Form 1065 Schedule K-1 Analysis – Basis Calculations & Distributions for Partnerships & LLCs – Case Suggested Solutions

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 – Partnership Formation & Initial Basis

1. None of the members will recognize a gain or loss on the contribution of property to the LLC.

2. Oliver will have an initial tax basis of $75,000 (i.e., $150,000 carryover basis - $100,000 recourse debt + 25% of the $100,000 debt assumed by the LLC). Sue will have an initial tax basis of $350,000 (i.e., $300,000 cash contributed + 50% of the $100,000 debt assumed by the LLC). Uma will have an initial tax basis of $325,000 (i.e., $300,000 carryover basis + 25% of the $100,000 debt assumed by the LLC).

3. The LLC will not recognize any gain or loss. The LLC will take a carryover basis in the property contributed. Thus, they will have an inside tax basis of $150,000 in the property Oliver contributed and $300,000 in the property Uma contributed. With the $300,000 of cash that Sue contributed the total inside tax basis would be $750,000. Note – the $750,000 is equal to the sum of each member's initial outside basis (i.e., $75,000 + $350,000 + $325,000). The tax and §704(b) Book balance sheet would be recorded as follows:

		§704(b)
	Tax	**Book**
Property Oliver contributed	$150,000	$250,000
Cash Sue contributed	$300,000	$300,000
Property Uma contributed	$300,000	$150,000
	$750,000	$700,000
Recourse liability assumed by LLC	$100,000	$100,000
Oliver, capital	$50,000	$150,000
Sue, capital	$300,000	$300,000
Uma, capital	$300,000	$150,000
	$750,000	$700,000

Case 2 - Recourse Debt – Guarantee by Limited Partner

In a constructive liquidation, the $150,000 liability becomes due and payable. All of the partnership's assets, including the depreciable property, are deemed to be worthless. The depreciable property is deemed sold for a value of zero. Capital accounts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	Fred	Barney
Initial contribution	$20,000	$80,000
Loss on hypothetical sale	($170,000)	($80,000)
	($150,000)	$ 0

Fred, as a general partner, would be obligated by operation of law to make a net contribution to the partnership of $150,000. Because Fred is assumed to satisfy that obligation, it is also assumed that he would not have to satisfy Barney's guarantee. The $150,000 mortgage is treated as a recourse liability because one or more partners bear the economic risk of loss. Fred's share of the liability is $150,000, and Barney's share is zero. This would be so even if Fred's net worth at the time of the determination is less than $150,000, unless the facts and circumstances indicate a plan to circumvent or avoid Fred's obligation to contribute to the partnership.

Case 3 – Partner Initial Contribution & Non-Recourse Debt

Any increase in a partner's share of partnership liabilities is treated as a contribution of money by that partner to the partnership (i.e., increase in their outside tax basis). The non-recourse liabilities are allocated to the members on their schedule K-1 under a 3-tiered method as follows:

	Brutus	**Sparky**
Tier 1 - Partners' share if §704(b) partnership minimum gain	N/A	N/A
Tier 2 – Partner's share of §704(c) minimum gain	N/A	$15,000
Tier 3 – Profit % in the LLC	$30,000	30,000
Total liabilities reported to each member on their Schedule K-1	$30,000	$45,000

Each member's outside tax basis would be calculated as follows:

	Brutus	**Sparky**
Initial Contribution	$100,000	$60,000
Less non-recourse liabilities contributed	N/A	(75,000)
Deemed contribution for increase in share of LLC liabilities	30,000	45,000
Interest income	2,000	2,000
Tax-free interest income	1,000	1,000
	133,000	33,000
Rental real estate loss	(20,000)	(20,000)
Non-deductible expenses	(3,000)	(3,000)
	$110,000	$10,000

Case 4 – Allocation Partnership Liabilities

Part 1 - Non-Recourse Debt Allocation

Non-recourse debt is allocated based on a 3-tiered allocation. Tier 1 is the §704(b) partnership minimum gain of $10,000 ($30,000 - $20,000) allocated 50% to Tom ($7,500) and 50% to Jerry ($5,000). There is no Tier 2 §704(c) pre-contribution gain. Therefore, the Tier 3 amount of $20,000 ($30,000 - $10,000) is allocated 50% to Tom ($10,000) and 50% to Jerry ($10,000). Total non-recourse debt allocated to Tom is $17,500 and allocated to Jerry is $17,500.

	Tom	Jerry
Tier 1 - Partners' share if §704(b) partnership minimum gain	$5,000	$5,000
Tier 2 – Partner's share of §704(c) minimum gain	N/A	N/A
Tier 3 – Profit % in the LLC	10,000	10,000
Total liabilities reported to each member on their Schedule K-1	$15,000	$15,000

Part 1 - Recourse Debt Allocation

The recourse debt is allocated to the partners based on economic risk of loss. A partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner. In a constructive liquidation, the $50,000 recourse liability becomes due and payable. All of the partnership's assets (excluding assets secured by the non-recourse debt), including the depreciable property, are deemed to be worthless. Thus, the cash ($25,000) and Asset #2 ($45,000) are deemed sold for a value of zero. This results in a hypothetical loss of $70,000. Upon a constructive liquidation the capital accounts would be calculated as follows:

	Tom (GP)	Jerry (GP)
Initial contribution	$5,000	$5,000
Partners' share if §704(b) partnership minimum gain (Tier 1 above)	$5,000	$5,000
Loss on hypothetical sale	($35,000)	($35,000)
Ending capital upon constructive liquidation	($25,000)	($25,000)

As a result, both Tom and Jerry would be obligated by operation of law to make a net contribution to the partnership of $25,000. Thus, the recourse debt would be allocated equally (i.e., $25,000/$25,000) to both Tom and Jerry on their Schedule K-1.

Part 2 - Non-Recourse Debt Allocation

Non-recourse debt is allocated based on a 3-tiered allocation. Tier 1 is the §704(b) partnership minimum gain of $10,000 ($30,000 - $20,000) allocated 90% to Tom ($9,000) and 10% to Jerry ($1,000). There is no Tier 2 §704(c) pre-contribution gain. Therefore, the Tier 3 amount of $20,000 ($30,000 - $10,000) is allocated 90% to Tom ($18,000) and 10% to Jerry ($2,000). Total non-recourse debt allocated to Tom is $31,500 and allocated to Jerry is $3,500.

	Tom	Jerry
Tier 1 - Partners' share if §704(b) partnership minimum gain	$9,000	$1,000
Tier 2 – Partner's share of §704(c) minimum gain	N/A	N/A
Tier 3 – Profit % in the LLC	18,000	2,000
Total liabilities reported to each member on their Schedule K-1	$27,000	$3,000

Part 2 - Recourse Debt Allocation

Upon a constructive liquidation the capital accounts would be calculated as follows:

	Tom (GP)	Jerry (GP)
Initial contribution	$5,000	$5,000
Partners' share if §704(b) partnership minimum gain (Tier 1 above)	$9,000	$1,000
Loss on hypothetical sale	($63,000)	($7,000)
Ending capital upon constructive liquidation	($49,000)	($1,000)

As a result, Tom and Jerry would be obligated by operation of law to make a net contribution to the partnership of $49,000 and $1,000 respectively. Thus, $49,000 of the recourse debt would be allocated to Tom on his Schedule K-1 and $1,000 on Jerry's Schedule K-1.

Part 3 - Non-Recourse Debt Allocation

Non-recourse debt is allocated based on a 3-tiered allocation. Tier 1 is the §704(b) partnership minimum gain of $10,000 ($30,000 - $20,000) allocated 90% to Tom ($9,000) and 10% to Jerry ($1,000). There is no Tier 2 §704(c) pre-contribution gain. Therefore, the Tier 3 amount of $20,000 ($30,000 - $10,000) is allocated 90% to Tom ($18,000) and 10% to Jerry ($2,000). Total non-recourse debt allocated to Tom is $31,500 and allocated to Jerry is $3,500.

	Tom	Jerry
Tier 1 - Partners' share if §704(b) partnership minimum gain	$9,000	$1,000
Tier 2 – Partner's share of §704(c) minimum gain	N/A	N/A
Tier 3 – Profit % in the LLC	18,000	2,000
Total liabilities reported to each member on their Schedule K-1	$27,000	$3,000

Part 3 - Recourse Debt Allocation

Upon a constructive liquidation the capital accounts would be calculated as follows:

	Tom (LP)	Jerry (GP)
Initial contribution	$5,000	$5,000
Partners' share if §704(b) partnership minimum gain (Tier 1 above)	$9,000	$1,000
Loss on hypothetical sale	($14,000)	($56,000)
Ending capital upon constructive liquidation	$ 0	($50,000)

As a result, Jerry, as general partner, would be obligated by operation of law to make a net contribution to the partnership of $50,000. Thus, all $50,000 of the recourse debt would be allocate to Jerry on his Schedule K-1.

Case 5 – Partner Basis Calculation

1. Sheila's ending outside tax basis would be $50,000 calculated as follows:

	Outside Basis	Tax Form
Initial basis	$20,000	
Deemed contribution (i.e., increase in share of partnership liabilities)	40,000	
Ordinary trade or business income	10,000	Schedule E
Dividend income	3,000	Schedule B
Short-term capital gain	6,000	Schedule D
Tax-free interest income	1,000	Form 1040, line 8b
	80,000	
Less distributions	(0)	N/A
	80,000	
Non-deductible	(2,000)	N/A
Rental loss	(28,000)	Form 8582
Ending basis	$50,000	

2. Sheila's $28,000 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 Sheila's MAGI is $538,000 the $25,000 offset is completely phased-out. Thus, none of her rental real estate loss is allowable and the entire $28,000 loss would be carried-forward as a passive-loss on the Form 8582.

3. Sheila will have an ending basis of zero with $10,000 of rental losses suspended in excess of her basis calculated as follows:

	Outside Basis	Tax Form
Initial basis	$50,000	
Ordinary trade or business income	2,000	Schedule E
Dividend income	1,000	Schedule B
Long-term capital gain	7,000	Schedule D
	60,000	
Deemed distribution - decrease in share of partnership liabilities	(20,000)	N/A
	40,000	
Rental loss	(40,000)	Form 8582
Ending basis	$ 0	$10,000 suspended rental loss in excess of basis

4. With a MAGI of $118,000, $9,000 of the $25,000 rental real estate offset is phased-out. Thus, Sheila will be able to deduct $16,000 of her $68,000 rental loss (i.e., $28,000 prior year passive rental loss carry-forward + $40,000 current year rental loss) on schedule E. The remaining $52,000 rental loss will carry-forward as a passive loss on the Form 8582.

Case 6 – Partner Basis Calculation

Year 1

	Outside Basis	Carry-forward
Initial contribution	$1,000	
Deemed contribution – increase in liabilities	$9,000	
Interest income	$1,000	
Dividend income	$3,500	
Tax-free interest	$1,500	
	$16,000	
Trade or business loss – 75%	($12,000)	($6,000)
Non-deductible expenses – 25%	($4,000)	($2,000)
Ending basis – Year 1	$ 0	($8,000)

NOTE – The non-deductible expenses ($6,000) and trade or business loss ($18,000) exceed Freddie's 16,000 outside basis. Losses and deductions in excess of basis are reported on the tax return pro-rata up to basis. Thus the non-deductible expense is 25% (i.e., $6,000/$24,000) and the trade or business loss is 75% (i.e., $18,000/$24,000) of the losses allowable up to the $16,000 outside basis.

Year 2

	Outside Basis	Carry-forward
Ending basis – Year 1	$ 0	
Trade or business income	$27,000	
	$27,000	
Cash distribution	($10,000)	
Deemed cash distribution – decrease in liabilities	($7,000)	
	$10,000	
Trade or business loss – 30%	($3,000)	($3,000)
Non-deductible expenses – 10%	($1,000)	($1,000)
Short-term capital loss – 60%	($6,000)	($6,000)
Ending basis – Year 2	$ 0	($10,000)

NOTE – The non-deductible expenses carry-forward ($2,000), trade or business loss carry-forward ($6,000) and current year short-term capital loss ($6,000) exceeds Freddie's 10,000 outside basis by $10,000. Losses and deductions in excess of basis are reported on the tax return pro-rata up to basis. Thus the non-deductible expense is 10% (i.e., ($2,000/$20,000), the trade or business loss is 30% (i.e., $6,000/$20,000) and the short-term capital loss is 60% (i.e., $12,000/$20,000) of the losses allowable up to the $10,000 outside basis. The $10,000 cash distribution and $7,000 deemed distribution (i.e., decrease in liabilities) are not taxable because they do not exceed Freddie's outside basis.

Case 7 – Partnership Distributions

1. The partnership will not recognize any gain or loss on the non-liquidating distribution.

2. Paddy will not recognize any gain or loss on the non-liquidating distribution because the cash does not exceed his outside basis. His outside basis after the distributions would be zero.

3. Paddy will take a $25,000 basis in the inventory and $35,000 basis in the land (i.e., $100,000 outside basis - $40,000 allocated to cash - $25,000 allocated to inventory).

Summary of the basis calculation and basis in property received

	Outside Basis	Basis in property received
Basis prior to distribution	$100,000	
1. Cash	(40,000)	$40,000 – Cash
	60,000	
2. Inventory & accounts receivable	(25,000)	$25,000 - Inventory
	35,000	
3. Allocate remaining basis to other assets	(35,000)	$35,000 - Land
Ending basis	$ 0	

Case 8 – Partnership Liquidating Distribution

1. The partnership will not recognize any gain or loss on the liquidating distribution.

2. A gain will only be recognized in this example to the extent cash exceeds the member's outside basis. Thus, Cal will have to recognize a $10,000 capital gain. Tim and Pat will not have to recognize a gain. See summaries below for the outside basis reduction and basis in property received. For the character and holding period of the distributed property, IRC §735 states:

    a. Gain or loss on the disposition by a distributee partner of **unrealized receivables** distributed by a partnership, shall be considered as ordinary income or as ordinary loss.

    b. Gain or loss on the sale or exchange by a distributee partner of **inventory** items distributed by a partnership shall, if sold or exchanged within 5 years from the date of the distribution, be considered as ordinary income or as ordinary loss.

    c. A partner's holding period for **property** distributed to him by a partnership shall include the period such property was held by the partnership. If the property has been contributed to the partnership by a partner, then the period that the property was held by such partner shall also be included. Thus, the distributee "tacks" or adds the partnership's holding period on to his/her own.

Tim’s basis calculation and basis in property received

	Outside	
	Basis	Basis in property received
Basis prior to distribution	$180,000	
1. Cash	(40,000)	$40,000 – Cash
	140,000	
2. Accounts receivable	(0)	$0 – Accounts receivable
Inventory	(30,000)	$30,000 - Inventory
	110,000	
3. Allocate remaining basis to land	(110,000)	$110,000 - Land
Ending basis	$ 0	

NOTE – If the partner whose interest is liquidated receives any property other than money, unrealized receivables, or inventory items, then no loss will be recognized.

Pat’s basis calculation and basis in property received

	Outside	
	Basis	Basis in property received
Basis prior to distribution	$120,000	
1. Cash	(40,000)	$40,000 – Cash
	80,000	
2. Accounts receivable	(0)	$0 – Accounts receivable
Inventory	(30,000)	$30,000 - Inventory
	50,000	
3. Allocate remaining basis to land	(50,000)	$50,000 - Land
Ending basis	$ 0	

NOTE – If the partner whose interest is liquidated receives any property other than money, unrealized receivables, or inventory items, then no loss will be recognized.

Cal’s basis calculation and basis in property received

	Outside	
	Basis	Basis in property received
Basis prior to distribution	$30,000	
1. Cash	(30,000)	$30,000 – Cash*
	0	
2. Accounts receivable	(0)	$0 – Accounts receivable
Inventory	(0)	$0 – Inventory
	0	
3. Allocate remaining basis to land	(0)	$0 - Land
Ending basis	$ 0	

***NOTE** – Cal must recognize a capital gain to the extent the cash distribution exceeds his outside basis (i.e., $10,000).

Case 9 - Sale of a Partnership Interest

Gain on Sale of Partnership

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

Selling price	$750,000
Outside basis	(50,000)
Gain	$ 700,000

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

	Gain	Rate	Tax
Accounts receivable	$50,000	39.6%	$19,800
§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	505,000	20%	100,000
	$700,000		$162,700

Statement Required (§1.751-1(a)(3))

A partner selling or exchanging any part of an interest in a partnership that has any §751 property at the time of sale or exchange must submit with its income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information:

1. The date of the sale or exchange;
2. The amount of any gain or loss attributable to the §751 property; AND
3. The amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

NOTE – A Form 8308 is filed by a partnership to report the sale or exchange by a partner of all or part of a partnership interest where any money or other property received in exchange for the interest is attributable to unrealized receivables or inventory items (i.e., a §751(a) exchange).

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 - $50,000 (i.e., ½ x $100,000) and
2. §1245 depreciation on the equipment - $25,000 (i.e., ½ x $50,000).

NOTE – The remaining $625,000 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. ½ x $40,000 of depreciation).

NOTE – Any residual long-term capital gain on the sale of a partnership interest will not be taxed higher than 20%.

Case 10 - Sale of Partnership Interest & §754 Election

Part 1

Doug will recognize a total gain of $140,000 calculated as follows:

Selling Price ($280,000 cash + ($80,000 liability x ¼))	$300,000
Less: Outside basis ($140,000 + $80,000 liability x ¼))	(160,000)
Gain on sale	$140,000

Doug will have to treat $50,000 of the gain as ordinary income because of hot assets (i.e., 25% x $200,000 of the accounts receivable). The remaining $90,000 will be treated as a capital gain. The $90,000 capital gain needs to be broken down into the different long-term capital gain rates as follows:

28% – collectibles	$ 0
25% - unrecaptured §1250 gain ($110,000 x 25%)	27,500
20% - remaining capital gain	$62,500
Total long-term capital gain	$90,000

Part 2

The $140,000 positive §743(b) adjustment is calculated as follows:

Oliver's outside basis:		
Cost of LLC interest	$280,000	
Oliver's share of liabilities ($80,000 x ¼)	20,000	
		$300,000
Less: Oliver's share of the inside basis:		
Cash from hypothetical sale (($1,200,000 - $80,000 liabilities) x 25%)	$280,000	
Less: Oliver's share of tax gain (($1,200,000 - $640,000) x 25%)	(140,000)	
Plus: Oliver's share of liabilities ($80,000 x ¼)	$20,000	
		$160,000
§743(b) adjustment		$140,000

The §743(b) adjustment must be allocated between the capital gain/§1231 asset group and all other assets as follows:

Step 1: Ordinary income property ($200,000 x 25%)	$ 50,000
Step 2: Capital gain/§1231 asset group ($360,000 x 25%)	$ 90,000
Total §743(b) adjustment	$140,000

Next the adjustment needs to be allocated to the assets within each class as follows:

Ordinary income assets:	
All allocated to the accounts receivable	$50,000
Capital gain/§1231 asset group:	
Land ($60,000/$360,000 x $90,000)	$15,000
Building ($300,000/$360,000 x $90,000)	$75,000

Part 3

The journal entry to record Oliver as a member is:

	Debit (Credit)
Accounts receivable - Oliver's §743(b) adjustment	$50,000
Land - Oliver's §743(b) adjustment	15,000
Building - Oliver's §743(b) adjustment	75,000
Capital account - Oliver	(140,000)

Part 4

The ending tax balance for Thwirs, LLC after Oliver becomes a member is:

Cash	$320,000
Accounts receivable ($0 + $50,000)	50,000
Land ($40,000 + $15,000)	55,000
Building ($280,000 + $75,000)	355,000
	$780,000
Liabilities	$80,000
Al, capital	$140,000
Bill, capital	$140,000
Charlie, capital	$140,000
Oliver, capital	$280,000
	$780,000

Part 5

Oliver will get allocated depreciation on his §743(b) adjustment to the building. The $75,000 will be treated as if it was newly acquired property. Therefore, Oliver will depreciate the $75,000 over 39 years.

Case 11 – Redemption of Partner's Interest

Part 1

Since Gina does not receive her proportionate share of "hot assets" from the distribution, §751(b) is triggered. §751(b) treats the disproportionate distribution as a sale or exchange between the FROG partnership and Gina. Thus, part or all of the transaction may be taxable. The calculation of the gain taxable to Gina is calculated as follows:

1. Gina is deemed to have received a current distribution of her share of the accounts receivable (i.e. FMV = $45,000 and adjusted basis = $0). Gina's outside basis after the current distribution is $75,000 (i.e. $75,000 - $0 deemed receivables).

2. Gina is deemed to sell the receivable back to the partnership. As a result she will recognize an ordinary gain of $45,000 (i.e. $45,000 - $0). The FROG partnership will take a $45,000 basis in those receivables it was deemed to have purchased from Gina.

3. Gina is deemed to receive the remaining $105,000 cash in a liquidating distribution. As a result, Gina must recognize an additional capital gain of $30,000 calculated as follows:

Cash proceeds to Gina	$150,000
Less: deemed cash from sale of receivables	(45,000)
Remaining liquidating cash distribution	105,000
Less: Gina's basis	(75,000)
Capital gain	$ 30,000

NOTE – the total gain recognized by Gina of $75,000 (i.e. $45,000 ordinary gain and $30,000 capital gain) accounts for the difference between Gina's basis ($75,000) and FMV ($150,000) of assets in the partnership. Also, the partnership does not recognize any gain or loss from this transaction.

The tax and §704(b) balance sheet after the distribution would be recorded as follows:

		§704(b)
	Tax	**Book**
Cash	$30,000	$30,000
Accounts receivable	$45,000	$180,000
Land	$150,000	$240,000
	$225,000	$450,000
Frank, capital	$75,000	$150,000
Ross, capital	$75,000	$150,000
Oliver, capital	$75,000	$150,000
	$225,000	$450,000

Part 2

Since Gina receives more than her proportionate share (i.e. $45,000) of "hot assets" §751(b) is triggered. The taxable amount of the transaction is calculated as follows:

1. Gina is deemed to have received her 25% proportionate share of partnership assets in a current distribution. Therefore, Gina is deemed to have received:

	Carryover Basis	FMV
Cash	$45,000	$45,000
Accounts receivable	$ 0	$45,000
Land	$30,000	$60,000
	$75,000	$150,000

2. Since Gina is already deemed to have received $45,000 worth of receivables, the remaining $105,000 of receivables are deemed to have been purchased by Gina selling her share of cash and land back to the partnership. Thus, Gina will have a capital gain of $30,000 calculated as follows:

FMV of accounts receivable received	$105,000
Less: adjusted basis of assets sold:	
Cash	(45,000)
Land	(30,000)
Capital gain on deemed sale	$30,000

NOTE – Gina will now have a cost basis in the receivables of $105,000 and a FMV of $150,000. Thus, $45,000 of ordinary gain to Gina will be deferred until she receives payment for the receivables.

3. The partnership will recognize a $105,000 ordinary gain from the deemed sale of accounts receivable as follows:

Cash received	$45,000
FMV land received	60,000
Total proceeds received	105,000
Less: adjusted basis in accounts receivable	(0)
Ordinary gain to partnership	$105,000

The tax and §704(b) balance sheet after the distribution would be recorded as follows:

	Tax	**§704(b) Book**
Cash	$180,000	$180,000
Accounts receivable	$ 0	$30,000
Land	$150,000	$240,000
	$330,000	$450,000
Frank, capital	$110,000	$150,000
Ross, capital	$110,000	$150,000
Oliver, capital	$110,000	$150,000
	$330,000	$450,000

Case 12 – Partner & LLC Member Basis & At Risk Limitations

Required #1

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

Capital contributed	$1,000
50% of loan to partnership	4,000
50% of personal guarantee	10,000
Outside basis before reductions to basis	15,000
Trade or business loss (80% x $15,000)	(12,000)
Non-deductible expenses (20% x $15,000)	(3,000)
Ending outside basis	$ 0

NOTE 1 – Each general partner is jointly and severally liable for the partnership debt. Thus, each general partner would be allocated 50% of the liabilities.

NOTE 2 – The non-deductible expenses ($4,000) and trade or business loss ($16,000) exceed Kathleen's 15,000 outside basis by $5,000. Losses and deductions in excess of basis are reported on the tax return pro-rata up to basis. Thus, the non-deductible expense is 20% (i.e., $4,000/$20,000) and the trade or business loss is 80% (i.e., $16,000/$20,000) of the losses allowable up to the $15,000 outside basis. Kathleen would have a $4,000 trade or business loss and $1,000 non-deductible expense carried forward in excess of her basis.

Required #2

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:

1. the member has no right of contribution or reimbursement from persons other than the LLC,
2. the member is not otherwise protected against loss within the meaning of § 465(b)(4), and
3. the guarantee is bona fide and enforceable by creditors of the LLC under local law."

Thus, assuming Grady Enterprises was a LLC and the three requirements under TAM 2014-003 are met, it appears Kathleen's basis would be calculated as follows:

Capital contributed	$1,000
100% of loan to partnership	8,000
100% of personal guarantee	20,000
Outside basis before reductions to basis	29,000
Trade or business loss	(16,000)
Non-deductible expenses	(4,000)
Ending outside basis	$ 9,000