

ACTION ON DECISION

Subject: Estate of Martinez v. Commissioner, T.C. Memo. 2004-150¹

Issue: Whether a general partner who guaranteed the debt of a partnership and was not in bankruptcy in his individual capacity may exclude from gross income under section 108(a) partnership debt cancelled in a title 11 case of the partnership.

Discussion: The decedent was a general partner in a partnership and personally guaranteed some of the partnership's debts. The partnership initiated a case under title 11 of the United States Code (relating to bankruptcy). The partners in the partnership, including the decedent, reached a settlement agreement with the trustee of the bankruptcy estate, under which they would make payments to the partnership's bankruptcy estate in exchange for the release of claims or potential claims of creditors against them relating to the partnership. The bankruptcy court approved the agreement, and discharged and released the partners from all liability related to the partnership, their status as general partners, and their personal guarantees of partnership debts. The same order provided that each partner "is subject to the jurisdiction of the Bankruptcy Court."

The decedent did not include the cancellation of debt income (COD income) allocated to him by the partnership on his tax return for the year of the discharge. In the notice of deficiency, the Service rejected the decedent's claim to an exclusion of the partnership COD income.

The Tax Court held that the decedent may exclude his share of the partnership COD income from gross income under section 108(a)(1)(A) because the partnership debt was discharged "in a title 11 case" within the meaning of section 108(d)(2). Invoking the principle of judicial comity, the Tax Court noted that the bankruptcy court's order discharged and released the partners from liability in a title 11 case and explicitly asserted jurisdiction over them.

The Service disagrees with the Tax Court's holding.

Section 61(a)(12) provides that gross income includes COD income. Section 108(a)(1)(A) excludes from gross income any amount derived from "the discharge (in whole or in part) of indebtedness of the taxpayer" if the discharge occurs in a title 11 case. Under section 108(d)(1), "indebtedness of the taxpayer" means any

¹ The Tax Court issued essentially identical opinions for three other partners in the partnership: Gracia v. Commissioner, T.C. Memo. 2004-147; Mirarchi v. Commissioner, T.C. Memo. 2004-148; and Price v. Commissioner, T.C. Memo. 2004-149.

indebtedness (A) for which the taxpayer is liable, or (B) subject to which the taxpayer holds property." Section 108(d)(2) defines a "title 11 case" as "a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Section 108(d)(6) provides that, in the case of a partnership, subsection (a) and certain other parts of section 108 must be applied at the partner level.

Under the Bankruptcy Code, the term "debtor" means a "person . . . concerning which a case under this title [title 11] has been commenced." 11 U.S.C. 101(13).

The Tax Court has observed that "the entire structure of section 108, as well as the . . . legislative history [of section 108(a)(1)(A)] (see, e.g., S. Rept. 96-1035, pp. 8-14 (1980), 1980-2 C.B. 620, 623-627), makes it plain that the provision [section 108(a)(1)(A)] operates to provide tax relief to the debtor in bankruptcy," and not a non-debtor party in a bankruptcy proceeding. Yamamoto v. Commissioner, T.C. Memo. 1990-549, aff'd without published opinion, 958 F.2d 380 (9th Cir. 1992).

In discussing the addition of section 108(d)(6), Congress explained that discharge of a partnership debt is an item of income allocated separately to each partner pursuant to section 702(a). Congress indicated its intent to limit the scope of section 108(a)(1) to bankrupt or insolvent partners, and not to all partners of a bankrupt partnership. "The tax treatment of the amount of discharged partnership debt which is allocated as an income item to a particular partner depends on whether that partner is in a bankruptcy case, is insolvent (but not in a bankruptcy case), or is solvent (and not in a bankruptcy case). . . . [I]f the particular partner is bankrupt, the debt discharge amount is excluded from gross income pursuant to amended section 108" S. Rep. No. 96-1035, at 21, 1980-2 C.B. 620, 631.

The legislative history further explains that the income tax treatment of debt discharge in bankruptcy is intended to preserve the debtor's "fresh start" after bankruptcy by excluding COD income from the debtor's income so that "the debtor coming out of bankruptcy . . . is not burdened with an immediate tax liability." S. Rep. No. 96-1035, supra, at 10, 1980-2 C.B. at 624.

The Tax Court's ruling is inconsistent with the structure of section 108 and underlying Congressional intent. The decedent was not under the jurisdiction of the bankruptcy court in a title 11 case as a debtor. The partnership, not the decedent, filed the petition in the bankruptcy court. The decedent was not a "person . . . concerning [whom] a case under this title [title 11] has been commenced." 11 U.S.C. 101(13). Section 108(a) applies at the partner level. The exclusion in section 108(a)(1)(A) applies only to

partners who are debtors in bankruptcy in their individual capacities and need a "fresh start." The decedent was not in bankruptcy in his individual capacity and, therefore, did not need a "fresh start." The decedent was not entitled to exclude his shares of the partnership COD income under section 108(a)(1)(A).

Recommendation: Nonacquiescence.

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Reviewers:

Approved:

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Internal Revenue Service

By: _____
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ACTION ON DECISION

Subject: Gracia v. Commissioner, T.C. Memo. 2004-147¹

Issue: Whether a general partner who guaranteed the debt of a partnership and was not in bankruptcy in his individual capacity may exclude from gross income under section 108(a) partnership debt cancelled in a title 11 case of the partnership.

Discussion: The taxpayer was a general partner in a partnership and personally guaranteed some of the partnership's debts. The partnership initiated a case under title 11 of the United States Code (relating to bankruptcy). The partners in the partnership, including the taxpayer, reached a settlement agreement with the trustee of the bankruptcy estate, under which they would make payments to the partnership's bankruptcy estate in exchange for the release of claims or potential claims of creditors against them relating to the partnership. The bankruptcy court approved the agreement, and discharged and released the partners from all liability related to the partnership, their status as general partners, and their personal guarantees of partnership debts. The same order provided that each partner "is subject to the jurisdiction of the Bankruptcy Court."

The taxpayer did not include the cancellation of debt income (COD income) allocated to him by the partnership on his tax return for the year of the discharge. In the notice of deficiency, the Service rejected the taxpayer's claim to an exclusion of the partnership COD income.

The Tax Court held that the taxpayer may exclude his share of the partnership COD income from gross income under section 108(a)(1)(A) because the partnership debt was discharged "in a title 11 case" within the meaning of section 108(d)(2). Invoking the principle of judicial comity, the Tax Court noted that the bankruptcy court's order discharged and released the partners from liability in a title 11 case and explicitly asserted jurisdiction over them.

The Service disagrees with the Tax Court's holding.

Section 61(a)(12) provides that gross income includes COD income. Section 108(a)(1)(A) excludes from gross income any amount derived from "the discharge (in whole or in part) of indebtedness of the taxpayer" if the discharge occurs in a title 11 case. Under section 108(d)(1), "indebtedness of the taxpayer" means any

¹ The Tax Court issued essentially identical opinions for three other partners in the partnership: Mirarchi v. Commissioner, T.C. Memo. 2004-148; Price v. Commissioner, T.C. Memo. 2004-149; and Estate of Martinez v. Commissioner, T.C. Memo. 2004-150.

indebtedness (A) for which the taxpayer is liable, or (B) subject to which the taxpayer holds property." Section 108(d)(2) defines a "title 11 case" as "a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Section 108(d)(6) provides that, in the case of a partnership, subsection (a) and certain other parts of section 108 must be applied at the partner level.

Under the Bankruptcy Code, the term "debtor" means a "person . . . concerning which a case under this title [title 11] has been commenced." 11 U.S.C. 101(13).

The Tax Court has observed that "the entire structure of section 108, as well as the . . . legislative history [of section 108(a)(1)(A)] (see, e.g., S. Rept. 96-1035, pp. 8-14 (1980), 1980-2 C.B. 620, 623-627), makes it plain that the provision [section 108(a)(1)(A)] operates to provide tax relief to the debtor in bankruptcy," and not a non-debtor party in a bankruptcy proceeding. Yamamoto v. Commissioner, T.C. Memo. 1990-549, aff'd without published opinion, 958 F.2d 380 (9th Cir. 1992).

In discussing the addition of section 108(d)(6), Congress explained that discharge of a partnership debt is an item of income allocated separately to each partner pursuant to section 702(a). Congress indicated its intent to limit the scope of section 108(a)(1) to bankrupt or insolvent partners, and not to all partners of a bankrupt partnership. "The tax treatment of the amount of discharged partnership debt which is allocated as an income item to a particular partner depends on whether that partner is in a bankruptcy case, is insolvent (but not in a bankruptcy case), or is solvent (and not in a bankruptcy case). . . . [I]f the particular partner is bankrupt, the debt discharge amount is excluded from gross income pursuant to amended section 108" S. Rep. No. 96-1035, at 21, 1980-2 C.B. 620, 631.

The legislative history further explains that the income tax treatment of debt discharge in bankruptcy is intended to preserve the debtor's "fresh start" after bankruptcy by excluding COD income from the debtor's income so that "the debtor coming out of bankruptcy . . . is not burdened with an immediate tax liability." S. Rep. No. 96-1035, supra, at 10, 1980-2 C.B. at 624.

The Tax Court's ruling is inconsistent with the structure of section 108 and underlying Congressional intent. The taxpayer was not under the jurisdiction of the bankruptcy court in a title 11 case as a debtor. The partnership, not the taxpayer, filed the petition in the bankruptcy court. The taxpayer was not a "person . . . concerning [whom] a case under this title [title 11] has been commenced." 11 U.S.C. 101(13). Section 108(a) applies at the partner level. The exclusion in section 108(a)(1)(A) applies only to

partners who are debtors in bankruptcy in their individual capacities and need a "fresh start." The taxpayer was not in bankruptcy in his individual capacity and, therefore, did not need a "fresh start." The taxpayer was not entitled to exclude his shares of the partnership COD income under section 108(a)(1)(A).

Recommendation: Nonacquiescence.

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ACTION ON DECISION

Subject: Mirarchi v. Commissioner, T.C. Memo. 2004-148¹

Issue: Whether a general partner who guaranteed the debt of a partnership and was not in bankruptcy in his individual capacity may exclude from gross income under section 108(a) partnership debt cancelled in a title 11 case of the partnership.

Discussion: The taxpayer was a general partner in a partnership and personally guaranteed some of the partnership's debts. The partnership initiated a case under title 11 of the United States Code (relating to bankruptcy). The partners in the partnership, including the taxpayer, reached a settlement agreement with the trustee of the bankruptcy estate, under which they would make payments to the partnership's bankruptcy estate in exchange for the release of claims or potential claims of creditors against them relating to the partnership. The bankruptcy court approved the agreement, and discharged and released the partners from all liability related to the partnership, their status as general partners, and their personal guarantees of partnership debts. The same order provided that each partner "is subject to the jurisdiction of the Bankruptcy Court."

The taxpayer included only a portion of the cancellation of debt income (COD income) allocated to him by the partnership on his tax return for the year of the discharge. In the notice of deficiency, the Service increased the amount includible, allowing taxpayer to exclude some of the COD income under the insolvency exclusion in section 108(a)(1)(B) of the Internal Revenue Code.

The Tax Court held that the taxpayer may exclude his entire share of the partnership COD income from gross income under the bankruptcy exclusion in section 108(a)(1)(A) because the partnership debt was discharged "in a title 11 case" within the meaning of section 108(d)(2). Invoking the principle of judicial comity, the Tax Court noted that the bankruptcy court's order discharged and released the partners from liability in a title 11 case and explicitly asserted jurisdiction over them.

The Service disagrees with the Tax Court's holding.

Section 61(a)(12) provides that gross income includes COD income. Section 108(a)(1)(A) excludes from gross income any amount derived from "the discharge (in whole or in part) of indebtedness of the taxpayer" if the discharge occurs in a title 11

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case. Under section 108(d)(1), "indebtedness of the taxpayer' means any indebtedness (A) for which the taxpayer is liable, or (B) subject to which the taxpayer holds property." Section 108(d)(2) defines a "title 11 case" as "a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Section 108(d)(6) provides that, in the case of a partnership, subsection (a) and certain other parts of section 108 must be applied at the partner level.

Under the Bankruptcy Code, the term "debtor" means a "person . . . concerning which a case under this title [title 11] has been commenced." 11 U.S.C. 101(13).

The Tax Court has observed that "the entire structure of section 108, as well as the . . . legislative history [of section 108(a)(1)(A)] (see, e.g., S. Rept. 96-1035, pp. 8-14 (1980), 1980-2 C.B. 620, 623-627), makes it plain that the provision [section 108(a)(1)(A)] operates to provide tax relief to the debtor in bankruptcy," and not a non-debtor party in a bankruptcy proceeding. Yamamoto v. Commissioner, T.C. Memo. 1990-549, aff'd without published opinion, 958 F.2d 380 (9th Cir. 1992).

In discussing the addition of section 108(d)(6), Congress explained that discharge of a partnership debt is an item of income allocated separately to each partner pursuant to section 702(a). Congress indicated its intent to limit the scope of section 108(a)(1) to bankrupt or insolvent partners, and not to all partners of a bankrupt partnership. "The tax treatment of the amount of discharged partnership debt which is allocated as an income item to a particular partner depends on whether that partner is in a bankruptcy case, is insolvent (but not in a bankruptcy case), or is solvent (and not in a bankruptcy case). . . . [I]f the particular partner is bankrupt, the debt discharge amount is excluded from gross income pursuant to amended section 108" S. Rep. No. 96-1035, at 21, 1980-2 C.B. 620, 631.

The legislative history further explains that the income tax treatment of debt discharge in bankruptcy is intended to preserve the debtor's "fresh start" after bankruptcy by excluding COD income from the debtor's income so that "the debtor coming out of bankruptcy . . . is not burdened with an immediate tax liability." S. Rep. No. 96-1035, supra, at 10, 1980-2 C.B. at 624.

The Tax Court's ruling is inconsistent with the structure of section 108 and underlying Congressional intent. The taxpayer was not under the jurisdiction of the bankruptcy court in a title 11 case as a debtor. The partnership, not the taxpayer, filed the petition in the bankruptcy court. The taxpayer was not a "person . . . concerning [whom] a case under this title [title 11] has been commenced." 11 U.S.C. 101(13). Section 108(a)

applies at the partner level. The exclusion in section 108(a)(1)(A) applies only to partners who are debtors in bankruptcy in their individual capacities and need a "fresh start." The taxpayer was not in bankruptcy in his individual capacity and, therefore, did not need a "fresh start." The taxpayer was not entitled to exclude his shares of the partnership COD income under section 108(a)(1)(A).

Recommendation: Nonacquiescence.

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ACTION ON DECISION

Subject: Price v. Commissioner, T.C. Memo. 2004-149¹

Issue: Whether a general partner who guaranteed the debt of a partnership and was not in bankruptcy in his individual capacity may exclude from gross income under section 108(a) partnership debt cancelled in a title 11 case of the partnership.

Discussion: The taxpayer was a general partner in a partnership and personally guaranteed some of the partnership's debts. The partnership initiated a case under title 11 of the United States Code (relating to bankruptcy). The partners in the partnership, including the taxpayer, reached a settlement agreement with the trustee of the bankruptcy estate, under which they would make payments to the partnership's bankruptcy estate in exchange for the release of claims or potential claims of creditors against them relating to the partnership. The bankruptcy court approved the agreement, and discharged and released the partners from all liability related to the partnership, their status as general partners, and their personal guarantees of partnership debts. The same order provided that each partner "is subject to the jurisdiction of the Bankruptcy Court."

The taxpayer included only a portion of the cancellation of debt income (COD income) allocated to him by the partnership on his tax return for the year of the discharge. In the notice of deficiency, the Service increased the amount includible, allowing taxpayer to exclude some of the COD income under the insolvency exclusion in section 108(a)(1)(B) of the Internal Revenue Code.

The Tax Court held that the taxpayer may exclude his entire share of the partnership COD income from gross income under the bankruptcy exclusion in section 108(a)(1)(A) because the partnership debt was discharged "in a title 11 case" within the meaning of section 108(d)(2). Invoking the principle of judicial comity, the Tax Court noted that the bankruptcy court's order discharged and released the partners from liability in a title 11 case and explicitly asserted jurisdiction over them.

The Service disagrees with the Tax Court's holding.

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case. Under section 108(d)(1), "'indebtedness of the taxpayer' means any indebtedness (A) for which the taxpayer is liable, or (B) subject to which the taxpayer holds property." Section 108(d)(2) defines a "title 11 case" as "a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Section 108(d)(6) provides that, in the case of a partnership, subsection (a) and certain other parts of section 108 must be applied at the partner level.

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The Tax Court's ruling is inconsistent with the structure of section 108 and underlying Congressional intent. The taxpayer was not under the jurisdiction of the bankruptcy court in a title 11 case as a debtor. The partnership, not the taxpayer, filed the petition in the bankruptcy court. The taxpayer was not a "person . . . concerning [whom] a case under this title [title 11] has been commenced." 11 U.S.C. 101(13). Section 108(a)

applies at the partner level. The exclusion in section 108(a)(1)(A) applies only to partners who are debtors in bankruptcy in their individual capacities and need a "fresh start." The taxpayer was not in bankruptcy in his individual capacity and, therefore, did not need a "fresh start." The taxpayer was not entitled to exclude his shares of the partnership COD income under section 108(a)(1)(A).

Recommendation: Nonacquiescence.

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