

# Basis Calculations & Distributions for Pass-Thru Entities – Case Suggested Solutions

**Suggested Solution Disclaimer** – All problems, exercises, activities, etc., have at least one suggested solution, even if there may be more than one way to solve the problem. There are no official answers, nor is there only one right way to solve the problem or to arrive at the solution.

## Case 1 – Shareholder Stock Basis

1. Brian’s ending stock basis would be zero with \$8,000 of losses/deductions suspended in excess of basis calculated as follows:

	<b>Brian’s Stock Basis</b>	<b>Where to report on personal income tax return?</b>
Initial basis	\$24,000	
Net business income	\$10,000	Schedule E if materially participates
Interest income	\$1,000	Schedule B
Dividend income	\$2,000	Schedule B - 20% maximum LTCG rate if qualified
Tax exempt interest income	<u>\$3,000</u>	Form 1040, page 1, line 8b
	\$40,000	
Distribution	<u>\$(20,000)</u>	Tax-free
	\$20,000	
Non-deductible expenses	<u>\$(8,000)</u>	Non-deductible & not reported on return
	\$12,000	
Rental real estate loss	\$(9,000)	Form 8582 as passive loss
Long-term capital loss	<u>\$(3,000)</u>	Schedule D
Ending basis	<u><u>\$ 0</u></u>	

**NOTE** – The rental real estate loss (\$15,000) and capital loss (\$5,000) exceeded Brian’s \$12,000 stock basis. The losses and deductions allowable in excess of the stock basis are pro-rated. Thus the rental loss is 75% (i.e., \$15,000/\$20,000) and the long-term capital loss is 25% (i.e., \$5,000/\$20,000) of the losses allowable up to the \$12,000 stock basis. Brian would have a (\$6,000) rental real estate loss and (\$2,000) long-term capital loss carry-forward in excess of his stock basis.

2. Yes! Brian could have done the following to increase his deductions:
- a. Made a loan to the S corporation (by December 31, Year 1) to increase debt basis;
  - b. Contributed capital (by December 31, Year 1) to increase stock basis; or
  - c. Made an irrevocable §1.1367-1(g) election on the Form 1040 to reduce basis for deductible losses and expenses prior to non-deductible.

## Case 2 - S Shareholder Stock & Debt Basis

### Required – Year 1

- Freddie's stock and debt basis will both be reduced to zero with \$15,000 of trade or business losses carrying forward to year 2.

	<u>Stock Basis</u>	<u>Debt Basis</u>	<u>Carry- Forward</u>
Beginning basis	\$1,000	\$9,000	
Interest income	\$1,000		
Dividend income	\$500		
Tax exempt interest income	<u>\$1,500</u>		
	\$4,000	\$9,000	
Non-deductible expenses	<u>\$(4,000)</u>	<u>\$(4,000)</u>	
	\$ -	\$5,000	
Trade or business loss	<u>\$ -</u>	<u>\$(5,000)</u>	<u>\$(15,000)</u>
Ending basis – Year 1	<u>\$ -</u>	<u>\$(5,000)</u>	<u>\$(15,000)</u>

### Required – Year 2

- Since there is not a net increase, the entire \$23,000 of increases to basis must be allocated to the stock basis. Thus, at the end of year 2, Freddie's stock and debt basis are:

	<u>Stock Basis</u>	<u>Debt Basis</u>	<u>Carry- Forward</u>
Beginning basis	\$ -	\$ -	
Trade or business income	<u>\$23,000</u>	<u>\$ -</u>	
	\$23,000	\$ -	
Non-deductible expenses	<u>\$(3,000)</u>	<u>\$ -</u>	
	\$20,000	\$ -	
Trade or business loss carry-forward*	<u>\$(12,000)</u>	<u>\$ -</u>	<u>\$(3,000)</u>
Short-term capital loss*	<u>\$(8,000)</u>	<u>\$ -</u>	<u>\$(2,000)</u>
Ending basis	<u>\$ -</u>	<u>\$ -</u>	<u>\$(5,000)</u>

**\*NOTE** – The losses and deductions allowable in excess of the stock basis are pro-rated. Thus the trade or business loss is 60% (i.e., \$15,000/\$25,000) and the short-term capital loss is 40% (i.e., \$10,000/\$25,000) of the losses and deductions allowable up to the \$20,000 stock basis.

**Loan Repayment** - Freddie must recognize \$6,000 of income on the repayment of the loan. If a note secures the debt, the gain is treated as a capital gain. Otherwise the gain is treated as ordinary income. The face amount of the loan owed to Freddie will be \$3,000.

**Required – Year 2**

3. The net increase of \$6,000 will be allocated to increase Freddie’s debt basis. Thus, at the end of year 2, Freddie’s stock and debt basis are:

	<u>Stock Basis</u>	<u>Debt Basis</u>	
Beginning basis	\$ -	\$ -	
Trade or business income	<u>\$28,000</u>	<u>\$6,000</u>	
	\$28,000	\$6,000	
Non-deductible expenses	<u>(\$3,000)</u>	<u>\$ -</u>	
	\$25,000	\$6,000	
Trade or business loss carry-forward	(\$15,000)	\$ -	
Short-term capital loss*	<u>(\$10,000)</u>	<u>\$ -</u>	
Basis prior to loan repayment	\$ -	\$6,000	
Loan repayment of \$6,000	N/A	(\$4,000)	\$2,000 income
	<u>\$ -</u>	<u>\$2,000</u>	

**Loan Repayment** – Freddie must pro-rate a portion of the loan repayment as return of debt principal and a portion as income. Thus, Freddie must recognize \$2,000 of income on the repayment of the loan and reduce his debt basis by \$4,000. If a note secures the debt, the gain is treated as a capital gain. Otherwise the gain is treated as ordinary income. The face amount of the loan owed to Freddie will be \$3,000.

### Case 3 – Debt Basis Loan Repayments

1. Nola will have a ending stock basis of zero and debt basis of \$1,200 calculated as follows:

	<b>Stock Basis</b>	<b>Debt Basis</b>
Beginning basis	\$ -	\$4,000
Trade or business income	<u>\$10,000</u>	<u>\$ -</u>
	\$10,000	\$4,000
Distribution	<u>(\$9,000)</u>	<u>\$ N/A</u>
	\$1,000	\$4,000
Loan Repayment	<u>N/A</u>	<u>(\$800)*</u>
	\$1,000	\$3,200
Non-deductible expenses	<u>(\$1,000)</u>	<u>(\$2,000)</u>
Ending basis	<u><u>\$ -</u></u>	<u><u>\$1,200</u></u>

**\*Loan Repayment** - Any indebtedness that has been satisfied by the corporation or disposed of or forgiven by the shareholder, during the taxable year, is not held by the shareholder at the close of that year and is not subject to basis reduction. Thus, the loan repayment is taken into consideration prior to any losses/deductions in excess of stock basis. Nola must pro-rate a portion of the loan repayment as return of debt principal and a portion as income (i.e., 4/5 is return of basis and 1/5 is income). Thus, she must recognize \$200 of income on the repayment of the loan and reduce her debt basis by \$800. If a note secures the debt, the gain is treated as a capital gain. Otherwise the gain is treated as ordinary income. The face amount of the loan owed to Nola will be \$4,000.

2. Nola will have a ending stock basis of zero and debt basis of \$200 calculated as follows:

	<b>Stock Basis</b>	<b>Debt Basis</b>
Beginning basis	\$ -	\$4,000
Trade or business income	<u>\$10,000</u>	<u>\$ N/A</u>
	\$10,000	\$4,000
Distribution	<u>(\$10,000)</u>	<u>\$ N/A</u>
	\$ -	\$4,000
Loan Repayment	<u>N/A</u>	<u>(\$800)*</u>
	\$1,000	\$3,200
Non-deductible expenses	<u>\$ -</u>	<u>(\$3,000)</u>
Ending basis	<u><u>\$ -</u></u>	<u><u>\$ 200</u></u>

**NOTE** – Nola will recognize a \$2,000 capital gain on the distribution in excess of her stock basis.

**\*Loan Repayment** - Any indebtedness that has been satisfied by the corporation or disposed of or forgiven by the shareholder, during the taxable year, is not held by the shareholder at the close of that year and is not subject to basis reduction. Thus, the loan repayment is taken into consideration prior to any losses/deductions in excess of stock basis. Nola must pro-rate a portion of the loan repayment as return of debt principal and a portion as income (i.e., 4/5 is return of basis and 1/5 is income). Thus, she must recognize \$200 of income on the repayment of the loan and reduce her debt basis by \$800. If a note secures the debt, the gain is treated as a capital gain. Otherwise the gain is treated as ordinary income. The face amount of the loan owed to Nola will be \$4,000.

## Case 4 – Multiple Shareholder Loans to the S Corporation

	<u>Stock</u>	<u>Debt #1</u>	<u>Debt #2</u>
Initial basis – Year 1	\$1,000	\$10,000	
Trade or business loss – Year 1	<u>(\$1,000)</u>	<u>(\$6,000)</u>	
<b>Ending basis – Year 1</b>	\$ 0	\$4,000	
Loan – Year 2			\$8,000
Trade or business loss – Year 2	<u>\$ 0</u>	<u>(\$3,000)</u>	<u>(\$6,000)</u>
<b>Ending basis – Year 2</b>	\$ 0	\$1,000	\$2,000
Trade or business income – Year 3		\$5,000	
Loan #1 repayment – Year 3 – return of loan basis		<u>(\$6,000)</u>	
<b>Ending basis – Year 3</b>	\$ 0	\$ 0	\$2,000

### Year 1

The \$7,000 loss will bring the stock basis to zero and debt #1 basis to \$4,000. Assuming Tara materially participated in the business, she will deduct the \$7,000 on schedule E as a non-passive loss.

### Year 2

Under §1.1367-2(b)(3), if a shareholder holds more than one indebtedness at the close of the corporation's taxable year or, if applicable, immediately prior to the termination of the shareholder's interest in the corporation, the reduction in basis is applied to each indebtedness in the same proportion that the basis of each indebtedness bears to the aggregate bases of the indebtedness to the shareholder. Thus, \$3,000 (i.e., \$9,000 loss x \$4,000 Debt #1 basis/\$12,000 total debt basis) of the trade or business loss will be allocated to Debt #1 and \$6,000 (i.e., \$9,000 loss x \$8,000 Debt #2 basis/\$12,000 total debt basis) to Debt #2.

### Year 3

Under §1.1367-2(c)(2), if a shareholder holds more than one indebtedness as of the beginning of a corporation's taxable year, any net increase is applied first, to restore the reduction of basis in any indebtedness repaid (in whole or in part) in that taxable year to the extent necessary to offset any gain that would otherwise be realized on the repayment. Thus, the entire \$5,000 of trade or business income is allocated to increase Debt #1 basis to increase it to \$6,000 before the loan repayment of \$10,000. The \$4,000 of gain on the loan repayment in excess of basis is treated as a long-term capital gain because the loan was secured by a note and held greater than one year.

## Case 5 – Open Account Debt

### Required – Year 1

Jack would be able to deduct the entire \$51,000 up to his stock basis first and then his debt basis as follows:

	<u>Stock Basis</u>	<u>Debt Basis</u>
Capital contribution	\$1,000	
Loan to S corporation – 12-31-Year 1	<u>\$ -</u>	<u>\$50,000</u>
	\$1,000	\$50,000
Trade or business loss	<u>(\$1,000)</u>	<u>(\$50,000)</u>
Ending basis – Year 1	<u>\$ -</u>	<u>\$ -</u>

### Required – Year 2

Final Reg. §1.1367-2(a)(2) states: The term open account debt means shareholder advances not evidenced by separate written instruments and repayments on the advances, the aggregate outstanding principal of which does not exceed \$25,000 of indebtedness of the S corporation to the shareholder at the close of the S corporation's taxable year. Advances and repayments on open account debt are treated as a single indebtedness. If the shareholder advances not evidenced by a separate written instrument, net of repayments, exceeds an aggregate outstanding principal amount of \$25,000 at the close of the S corporation's taxable year, for any subsequent taxable year the aggregate principal amount of that indebtedness is treated in the same manner as indebtedness evidenced by a separate written instrument for purposes of this section. For any subsequent taxable year, that indebtedness is not open account debt and is subject to all basis adjustment rules applicable to basis of indebtedness of an S corporation to a shareholder in this section.

Thus based upon the final regulations, the loan made in Year 1 has to be treated as a separate loan from the loan in Year 2. Thus, the loan repayment of \$50,000 will result in ordinary income for Jack. The ending stock and debt basis are calculated as follows:

	<u>Stock Basis</u>	<u>Debt #1 Basis</u>	<u>Debt #2 Basis</u>
Beginning basis	\$ -	\$ -	
Loan to S corporation – 12-31-Year 2	<u>\$ -</u>	<u>\$ -</u>	<u>\$80,000</u>
	\$ 0	\$ 0	\$80,000
Trade or business loss	<u>\$ -</u>	<u>\$ -</u>	<u>(\$30,000)</u>
Ending basis – Year 2	<u>\$ -</u>	<u>\$ -</u>	<u>\$50,000</u>

**NOTE** – Jack will be able to deduct the entire \$30,000 trade or business loss since he has enough debt basis. However, since the loan repayment on Debt #1 in Year 2 exceeds the basis (i.e., zero) by \$50,000, Jack will have to recognize ordinary income.

## Case 6 - Sale of S Corporation Stock & Partnership Interest

### Gain on Sale of S corporation

1. Archie will have a \$750,000 long-term capital gain on the sale of his stock calculated as follows:

Selling price	\$750,000
Stock basis	<u>( 50,000)</u>
Long-term capital gain	<u>\$700,000</u>

2. Per §1.1(h)-1: when an interest in a S corporation held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the transferor shall recognize as collectibles gain the amount of net gain (but not net loss) that would be allocated to that shareholder if the S corporation transferred all of its collectibles for cash equal to the fair market value of the assets in a fully taxable transaction immediately before the transfer of the interest in the S corporation. When Archie sold his 50% interest in the S corporation, the collectibles had a FMV of \$250,000 and cost basis \$50,000 (i.e. unrealized gain of \$200,000). Archie is deemed to have sold his 50% share of the collectibles to Buckeye (i.e. a deemed gain of \$100,000). As a result, Archie's \$700,000 long-term capital gain is taxed as follows:

	<u>Gain</u>	<u>Rate</u>	<u>Tax</u>
Collectibles	\$100,000	28%	\$ 28,000
Remaining gain	<u>600,000</u>	20%	<u>120,000</u>
Totals	<u>\$700,000</u>		<u>\$148,000</u>

### Gain on Sale of Partnership

3. Archie will have a \$700,000 gain on the sale of his partnership interest calculated as follows:

Selling price	\$750,000
Outside basis	<u>( 50,000)</u>
Gain	<u>\$ 700,000</u>

Archie's \$700,000 gain is taxed as follows:

	<u>Gain</u>	<u>Rate</u>	<u>Tax</u>
Accounts receivable	\$200,000	39.6%	\$79,200
§1245 depreciation recapture	25,000	39.6%	9,900
Collectibles	100,000	28%	28,000
Unrecaptured §1250 gain	20,000	25%	5,000
Residual LTCG	<u>355,000</u>	20%	<u>71,000</u>
	<u>\$700,000</u>		<u>\$193,100</u>

### **Ordinary Income (Hot Assets)**

Under §751, to the extent a partner is deemed to have sold his/her share of the partnership's unrealized receivables or inventory items (i.e., Hot Assets), ordinary income or loss is recognized. Archie will have a \$700,000 gain that must be broken up into ordinary income and capital gains. Archie will have to recognize \$225,000 of ordinary income to the extent of his share of:

1. the accounts receivable - \$200,000 (i.e.,  $\frac{1}{2} \times \$400,000$ ) and
2. §1245 depreciation on the equipment - \$25,000 (i.e.,  $\frac{1}{2} \times \$50,000$ ).

**NOTE** – The remaining \$475,000 gain is a long-term capital gain the must be allocated to the three categories of LTCGs.

### **28% LTCG Rate - Collectibles**

Per §1.1(h)-1: when an interest in a partnership held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the transferor shall recognize as collectibles gain the amount of net gain (but not net loss) that would be allocated to that partner if the partnership transferred all of its collectibles for cash equal to the fair market value of the assets in a fully taxable transaction immediately before the transfer of the interest in the partnership. When Archie sold his 50% interest in the partnership, the investments had a FMV of \$250,000 and cost basis \$50,000 (i.e. unrealized gain of \$200,000). Archie is deemed to have sold 50% of the investments to Buckeye (i.e. a deemed gain of \$100,000).

### **25% LTCG Rate – Unrecaptured §1250 Gains**

When an interest in a partnership held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the partner shall recognize as unrecaptured §1250 capital gain an amount that would be allocated to that partner (to the extent attributable to the portion of the partnership interest transferred that was held for more than one year) if the partnership transferred all of its §1250 property in a fully taxable transaction for cash equal to the fair market value of the assets immediately before the transfer of the interest in the partnership. When Archie sold his 50% interest in the partnership, the building had a FMV of \$400,000 and cost basis \$110,000 (i.e. unrealized gain of \$290,000). Archie is deemed to have sold 50% of the building and to the extent of his share of the depreciation not taxed as ordinary income under §1250, he must recognize \$20,000 of unrecaptured §1250 capital gain (i.e.  $\frac{1}{2} \times \$40,000$  of depreciation).

### **20% LTCG Rate – Residual LTCG**

Any remaining (i.e., residual) long-term capital gain on the sale of a partnership interest will not be taxed higher than 20%.



## Case 7 – Partner Basis Calculation

Justin’s outside tax basis would be zero with \$20,000 of losses/deductions suspended in excess of basis calculate as follows:

	Outside Basis	Suspended loss in excess of basis
Initial basis - prior year ending basis	\$20,000	
Ordinary trade or business income – schedule E	<u>40,000</u>	
	60,000	
Deemed cash distribution – decrease in liabilities	<u>(30,000)</u>	
	30,000	
Non-deductible expenses (5,000/50,000 x 30,000)	(3,000)	(2,000)
Rental loss (30,000/50,000 x 30,000) – Form 8582	(18,000)	(12,000)
Short-term capital loss (15,000/50,000 x 30,000) – Schedule D	<u>(9,000)</u>	(6,000)
Ending basis	<u>\$ 0</u>	

Justin’s (\$18,000) rental loss allowable up to his basis in the partnership is a passive loss. In general, passive losses can only be deducted up to passive income. However, if the taxpayer or spouse actively participated in a passive rental real estate activity, the taxpayer can deduct up to \$25,000 of loss from the rental real estate activity from their non-passive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. The maximum amount of the special allowance is reduced if the taxpayer’s modified adjusted gross income is more than \$100,000 (\$50,000 if married filing separately). The \$25,000 allowable limit on losses is phased-out by 50 cents for each \$1 that modified adjusted gross income exceeds \$100,000. Since Justin’s MAGI is \$142,000 the maximum rental real estate loss allowable under this special provision is \$4,000. Thus, he would deduct a (\$4,000) rental loss on schedule E, page 2 and have to carry-forward (\$14,000) as a passive-loss of the Form 8582.

## Case 8 – Partner Basis Calculation

1. Maggie’s outside tax basis would be zero with a \$9,000 rental real estate loss in excess of basis (i.e., suspended) calculated as follows:

	<u>Outside Basis</u>	<u>Tax Form</u>
Initial basis	\$20,000	
Ordinary trade or business income	11,000	Schedule E
Dividend income	3,000	Schedule B
Tax-free interest income	<u>2,000</u>	Form 1040, line 8b
	36,000	
Deemed distribution (i.e., decrease in share of partnership liabilities)	<u>(15,000)</u>	N/A
	21,000	
Rental real estate loss allowable up to basis	<u>(21,000)</u>	Form 8582
Ending basis	<u>\$ 0</u>	

**NOTE** – Only \$21,000 of the rental real estate loss will be reported on the tax return due up to Maggie’s basis. The remaining 9,000 is a suspended loss in excess of basis.

2. Maggie’s \$21,000 rental loss allowable up to basis is a passive loss. In general, passive losses can only be deducted up to passive income. However, if the taxpayer or spouse actively participated in a passive rental real estate activity, the taxpayer can deduct up to \$25,000 of loss from the rental real estate activity from their non-passive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. The maximum amount of the special allowance is reduced if the taxpayer’s modified adjusted gross income is more than \$100,000 (\$50,000 if married filing separately). The \$25,000 allowable limit on losses is phased-out by 50 cents for each \$1 that modified adjusted gross income exceeds \$100,000. Since Maggie’s MAGI is \$138,000 the maximum rental real estate loss allowable under this special provision is \$6,000. She would have to carry-forward \$15,000 as a passive-loss of the Form 8582.

3. At the end of Year 2 Maggie will have an ending basis of \$12,000 calculated as follows:

	<u>Outside Basis</u>	<u>Tax Form</u>
Initial basis	\$ 0	
Deemed capital contribution - increase in share of partnership liabilities	20,000	N/A
Rental real estate income	10,000	Form 8582
Dividend income	5,000	Form 1040, line 8b
Tax-free interest income	<u>1,000</u>	
	36,000	N/A
Ordinary trade or business loss	<u>(15,000)</u>	Schedule E
Prior year rental real estate loss suspended in excess of basis	<u>(9,000)</u>	Form 8582
Ending basis	\$12,000	

Because Maggie's MAGI is above \$150,000 she would not be eligible for any of the \$25,000 offset that applies to rental real estate activities with active participation. Thus, Maggie would only be able to deduct \$10,000 of the \$24,000 passive rental real estate losses to the extent of the \$10,000 current year passive income. The remaining \$14,000 would be carried forward on the Form 8582. Maggie's Form 8582, line 1 (i.e., Rental Real Estate with Active Participation) would look like the following:

<b>Rental Real Estate Activities with Active Participation</b>	
1a. Activities with net Income	\$10,000
1b. Activities with net Loss	(9,000)
1c. Prior year unallowed losses	<u>(15,000)</u>
1d. Combine lines 1a, 1b & 1c	(14,000)

### Case 9 – Partnership Distributions

1. A partnership will not recognize any gain or loss on the non-liquidating distribution.
2. Ricky will not recognize any gain or loss on the non-liquidating distribution because the cash does not exceed his outside basis. Ricky's outside basis after the distribution would be zero.
3. Ricky will take a \$30,000 basis in the inventory and \$10,000 basis in the land (i.e., \$100,000 outside basis - \$60,000 allocated to cash - \$30,000 allocated to inventory).

#### Summary of the basis calculation and basis in property received

	Outside Basis	<u>Basis in property received</u>
Basis prior to distribution	\$100,000	
1. Cash	(60,000)	\$60,000 – Cash
2. Inventory & accounts receivable	(30,000)	\$30,000 - Inventory
3. Allocate remaining basis to other assets	<u>(10,000)</u>	\$10,000 - Land
Ending basis	<u>\$ 0</u>	

## Case 10 - Partner, LLC Member & S Shareholder Basis & At Risk Limitations

### Required #1

Assuming Kathleen is an S corporation shareholder in Grady Enterprises, her ending stock & debt basis would be calculated as follows:

	<u>Stock</u>	<u>Debt</u>
Capital contributed	\$1,000	\$9,000
Non-deductible expenses	<u>(1,000)</u>	<u>(1,000)</u>
	0	8,000
Trade or business loss (6,000/10,000 x (8,000))		(4,800)
§1231 loss (3,000/10,000 x (8,000))		(2,400)
Short-term capital loss (1,000/10,000 x (8,000))	<u>0</u>	<u>(800)</u>
Ending outside basis	<u>\$ 0</u>	<u>\$ 0</u>

**NOTE** – The personal guarantee does not affect Kathleen’s basis.

### Required #2

Assuming Grady Enterprises was a general partnership, Kathleen’s basis would be calculated as follows:

Capital contributed	\$1,000
50% of loan to partnership	4,500
50% of personal guarantee	<u>10,000</u>
Outside basis before reductions to basis	15,500
Trade or business loss	(6,000)
§1231 loss	(3,000)
Short-term capital loss	(1,000)
Non-deductible expenses	<u>(2,000)</u>
Ending outside basis	<u>\$3,500</u>

**NOTE** – Most likely Kathleen would not have been liable for the entire loan she guaranteed (i.e., \$20,000) and the personal loan to the company (i.e., \$9,000) because she would have a right to reimbursement from the other general partner. Thus, she would only be allocated only 50% of these loans.

### Required #3

Assuming Grady Enterprises is a limited liability company (taxed as a partnership), Kathleen's ending basis would be calculated as follows:

Capital contributed	\$1,000
Loan to LLC	9,000
100% of personal guarantee	<u>20,000</u>
Outside basis before reductions to basis	30,000
Trade or business loss	(6,000)
§1231 loss	(3,000)
Short-term capital loss	(1,000)
Non-deductible expenses	<u>(2,000)</u>
Ending outside basis	<u>\$18,000</u>

**NOTE** – Since the entity is a LLC, the members (other than Kathleen who personally guaranteed the debt) would not be liable for the loan. Thus, Kathleen would be personally liable for the entire loan she guaranteed assuming she does not have a right to reimbursement from the other members. As a result, she would be at-risk for her entire basis.

### Proposed Regulations

Prop. Reg. §1.465-6(d) states: If a taxpayer guarantees repayment of an amount borrowed by another person (primary obligor) for use in an activity, the guarantee shall not increase the taxpayer's amount at risk. If the taxpayer repays to the creditor the amount borrowed by the primary obligor, the taxpayer's amount at risk shall be increased at such time as the taxpayer has no remaining legal rights against the primary obligor. Thus, in general a limited liability company member would not be at-risk for personal guarantees.

**NOTE** – This regulation was issued in 1979 before the development of LLCs under various state laws, and at a time when entities treated as partnerships for federal tax purposes were usually state law general partnerships and limited partnerships.

### CCA 201308028 & TAM 2014-003

It appears the IRS is now interpreting §1.465.6(d) differently for LLC members:

**CCA 201308028 states:** “Accordingly, we conclude that an LLC member is at risk with respect to LLC debt guaranteed by the member (where the LLC is treated as either a partnership or a disregarded entity for federal tax purposes), but only to the extent that the member has no right of contribution or reimbursement from other guarantors and is not otherwise protected against loss within the meaning of § 465(b)(4) with respect to the guaranteed amounts. Therefore, we conclude that Prop. § 1.465-6(d) is generally not applicable to situations involving bona fide guarantees of LLC debt by one or more members of the LLC that is enforceable by creditors of the LLC under local law, where the LLC is treated as either a partnership or a disregarded entity for federal tax purposes.”

**TAM 2014-003 states:** “When a member of an LLC classified as a partnership or disregarded entity for federal tax purposes guarantees the LLC's debt, the member is at risk with respect to the amount of the guaranteed debt, without regard to whether such member waives any right to subrogation, reimbursement, or indemnification from the LLC, but only to the extent that the member has no right of contribution or reimbursement from persons other than the LLC, the member is not otherwise protected against loss within the meaning of § 465(b)(4), and the guarantee is bona fide and enforceable by creditors of the LLC under local law.”