



# TaxNewsFlash

United States



No. 2022-314  
October 13, 2022

## U.S. Tax Court: Partnership distribution of “clients” was distribution of intangible assets

The U.S. Tax Court today released a memorandum opinion holding that a distribution by a partnership (an accounting firm) of “clients” to withdrawing partners was a distribution of client-based intangible assets—the value of which was properly determined under the terms of the partnership agreement.

The court also held, however, that the partnership’s special allocations of income to the withdrawing partners following the distributions lacked substantial economic effect and must be reallocated in accordance with the partners’ interests in the partnership.

The case is: *Clark Raymond & Company PLLC v. Commissioner*, T.C. Memo 2022-105 (October 13, 2022). Read the Tax Court’s [opinion](#) [PDF 519 KB]

### Summary

The partners in the partnership in 2013, consisting of three single-member entities, negotiated a buyout of one of the partners in anticipation of the retirement of that partner’s principal owner. The partners memorialized the buyout in a restated partnership agreement that included provisions governing allocations of income and distributions (both liquidating and non-liquidating) to the partners, as well as a qualified income offset (QIO) provision. The partnership agreement anticipated that a partner could receive a distribution of “clients” from the partnership and provided a method for valuing such a distribution.

Shortly after executing the restated partnership agreement, two of the partners withdrew from the partnership, and certain clients of the partnership stopped engaging the partnership and instead retained the withdrawing partners’ new partnership. The remaining partner in the partnership, as tax matters partner for the partnership, reported on the partnership’s 2013 Form 1065, “U.S. Return of Partnership Income,” that the withdrawing partners received distributions from the partnership in amounts equal to the value of the clients (as determined under the restated partnership agreement) that followed the withdrawing partners to their new partnership. The remaining partner also decreased the withdrawing partners’ capital accounts by the value of the reported distributions, and thereby reduced the withdrawing partners’ capital accounts below zero. To restore the withdrawing partners’ capital accounts to zero, the remaining partner allocated (for tax purposes) all of the partnership’s ordinary income for 2013 to the withdrawing partners, pursuant to a QIO provision in the

partnership agreement. As a result, the retiring partner allocated to itself no taxable income from the partnership.

The withdrawing partners filed Forms 8082, "Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)," contesting the partnership's 2013 income allocations, and the IRS subsequently audited the partnership's 2013 return. The IRS determined that the partnership's "client distributions" had not been substantiated and that the partnership's corresponding allocations of income lacked substantial economic effect.

The Tax Court rejected the IRS' determination that the partnership did not distribute client-based intangibles to the withdrawing partners that could be properly valued under the terms of the partnership agreement. However, the Tax Court found that the partnership failed to maintain capital accounts in accordance with Treas. Reg. § 1.704-1(b)(2)(iv) because the partnership did not allocate the unrealized gain inherent in the client-based intangibles across the partners' capital accounts before decreasing the withdrawing partners' capital accounts by the value of the distributions. Thus, the partnership's special allocations of income to the withdrawing partners lacked substantial economic effect and must be reallocated in accordance with the partners' interests in the partnership under section 704(b) and Treas. Reg. § 1.704-1(b)(3). The Tax Court also confirmed that because the withdrawing partners had negative capital accounts at the end of the taxable year and the partnership agreement included a QJO, ordinary income must be allocated first to the withdrawing partners in an amount necessary to bring each partner's capital account up to zero.

[kpmg.com/socialmedia](https://kpmg.com/socialmedia)



The information contained in TaxNewsFlash is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230, as the content of this document is issued for general informational purposes only, is intended to enhance the reader's knowledge on the matters addressed therein, and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

Direct comments, including requests for subscriptions, to [Washington National Tax](#). For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at +1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.

To unsubscribe from TaxNewsFlash-United States, reply to [Washington National Tax](#).

[Privacy](#) | [Legal](#)