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Issue Contents

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After Repeal of the "Small Partnership" in 2015, What Next?

-by Neil E. Harl*

After a shocking and unannounced repeal of the "small partnership" provision in late 2015, as part of the Bipartisan Budget Act of 2015,[1] which was enacted as part of the Tax Equity and Fiscal Responsibility of 1982, the stunned users of that part of the 1982 Act began to raise questions. When does it go into effect? Will I end up with partnership status? Will I have a choice on what I can shift to? Will that shift be automatic or will it be an election? In the 27 months which have elapsed since enactment, not one word has emanated from the Internal Revenue Service. This article will, hopefully, focus on the problems and some of the likely options, but will certainly not be the last word on the issue.

What the "Small Partnership" has allowed

Stated briefly, the "small partnership" exception has allowed for 36 years a simple way for 10 or fewer individuals to report their income, losses and credits by simply passing those items (and any others) to the taxpayers individually each year and report the items on their own Form 1040.[2] No other filing or Forms was required. The provision itself could be used by individuals (other than non-resident aliens), estates of deceased partners (C corporations have been eligible since 1997) or a husband and wife who are treated as one partner. The provision has been popular and fairly widely used. Some individuals, notably CPAs, have complained that the simplicity of tax reporting by clients using the "small partnership" affected negatively "their bottom line" and lobbied for repeal.

The repeal was carefully camouflaged in the legislation.

What's Next?

The repeal statement merely states that the repeal was "effective generally beginning for returns filed for partnership tax years beginning after 12-31-2017." Does that mean that tax returns for 2017 must be filed under the new rule? Or does it mean that the first returns requiring the new rules are those filed in 2019? That is not clear.

What are the options for those making use of the provision?

The dozens of mostly letter rulings are rather vague as to the options open to those

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who had been using the provision in past years.[3] Many of those making use of the "small partnership" as it was called, know that the trend is for partnership tax law to gradually become more complex (and expensive for professional assistance in filing) and are looking elsewhere for assistance. For many, shifting to a partnership status is unattractive for that reason and also because the clear trend has been for partnership status to shift gradually for other reasons to greater and greater complexity. Some are considering shifting to tenancy common ownership status. Others, in light of the dramatically larger amount passing at death under the 2017 tax bill for federal estate tax purposes, are considering shifting to joint tenancy with right of survivorship. Others are looking at limited liability company status but are wary that some authority exists that shifting to LLC status could lead to partnership characterization (which could invoke several undesirable features along the complexity line). There is really no clear choice that is free of negatives. Yet, for many it is a high stakes choice with the chosen path possibly leading to costly outcomes both in time and in funding.

One farm couple in their 80s with 1,000 acres abhors the partnership complexity and has no desire to get into partnership complexities now existing and even more being considered under the guise of partnership "audits." Their plea – why would Congress bow to a few CPAs and repeal what has worked very well for many, many years?

ENDNOTES

[1] Bipartisan Budget Act of 2015, Pub. L. No. 114-74, § 1101[a], 129 Stat. 584 (2015).

[2] *Id*.

[3] See, e.g., Ltr. Rul. 200418028, Jan. 27, 2004.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

DISMISSAL. The debtor was an LLC which filed its articles of organization with the secretary of state on August 2, 2017 at 10:52 a.m. That same day, the two members of the LLC transferred by quitclaim deed to the LLC farm property which was scheduled for a sheriff's sale the next day. The LLC filed for Chapter 12 on the same day at 4:59 p.m. The debtor filed only the petition and the creditors' matrix. Two weeks later, the trustee filed a motion to dismiss the case with a request to bar any refiling for 180 days. The case was dismissed on September 11 prior to a hearing on the trustee's motion and no refiling bar was included. The case was reinstated but before the trustee's motion could be heard, the debtor filed a motion to dismiss. The members of the LLC had filed personal Chapter 12 cases which were all dismissed for failure to file confirmable plans. Section 1208(b) provides that Chapter 12 debtors may move to dismiss their cases at any time, and upon such a request, the court shall dismiss the case, provided that the case has not previously been converted from another chapter. The trustee argued that a Chapter 12 case can be dismissed for cause under Section 1208(c) and that the debtor filed the case only to hinder and delay the collection of debts because the debtor could not have generated any farm income or debt within a day before filing the petition so as to qualify as a farm debtor under Section 101(18). The issue was whether the right to seek a dismissal under Section 1208(c) overrides the debtor's right to dismiss a case. The court noted a split in authority over the issue but refused to rule one way or the other on the issue but held that the court could accept the debtor's motion to dismiss and as part of the dismissal impose conditions on the debtor's right to refile. The debtor argued that Sections 349 and 109(g) set out two instances in which the court can impose a 180-day bar to refiling upon dismissal of a case: (1) the dismissal was due to the debtor's willful failure to abide by the court's orders or to appear before the court in proper prosecution of the case and (2) the debtor asks for and obtains voluntary dismissal of his case in response to a creditor's relief from stay motion. The court disagreed and held that Section 349(a) allowed the court authority to place conditions on refiling where the conduct of the members of the debtor amounted to bad faith serial filings in bankruptcy. Therefore, the court ordered the case to be dismissed and prohibited the debtor from refiling in Chapter 12 for 180 days. ***In re* Valentine Hill Farm, LLC, 2018 Bankr. LEXIS 184 (Bankr. S.D. Ind. 2018)**.

The debtor filed a Chapter 12 case in November 2017 and listed secured debt of $700,000 and unsecured debt of $1 million. The debtor listed income for 2015 and 2016 of about $10 million each year but no income for 2017. At the meeting of creditors, the debtor invoked the Fifth Amendment in refusing to answer questions and refused to produce any documents, giving the reasons that either no documents existed or that they were under the control of the debtor's father. The trust filed a motion to dismiss the case for bad faith for the failure of the debtor to answer the questions and provide records. In addition, a bank holding a secured claim sought an order to compel the debtor to explain the disappearance of 2,100 head of cattle which secured a loan with the bank. The court also heard from the USDA which was interested in the debtor as to whether the debtor sold corn-fed cattle as grass-fed cattle, a possible criminal violation. The court noted that these complaints and the potential for more from other creditors indicated that many of the claims against the debtor would be nondischargeable. The court found that the failure of the debtor to answer questions and produce documents about the debtor's business and finances was a clear indication of a bad faith filing by the debtor, solely for the purpose of delaying the investigation of the debtor's estate. Thus, the court ordered the case to be dismissed and prohibited the debtor from refiling any case within 180 days. The court also rejected a creditor's motion