnerships was to deduct the payments made to the promoter-general partner for services rendered in connection with the formation of the partnership. The typical case involved the promoter incurring legal, accounting and recording fees, and other miscellaneous expenditures in locating a tax shelter activity, and then tailoring it to fit the individual needs of the limited partners, including expenditures for selling partnership

110. Cagle v. Commissioner, 63 T.C. 86, 95 (1974), *aff'd*, 539 F.2d 409 (5th Cir. 1976).
111. Cagle v. Commissioner, 539 F.2d 409 (5th Cir. 1976).
112. *Id.* at 416.

interests. Inasmuch as the promoter generally desired reimbursement for these costs, the usual way of protecting these expenses was in the form of a management fee, as in the *Cagle* case. However, the error in that case was that the expense was so large in comparison to other costs that it aroused Internal Revenue Service scrutiny. Those fees were deducted under the pretext that section 707(c) authorized a deduction.

The House Ways and Means Committee recognized this ambiguity, even in view of the Tax Court opinion in *Cagle* and Revenue Ruling 75-214, and purported to solve the dispute by enacting new section 724.[113] That section provided that no deduction would be allowed to the partnership or to any partner for any amounts paid or incurred to organize a partnership or an interest in the partnership.[114] Further, the Ways and Means Committee sought to resolve any questions left unanswered by *Cagle,* through amendment of section 707(c). In order for a guaranteed payment to be deductible by the partnership, therefore, it must meet the same test under section 162(a), as if the payment had been made to a non-partner.[115]

When the House Ways and Means Committee Report reached the Senate Finance Committee, it was apparent that the House Bill left as a fact issue the question of whether partnership organizational and promotional expenditures were deductible.[116] For example, a tax lawyer rendering tax advice in the formation of a partnership might place different values on advice rendered in tax planning, the amount of which is deductible, as distinguished from organizational expenses. Furthermore, the House Bill failed to specify if and when the partnership could recover capitalized expenses.

Rather than amend the House's new section 724, the Finance Committee created new section 709,[117] which basically reflected the

113. H.R. REP. No. 94-658, 94th Cong., 1st Sess. 121 (1975).

114. *Id.*

115. *Id.*

116. Lee, *Tax Shelters Under the Tax Reform Act of 1976,* 22 VILL. L. REV. 223 (1977).

117. I.R.C. § 709—**Treatment of organization and syndication fees.**

(a) **General rule.**—Except as provided in subsection (b), no deduction shall be allowed under this chapter to the partnership or to any partner for any amounts paid or incurred to organize a partnership or to promote the sale of (or to sell) an interest in such partnership.

(b) **Amortization of organization fees.**—

(1) **Deduction.**—Amounts paid or incurred to organize a partnership may, at the election of the partnership (made in accordance with regulations prescribed by the Secretary), be treated as deferred expenses. Such deferred expenses shall be allowed as a deduction ratably over such period of not less than 60 months as may be selected

language in the House provision, but added a subsection (b). This subsection permitted amortization of organizational expenses over sixty months, but syndication fees, printing, and similar costs were not permitted to be amortized:

> The committee amendment adds a new provision (section 709) which provides that, subject to the special amortization provision described below, no deduction shall be allowed to a partnership or to any partner under the partnership tax provisions (subchapter K of the code) for any amounts paid or incurred to organize a partnership or promote the sale (or to sell) an interest in the partnership. The committee amendment also amends section 707(c) to make it clear that, in determining whether a guaranteed payment is deductible by the partnership, it must meet the same tests under section 162(a), as if the payment had been made to a person who is not a member of the partnership, and the normal rules of section 263 (relating to capital expenditures) must be taken into account. The committee amendment provides that a partnership could elect to deduct ratably over a period of not less than sixty months the amounts paid or incurred in organizing the partnership. The organizational expenses subject to the sixty-month amortization provision are defined as those expenditures which are incident to the creation of the partnership, chargeable to the capital account, and of a character which, if expended in connection with the creation of a partnership having an ascertainable life, would be amortized over that period of time.[118]

The committee report concluded with the provision that capitalized syndication fees, such as expenditures involved in marketing partnership interests (professional fees, commissions, etc.) are not permitted to be amortized under the sixty-month rule.

The House-Senate Conference Committee[119] followed the Senate Finance Committee amendment to the House bill, creating section

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by the partnership (beginning with the month in which the partnership begins business), or if the partnership is liquidated before the end of such 60-month period, such deferred expenses (to the extent not deducted under this section) may be deducted to the extent provided in section 165.

(2) **Organizational expenses defined.**—The organizational expenses to which paragraph (1) applies, are expenditures which—

(A) are incident to the creation of the partnership;

(B) are chargeable to capital account; and

(C) are of a character which, if expended incident to the creation of a partnership having an ascertainable life, would be amortized over such life.

Id.

118. S. REP. No. 94-938, 94th Cong., 2d Sess. 92-94 (1976).

119. HOUSE-SENATE CONFERENCE COMMITTEE REPORT, H.R. REP. No. 94-1515, 94th Cong., 2d Sess. 421 (1976).

709, which requires the capitalization of organizational expenditures, and which allows the partnership to amortize these expenses over sixty months upon election. To the extent amortization is elected, it begins with the month in which the partnership begins business. If the partnership is liquidated prior to the end of the sixty-month period, organizational expenses not previously deducted may be recovered as provided in section 165.

Effectiveness of 1976 Tax Reform Act Changes

In comparison with its efforts in the area of special allocations, Congress has concisely stated its views with respect to guaranteed payments, and partnership organization and syndication fees. Although the Fifth Circuit's opinion in *Cagle* greatly stabilized this aspect of the partnership tax law, revised section 707(c) now eliminates any question that guaranteed payments must run the gauntlet of section 162(a) in addition to the requirements of section 707(c). Furthermore, new section 709, in conjunction with section 707(c), makes it abundantly clear that syndication and organizational fees cannot be deducted in one year by disguising them as guaranteed payments under section 707(c).

Conclusion

As the above analysis of the recent amendments of subchapter K demonstrates, Judge Raum's observations regarding the complexities of partnership tax law are as apropos in 1977 as they were in 1964. In three of the four areas discussed—retroactive allocations, special allocations, and limitations on partnership losses—the law is virtually unchanged by the 1976 amendments. Only in the area of organizational and syndication expenses has Congress actually eliminated the problems it detected under former law.