Chapter 20

Partnerships

**Eugene Willis, William H. Hoffman, Jr.,
David M. Maloney and William A. Raabe**

Partnership Definition

- An association of two or more persons to carry on a trade or business
  - Contribute money, property, labor
  - Expect to share in profit and losses
- For tax purposes, includes:
  - Syndicate
  - Group
  - Pool
  - Joint venture, etc

Entities Taxed As Partnerships
(slide 1 of 4)

- General partnership
  - Consists of at least 2 partners
  - Partners are jointly and severally liable
    - Creditors can collect from both partnership and partners' personal assets
    - General partner's assets are at risk for malpractice of other partners even though not personally involved

Entities Taxed As Partnerships
(slide 2 of 4)

- Limited liability partnership (LLP)
  - An LLP partner is not liable for malpractice committed by other partners
  - Popular organizational form for large accounting firms

Entities Taxed As Partnerships
(slide 3 of 4)

- Limited partnership
  - Has at least one general partner
    - One or more limited partners
  - Only general partner(s) are liable to creditors
    - Limited partners' loss is limited to equity investment

Entities Taxed As Partnerships
(slide 4 of 4)

- Limited liability company (LLC)
  - Combines the corporate benefit of limited liability with benefits of partnership taxation
    - Unlike corporations, income is subject to tax only once
    - Special allocations of income, losses, and cash flow are available
  - Owners are "members", not partners, but if properly structured will receive partnership tax treatment

“Check-The-Box” Regs (slide 1 of 2)

- Allows most unincorporated entities to select their federal tax status
  - If 2 or more owners, can choose to be treated as:
    - Partnership, or
    - Corporation
  - Permits some flexibility
    - Not all entities have a choice
    - e.g., New publicly traded partnerships must be taxed as corporations

“Check-The-Box” Regs (slide 2 of 2)

- Some entities can be excluded from partnership treatment if organized for:
  – Investment (not active trade or business)
  – Joint production, extraction, or use of property
  – Underwriting, selling, or distributing a specific security
- Owners simply report their share of operations on their own tax return

Partnership Taxation (slide 1 of 3)

- Partnership is not a taxable entity
  - Flow through entity
    - Income taxed to owners, not entity
    - Partners report their share of partnership income or loss on their own tax return

Partnership Taxation (slide 2 of 3)

- Generally, the calculation of partnership income is a 2-step approach

  Step 1: Net ordinary income and expenses related to the trade or business of the partnership

  Step 2: Segregate and report separately some partnership items

  - If an item of income, expense, gain or loss *might* affect any 2 partners' tax liabilities differently, it is separately stated
  - e.g., Charitable contributions

Partnership Taxation (slide 3 of 3)

- Electing large partnerships can net some items that would otherwise be separately stated
  - Must have at least 100 partners and elect simplified reporting procedures
  - Report no more than 16 separately stated items
    - e.g., Net short-term and long-term capital gains and losses at partnership level and report the net amount to partners

Partnership Reporting

- Partnership files Form 1065
  - Includes Schedule K which accumulates the information to be reported to partners
    - Provides ordinary income and separately stated items in total
  - Each partner (and the IRS) receives a Schedule K-1 for each partner
    - Reports each partner’s share of income, expense, gain, and loss

Partner’s Ownership Interest

- Each owner normally has a:
  - Capital interest
    - Measured by capital sharing ratio
      - Partner’s percentage ownership of capital
  - Profits(loss) interest
    - Partner’s % allocation of partnership ordinary income (loss) and separately stated items
    - Certain items may be “specially allocated”
  - Specified in the partnership agreement

Basis Issues (slide 1 of 3)

- Each partner has a basis in their partnership interest
  - Partner's basis is adjusted for income and losses that flow through
    - This ensures that partnership income is only taxed once

Basis Issues (slide 2 of 3)

- Partner's basis is important for determining:
  - Deductibility of partnership losses
  - Tax treatment of partnership distributions
  - Gain or loss on disposition of partnership interest

Basis Issues (slide 3 of 3)

- Partner's basis is important (cont'd):
  - Partner's capital account balance is usually not a good measure of a partner's adjusted basis in a partnership interest for several reasons
    - e.g., Basis includes partner's share of partnership liabilities; Capital account does not

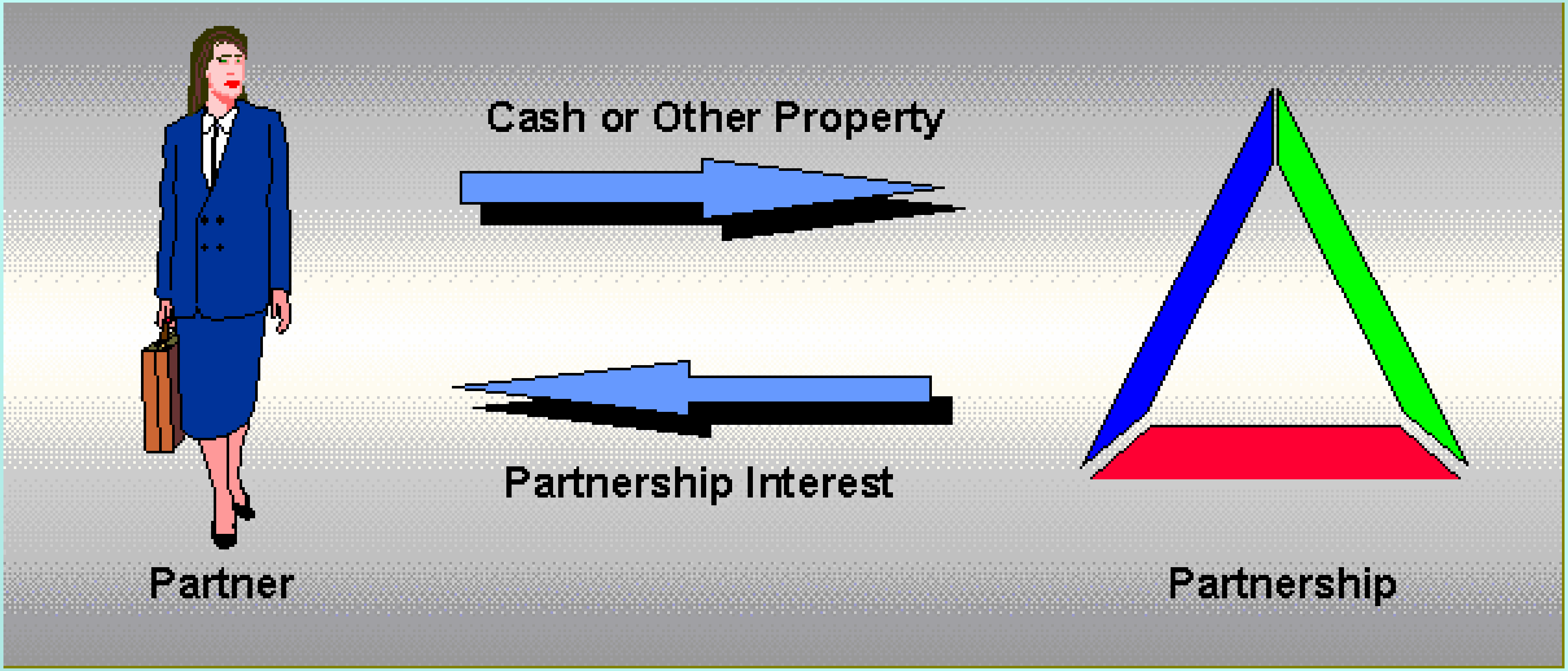
Conceptual Basis For Partnership Taxation (slide 1 of 2)

- Involves 2 legal concepts:
  - Aggregate (or conduit) concept - Treats partnership as a channel with income, expense, gains, etc. flowing through to partners
    - Concept is reflected by the imposition of tax on the partners, not the partnership

Conceptual Basis For Partnership Taxation (slide 2 of 2)

- Involves 2 legal concepts (cont'd):
  - Entity concept - Treats partners and partnership as separate and is reflected by:
    - Partnership requirement to file its own information return
    - Treating partners as separate from the partnership in certain transactions between the two

Partnership Formation Transaction



Tax Consequences of Partnership Formation (slide 1 of 2)

- Usually, no gain or loss is recognized by a partner or partnership on the contribution of money or property in exchange for a partnership interest
- Gain (loss) is deferred until taxable disposition of:
  - Property by partnership, or
  - Partnership interest by partner

Tax Consequences of Partnership Formation (slide 2 of 2)

- Partner's basis in partnership interest = basis of contributed property
  - If partner contributes capital assets and §1231 assets, holding period of partnership interest includes holding period of assets contributed
  - For other assets including cash, holding period begins on date partnership interest is acquired
  - If multiple assets are contributed, partnership interest is apportioned and separate holding period applies to each portion

WST Partnership Formation Example (slide 1 of 2)

- William contributes cash
  - Amount $20,000
- Sarah contributes land
  - Basis $ 6,000
  - FMV $20,000
- Todd contributes equipment
  - Basis $22,000
  - FMV $20,000

WST Partnership Formation Example (slide 2 of 2)

Partner	Gain or loss Recognized	Basis in Interest	Partnership's Property Basis
William	$-0-	$20,000	$20,000
Sarah	$-0-	$ 6,000	$ 6,000
Todd	$-0-	$22,000	$22,000

Neither the partnership nor any of the partners recognizes gain or loss on the transaction

Exceptions to Tax-Free Treatment on Partnership Formation (slide 1 of 4)

- Transfers of appreciated stock to investment partnership
  – Gain will be recognized by contributing partner
  – Prevents multiple investors from diversifying their portfolios tax-free

Exceptions to Tax-Free Treatment on Partnership Formation (slide 2 of 4)

- If transaction is essentially a taxable exchange of properties, gain will be recognized
  - e.g., Individual A contributes land and Individual B contributes equipment to a new partnership; shortly thereafter, the partnership distributes the land to B and the equipment to A; Partnership liquidates
  - IRS will disregard transfer to partnership and treat as taxable exchange between A & B

Exceptions to Tax-Free Treatment on Partnership Formation (slide 3 of 4)

- Disguised Sale
  - e.g., Partner contributes property to a partnership; Shortly thereafter, partner receives a distribution from the partnership
    - Payment may be viewed as a purchase of the property by the partnership

Exceptions to Tax-Free Treatment on Partnership Formation (slide 4 of 4)

- Receipt of partnership interest in exchange for services rendered to partnership
  - Services are not treated as "property"
  - Partner recognizes ordinary compensation income = FMV of partnership interest received

Tax Issues Relative To Contributed Property (slide 1 of 4)

- Partnership's basis in property contributed to the partnership equals contributing partner's basis (i.e., a carryover basis)
- Partner's basis in partnership interest received equals basis in contributed property (i.e., a substituted basis)

Tax Issues Relative To Contributed Property (slide 2 of 4)

- Contributions of depreciable property and intangible assets
  - Partnership “steps into shoes” of contributing partner
    - Continues the same cost recovery (amortization) calculations
    - Cannot expense contributed depreciable property under §179

Tax Issues Relative To Contributed Property (slide 3 of 4)

- Gain or loss is ordinary when partnership disposes of:
  - Contributed unrealized receivables
  - Contributed property that was inventory in contributor’s hands, if disposed of within 5 years of contribution
    - Inventory includes all tangible property except capital assets and real or depreciable business assets

Tax Issues Relative To Contributed Property (slide 4 of 4)

- If contributed property is disposed of at a loss and the property had a “built-in” capital loss on the contribution date
  - Loss is treated as a capital loss if disposed of within 5 years of contribution
  - Capital loss is limited to built-in loss on date of contribution

Elections Made by Partnership
(slide 1 of 2)

- Inventory method
- Accounting method
  - Cash, accrual or hybrid
- Depreciation method
- Tax year
- Organizational cost amortization
- Start-up expense amortization

Elections Made by Partnership
(slide 2 of 2)

- Optional basis adjustment (§754)
- §179 deduction
- Nonrecognition treatment for involuntary conversions
- Election out of partnership rules

Initial Costs of Partnership

Sec.	Type of cost	Treatment
709	Organization expense	≥ 60 mo. Amort
709	Syndication costs	Capitalized
195	Pre-operating expense	≥ 60 mo. Amort.
162	Ordinary/Necessary Exp.	Deduction
167	Acquisition of property	Depreciated
197	§197 Intangible	15 yr. Amort.

Method Of Accounting
(slide 1 of 2)

- New partnership may adopt cash, accrual or hybrid method
  - Cash method cannot be adopted if partnership:
    - Has one or more C corporation partners
    - Is a tax shelter

Method Of Accounting
(slide 2 of 2)

- New partnership may adopt cash, accrual or hybrid method (cont'd)
  - C Corp partner does not preclude use of cash method if:
    - Partnership has average annual gross receipts of $5 million or less for preceding 3 year period
    - C corp partner(s) is a qualified personal service corp, or
    - Partnership is engaged in farming business

Required Taxable Year

- Partnership must adopt tax year under earliest of following tests met:
  - Majority partner's tax year (partners with same tax year owning >50%)
  - Principal partners' tax year (all partners owning 5% or more)
  - Least aggregate deferral rule

Least Aggregate Deferral Example (slide 1 of 2)

- George owns 50% and has June 30 year end
- Henry owns 50% and has October 31 year end
- Neither partner owns a "majority" (>50%)
- Both are "principal partners" (5% or more), but do not have same year end
  - Must use least aggregate deferral test to determine required taxable year

Least Aggregate Deferral Example(slide 2 of 2)

1. Test June 30 as possible year end:

Partner.	Year End	%	Mo. Deferral	Weight
George	June	50%	0	0.0
Henry	October	50%	4	2.0
Total weighed deferral				2.0

2. Test October 31 as possible year end:

George	June	50%	8	4.0
Henry	October	50%	0	0.0
Total weighed deferral				4.0

June has the least aggregate deferral so it is the tax year for partnership.

Alternative Tax Years

- Other alternatives may be available if:
  - Establish to IRS's satisfaction that a business purpose exists for another tax year
    - e.g., Natural business year at end of peak season
    - Obtain IRS approval to use natural business year
  - Choose tax year with no more than 3 month deferral
    - Partnership must maintain with IRS a prepaid, non-interest-bearing deposit of estimated deferred taxes based on highest individual tax rate + 1%

Measuring Income of Partnership

- Calculation of partnership income is a 2-step approach

  Step 1: Net ordinary income and expenses related to the trade or business of the partnership

  Step 2: Segregate and report separately some partnership items

Separately Stated Items (slide 1 of 2)

- If an item of income, expense, gain or loss *might* affect any 2 partners' tax liabilities differently, it is separately stated

Separately Stated Items (slide 2 of 2)

- Separately stated items fall under the "aggregate" concept
  - Each partner owns a specific share of each item of partnership income, gain, loss or deduction
    - Character is determined at partnership level
    - Taxation is determined at partner level

Examples Of Separately Stated Items (slide 1 of 2)

- Short and long-term capital gains and losses
- §1231 gains and losses
- Charitable contributions
- Interest income and other portfolio income

Examples Of Separately Stated Items (slide 2 of 2)

- Personalty expensed under §179
- Special allocations of income or expense
- AMT preference and adjustment items
- Passive activity items
- Self-employment income
- Foreign taxes paid

Partnership Taxable Income Example (slide 1 of 3)

Sales revenue	100,000
Salaries	35,000
Rent	15,000
Utilities	6,000
Interest income	1,500
Charitable contribution	2,000
AMT adjustment for depreciation	3,600
Payment of partner’s medical expenses	4,000

Partnership Taxable Income Example (slide 2 of 3)

- Partnership ordinary taxable income:

Sales revenue	$100,000
Salaries	35,000
Rent	15,000
Utilities	6,000
Partnership Ordinary Income	$ 44,000

Partnership Taxable Income Example (slide 3 of 3)

- Separately stated items:
  - Interest income $1,500
  - Charitable contribution 2,000
  - AMT adjustment for depreciation 3,600
- Distribution to partner:
  - Payment of partner's medical exp. $4,000

Partnership Allocations (slide 1 of 3)

- Partnership agreement can provide that partners share capital, profits, and losses in different ratios
  - e.g., Partnership agreement may provide that a partner has a 30% capital sharing ratio, yet be allocated 40% of the profits and 20% of the losses
  - Such special allocations are permissible if certain rules are followed
    - i.e., Economic effect test

Partnership Allocations (slide 2 of 3)

- The economic effect test requires that:
  - An allocation must be reflected in a partner's capital account
  - When partner's interest is liquidated, partner must receive assets with FMV = the positive balance in the capital account
  - A partner with a negative capital account must restore that account upon liquidation

Partnership Allocations (slide 3 of 3)

- Precontribution gain or loss
  - Must be allocated to partners taking into account the difference between basis and FMV on date of contribution
    - For nondepreciable property this means any built-in gain or loss must be allocated to the contributing partner when disposed of by partnership in taxable transaction

Basis of Partnership Interest
(slide 1 of 3)

- For new partnerships, partner's basis usually equals:
  - Adjusted basis of property contributed, plus
  - FMV of any services performed by partner in exchange for partnership interest

Basis of Partnership Interest

(slide 2 of 3)

- For existing partnerships, basis depends on how interest was acquired
  - If purchased from another partner, basis = amount paid for the interest
  - If acquired by gift, basis = donor's basis plus, in certain cases, a portion of the gift tax paid on the transfer
  - If acquired through inheritance, basis = FMV on date of death (or alternate valuation date)

Basis of Partnership Interest
(slide 3 of 3)

- A partner's basis in partnership interest is adjusted to reflect partnership activity
  - This prevents double taxation of partnership income

Basis Example (slide 1 of 2)

- Pam is a 30% partner in the PDQ partnership
- Pam's beginning basis is $20,000
- PDQ reports current income of $50,000
- Pam sells her interest for $35,000 at the end of the year

Basis Example (slide 2 of 2)

	With Basis Adjustment	Without Basis Adjustment
Selling Price(A)	$ 35,000	$ 35,000
Less: Basis in interest		
Beginning basis	20,000	20,000
Share of current income	15,000	- 0-
Ending basis (B)	35,000	20,000
Taxable gain (A)-(B)	$ -0-	$ 15,000

-If no basis adjustment, Pam's $15,000 share of partnership income is taxed twice: as ordinary income and as gain on sale of interest

Adjustments to Basis

- Initial Basis

  \+ Partner's subsequent contributions to partnership

  \+ Partner's share of partnership:

    - Debt increase
    - Taxable income items
    - Exempt income items
    - Depletion adjustment

  \- Distributions and withdrawals from partnership

  \- Partner's share of partnership:

    - Debt decreases
    - Nondeductible expenses
    - Losses

Basis Limitation

- A partner's basis in the partnership interest can never be negative

Partnership Liabilities

- Affect partner's adjusted basis
  - Increase in partner's share of liabilities
    - Treated as a cash contribution to the partnership
    - Increases partner's adjusted basis
  - Decrease in partner's share of liabilities
    - Treated as a cash distribution to the partner
    - Decreases partner's adjusted basis

Allocation of Partnership Liabilities

- Two types of partnership debt
  - Recourse debt - At least one partner is personally liable
    - Allocate to partners using a “Constructive Liquidation Scenario”
  - Nonrecourse debt - No partner is personally liable
    - Allocate to partners using a three-tiered allocation

Constructive Liquidation Scenario

1. Partnership assets deemed to be worthless
2. Assets deemed sold at $0; losses determined
3. Losses allocated to partners under partnership agreement
4. Partners with negative capital accounts deemed to contribute cash
5. Deemed contributed cash would repay partnership debt
6. Partnership deemed to liquidate

- Partner's share of recourse debt = Cash contribution used to repay debt (Step 5)

Nonrecourse Debt Allocation

- Three step allocation:
  1. "Minimum Gain" allocated under regulations
     - Minimum gain is basically gain which would arise on foreclosure of property
  2. Liability = precontribution gain allocated to contributing partner
  3. Remaining debt commonly allocated by profit sharing ratios (other allocation methods could be used)

Loss Limitations (slide 1 of 2)

- Partnership losses flow through to partners for use on their tax returns
  - Amount and nature of losses that may be used by partners may be limited
  - Three different loss limitations apply
    - Only losses that make it through all three limits are deductible by a partner

Loss Limitations (slide 2 of 2)

Section	Description
704(d)	Basis in partnership interest
465	At-risk limitation
469	Passive loss limitation

- Limitations are applied successively to amounts which are deductible at all prior levels

Loss Limitation Example (slide 1 of 2)

Meg's basis in interest	$50,000
At-risk amount	$35,000
Passive income, other sources	$25,000
Share of partnership losses(passive)	$60,000

Loss Limitation Example (slide 2 of 2)

Provisions	Deductible loss	Suspended loss
704(d)	$ 50,000	$ 10,000
465	35,000	15,000
469	25,000*	10,000

*Amount deducted on tax return: $25,000

-passes all three loss limitations

Guaranteed Payments

- Payment to partner for use of capital or for services provided to partnership
  – May not be determined by reference to partnership income
  – Usually expressed as a fixed dollar amount or as a % of capital

Treatment of Guaranteed Payments (slide 1 of 2)

- May be deducted or capitalized by partnership depending on the nature of the payment
  - Deductible by partnership if meets "ordinary and necessary business expense" test
  - May create partnership loss

Treatment of Guaranteed Payments (slide 2 of 2)

- Included in income of partner
  - Treated as if received on last day of partnership tax year
  - Character is ordinary income to recipient partner

Other Transactions Between Partner and Partnership (slide 1 of 2)

- May be treated as if partner were an outsider, for example:
  - Loan transactions
  - Rental payments
  - Sales of property

Other Transactions Between Partner and Partnership (slide 2 of 2)

- Timing of deduction for payment by an accrual basis partnership to a cash basis partner depends on whether payment is:
  - – Guaranteed payment
    - Included in partner’s income on last day of partnership year when accrued (even if not paid until the next year)
  - – Payment to partner treated as an outsider
    - – Deduction cannot be claimed until partner includes the amount in income

Sales of Property

- No loss is recognized on the sale of property between a partnership and a partner who owns > 50% of partnership capital or profits
  - If property is subsequently sold at a gain, the disallowed loss reduces gain recognized

Distributions From A Partnership

(slide 1 of 4)

- All distributions of cash and property fall into two categories:
  - Liquidating distributions
  - Nonliquidating distributions
    - Depends on whether the partner remains a partner in the partnership after the distribution

Distributions From A Partnership

(slide 2 of 4)

- A liquidating distribution occurs when either:
  - Partnership itself liquidates and distributes all its property to the partners, or
  - Ongoing partnership redeems interest of one of its partners
    - e.g., Partner retires

Distributions From A Partnership

(slide 3 of 4)

- A nonliquidating distribution is any distribution from a continuing partnership to a continuing partner
  - Two types of nonliquidating distributions
    - Draw
      - Distribution of partner’s share of current or accumulated profits
    - Partially liquidating distribution
      - Reduces partner’s interest in partnership capital but does not liquidate partner’s interest

Distributions From A Partnership

(slide 4 of 4)

- Distributions from a partnership may be either:
  - Proportionate - Partner receives his or her share of certain ordinary income-producing assets
  - Disproportionate - Partner's share of certain ordinary income-producing assets increases or decreases

Proportionate Nonliquidating Distributions (slide 1 of 3)

- Neither partner nor partnership recognizes gain or loss on proportionate nonliquidating distributions
  - Partner usually takes a carryover basis in assets distributed
  - Basis in partnership interest is reduced by amount of cash and basis of property distributed

Proportionate Nonliquidating Distributions (slide 2 of 3)

- Partner recognizes gain to extent cash received exceeds partner's adjusted basis in partnership interest
- Partner cannot recognize loss in a nonliquidating distribution

Proportionate Nonliquidating Distributions (slide 3 of 3)

- Property distributions
  - No gain recognized on a property distribution
    - If inside basis of property distributed exceeds partner's outside basis in partnership interest, distributed asset takes substituted basis
    - Assets are deemed distributed and basis applied in a certain order

Ordering Rules For Basis Determination

When basis of distributed assets exceeds partner's basis in partnership interest, assets are deemed distributed in the following order:

1. Cash
2. Unrealized receivables and inventory
3. All other assets

Proportionate Nonliquidating Distribution Examples (slide 1 of 6)

Bill's basis in partnership interest: $30,000

Proportionate nonliquidating distributions

(independent fact situations):

	A	B	C
Cash	$15,000	$15,000	$ 5,000
Land - basis	N/A	$ 6,000	N/A
(Fair mkt value)	N/A	$10,000	N/A
Accts rec -basis	N/A	N/A	-0-
(Fair mkt value)	N/A	N/A	$16,000

Proportionate Nonliquidating Distribution Examples (slide 2 of 6)

	A	B	C
Basis in interest	$30,000	$30,000	$30,000
Cash distributed	(15,000)	(15,000)	(5,000)
Basis after cash	15,000	15,000	25,000
Acct. rec. distrib.	N/A	N/A	(-0-)
Basis after A.R.	15,000	15,000	25,000
Land Distrib.	N/A	(6,000)	N/A
Basis after all dist.	$15,000	$ 9,000	$25,000

Proportionate Nonliquidating Distribution Examples (slide 3 of 6)

	A	B	C
Basis in p'ship int.	$15,000	$9,000	$25,000
Basis in cash	15,000	15,000	5,000
Basis in land	N/A	6,000	N/A
Basis in A/R	N/A	N/A	-0-
Total basis	$30,000	$30,000	$30,000

	A	B	C
Sale of non-cash assets			
at FMV: Selling price	N/A	$10,000	$16,000
Basis	N/A	(6,000)	(-0-)
Gain	N/A	$4,000	$16,000

Proportionate Nonliquidating Distribution Examples (slide 4 of 6)

Bill's basis in partnership interest: $30,000

Proportionate nonliquidating distributions (independent fact situations):

	D	E	F
Cash	$40,000	N/A	$20,000
Relief of liabilities	N/A	40,000	N/A
Land -basis	N/A	N/A	$30,000
(Fair mkt value)	N/A	N/A	$50,000

Proportionate Nonliquidating Distribution Examples (slide 5 of 6)

	D	E	F
Basis in interest	$30,000	$30,000	$30,000
Cash distributed	(40,000)	N/A	(20,000)
Relief of liabilities	N/A	(40,000)	N/A
Gain recognized	10,000	10,000	N/A
Basis after cash (and deemed cash) dist.	-0-	-0-	10,000
Land distrib.	N/A	N/A	(10,000)
Basis after all distrib.	-0-	-0-	-0-

Proportionate Nonliquidating Distribution Examples (slide 6 of 6)

	D	E	F
Basis in p'ship int.	-0-	-0-	-0-
Basis in cash	40,000	N/A	20,000
Liabilities relieved	N/A	40,000	N/A
Basis in land	N/A	N/A	10,000
Gain recognized	(10,000)	(10,000)	N/A
Original basis	30,000	30,000	30,000
Sale of non-cash assets			
at FMV: Selling price	N/A	N/A	$50,000
Basis	N/A	N/A	(10,000)
Gain	N/A	N/A	$40,000

Basis Determination In Proportionate Nonliquidating Distribution

- When more than one asset in a class is distributed and partner's basis in partnership interest is less than adjusted basis of assets distributed, basis of distributed assets is determined as follows:
  - Each distributed asset in a class initially takes a carryover basis
  - Then, carryover basis for each asset is reduced in proportion to amount carryover basis > FMV
    - Cannot reduce below FMV
  - Any remaining decrease is allocated to assets in the class in proportion to respective adjusted bases

Effect of Liquidating Distribution

- In general:
  - No gain or loss is recognized by partner or partnership
  - Partner reduces basis in partnership interest by basis in property received at each level using Ordering Rules
  - Partner's entire basis in interest will be absorbed by distributed assets

Exceptions to Liquidating Distribution Rules (slide 1 of 2)

- Gain is recognized if cash distributed exceeds partner's basis in partnership interest

Exceptions to Liquidating Distribution Rules (slide 2 of 2)

- Loss is recognized only if:
  - Assets received include ONLY cash, unrealized receivables and inventory, and
  - Outside basis exceeds partnership's inside basis in distributed property

Proportionate Liquidating Distribution Examples (slide 1 of 4)

Bill's basis in partnership interest: $30,000

Proportionate liquidating distributions (partnership also liquidates) (independent fact situations):

	G	H	I
Cash	$50,000	$10,000	$10,000
Unrealized rec.	N/A	-0-	-0-
(Fair mkt value)	N/A	$16,000	$16,000
Filing cabinet (§1231)	N/A	N/A	300
(Fair mkt value)	N/A	N/A	300

Proportionate Liquidating Distribution Examples (slide 2 of 4)

	G	H	I
Basis in interest	$30,000	$30,000	$30,000
Cash distribution	(50,000)	(10,000)	(10,000)
Gain recognized	20,000	N/A	N/A
Basis after cash	-0-	20,000	20,000
A/R distrib.	N/A	-0-	-0-
Loss recognized	N/A	(20,000)	N/A
Basis after A/R	-0-	-0-	20,000
Filing cabinet	N/A	N/A	(20,000)
Ending basis	$ -0-	$ -0-	$ -0-

Proportionate Liquidating Distribution Examples (slide 3 of 4)

	G	H	I
Basis in p'ship int.	$ -0-	$ -0-	$ -0-
Basis in cash	50,000	10,000	10,000
Basis in A/R	N/A	-0-	-0-
Basis in filing cabinet	N/A	N/A	20,000
Capital (Gain)/loss	(20,000)	20,000	N/A
Original basis	$30,000	$30,000	$30,000

Proportionate Liquidating Distribution Examples (slide 4 of 4)

Sale of non-cash assets at FMV:

Example H:	A/R	Fil.Cab.	Total
Selling price	$16,000	N/A	$16,000
Basis	-0-	N/A	-0-
Gain/(loss)	$16,000 (Ordinary)	N/A	$16,000

Example I:			
Selling price	$16,000	$ 300	$16,300
Basis	-0-	20,000	20,000
Gain/(loss)	$16,000 (Ordinary)	($19,700) (May be ord)	($3,700)

Sale Of Partnership Interest
(slide 1 of 4)

- Generally, results in gain or loss recognition by selling partner
  - Gain(loss) = amount realized less partner's basis in partnership interest
  - Partnership liabilities assumed by purchasing partner are treated as part of consideration paid for the partnership interest

Sale Of Partnership Interest
(slide 2 of 4)

- Partnership tax year closes for that partner on sale date
  - Partner's share of income through sale date is calculated
    - Can prorate annual income or use interim closing of the books
  - Taxed to selling partner and increases basis in partnership interest

Sale Of Partnership Interest
(slide 3 of 4)

- Effect of hot assets
  - Hot assets include:
    - Unrealized receivables (same as for disproportionate distributions)
    - Inventory
      - Includes all partnership property except money, capital assets, and §1231 assets

Sale Of Partnership Interest
(slide 4 of 4)

- Effect of hot assets (cont'd)
  - Must allocate sales price of partnership interest between "hot" (ordinary income) assets and "nonhot" (capital gain) components
  - Selling partner's gain is classified as a capital gain or loss portion and an ordinary income or loss amount related to the hot assets

If you have any comments or suggestions concerning this PowerPoint Presentation for West's Federal Taxation, please contact:

Dr. Donald R. Trippeer, CPA

donald.trippeer@colostate-pueblo.edu

Colorado State University-Pueblo